

<b>Report to:</b>	Audit and Governance Committee	<b>Date:</b>	16 May 2019
<b>Report title:</b>	AG/2018/29 - Treasury Management - Quarter Three 2018/19		
<b>Report from:</b>	Richard Simpson, Interim Strategic Director - Resources		
<b>Ward/Areas affected:</b>	Borough Wide		
<b>Chair of Committee/Lead Member:</b>	Councillor Richard Clifton		
<b>Author(s)/Contact Number(s):</b>	Lyndsey Gamble, Head of Investment, Risk & Commercial Finance, 020 8770 5358		
<b>Corporate Plan Priorities:</b>	<ul style="list-style-type: none"> <li>• Making Informed Choices</li> </ul>		
<b>Open/Exempt:</b>	Open		
<b>Signed:</b>		<b>Date:</b>	02 May 2019

## 1. Summary

- 1.1. This report is the treasury management review for the quarter ended 31 December 2018. It summarises the Council's Treasury Management operations during the first nine months of 2018/19. It is presented for the purpose of monitoring and review and meets best practice as suggested by the Treasury Management Code of Practice.
- 1.2. The Council invested surplus funds when available and complied with the requirements of the Prudential Code. The Council is operating the agreed Treasury Management Strategy for 2018/19.

## 2. Recommendations

The Audit and Governance Committee is recommended to:

- 2.1. Note the treasury management activity undertaken during the first nine months of the year.

## 3. Background

- 3.1. The Council approved the Treasury Management Strategy for operation during 2018/19 at its meeting on 26 February 2018. The Strategy is carried out under delegated authority and quarterly monitoring reports are brought to this Committee. This is in line with best practice as outlined in the CIPFA Treasury Management Code of Practice.

- 3.2. The Treasury Management function covers the borrowing and investment of Council money. This includes both the management of the Council's day-to-day cash position and the management of its long-term debt. All transactions are conducted in accordance with the Council's Treasury Management Policy Statement, which complies with the latest CIPFA Code of Practice. Good treasury management plays an important part in underpinning the Council's sound financial health.

#### **4. Treasury Management Activity from April to December 2018**

##### Long Term Borrowing

- 4.1 Prudential Indicator 8 requires that no more than 15% of the debt portfolio should mature in any year. This is to minimise the risk of needing to refinance a large part of the portfolio at one time when interest rates might be unfavourable. There is a planned exception to this in 2042 when the loan to fund the HRA self-financing payment matures. It is intended that an element of the HRA surpluses will be set aside in future years so that the loan can be repaid on maturity without needing to refinance. In light of this, the indicator has been RAG rated as Green despite the exception.
- 4.2 Under the prudential regime the Council can borrow as required as long as this falls within the agreed Prudential Limits. The Authorised Limit and Operational Boundary are shown in Appendix A. The Council's overall external debt at 31 December 2018 totalled £287.2m of which £246.9m was with the Public Works Loan Board (PWLB), £25.3m was with individual banks and £15m with other local authorities. This falls within the Authorised Limit and Operational Boundary. The average annual interest rate of the Council's long term debt at 31 December 2018 was 3.39%.
- 4.3 As part of the Council's longer term borrowing, five Lender Option Borrower Option (LOBO) loans totalling £25m are held with three counterparties. These are simple structured loans with no complicated mechanisms which are present in other LOBOS e.g. inverse floating rate structures. The interest rates on these loans are between 3.49% and 4.55%.
- 4.4 The Council's treasury advisors (Link Asset Services, previously known as Capita) carried out a review of the Councils LOBOs in 2016, the outcome of which was reported orally to the 8 December 2016 Audit Committee. This review concluded that levels of risk with the Council's LOBO loans were low, with just a small risk that the lender may look to increase the interest rate in the future. However, if this happens the Council has access to the PWLB for refinancing with no penalty applied.
- 4.5 Two new PWLB loans were undertaken on 24 December 2018 for £10m each and both at a rate of 2.48%. One loan was for a duration of 49 years and the other for 47.5 years. This borrowing was undertaken to fund the capital programme and to replace temporary borrowing. Long term rates had increased since the summer by 40 basis points but the volatility in financial markets in December saw a marked fall in rates to the same level as at the start of the summer and this provided an opportunity to borrow at more favourable rates.

### Temporary Borrowing

- 4.6 The Council set an original temporary borrowing limit of £82.4m for 2018/19. It has been necessary for the Council to undertake temporary borrowing on occasions during the first nine months of the year, however this limit has not been breached.

### Investments

- 4.7 During the first nine months of the financial year, the Council has had surplus funds available for investment. The amount fluctuates on a day to day basis, as shown in Appendix B where the Council's investment balances are summarised.
- 4.8 The following table shows the breakdown of investments as at the end of December 2018. Colour ratings are explained in paragraph 4.32.

Counterparty	Investment Type	Investment Duration	£'000	Colour Rating	Interest Rate %
Santander	Notice a/c	95 day notice	15,000	Red	0.85
Federated	MMF	Instant	8,525	N/A	0.75
Aberdeen	MMF	Instant	8,930	N/A	0.75
Insight	MMF	Instant	3,815	N/A	0.73
<b>Total</b>			<b>36,270</b>		

- 4.9 The average level of funds available for investment purposes in the first nine months of 2018/19 was £21m. These funds were available on a temporary basis, with in-year fluctuations around this amount largely dependent on the timing of payments, receipt of Council Tax and grants and progress of the capital programme. Interest earned during nine months on these deposits totalled £0.10m and represented a weighted average interest rate earned by the Council of 0.68%. This reflects prevailing market conditions and compares favourably with the average of the 7 day and 3 month LIBID (London Interbank Bid Rate) being 0.57%.
- 4.10 During the first nine months of 2018/19 the Council continued to make use of Money Market Funds (MMFs) to manage liquidity risk. A 95 day notice account with Santander has also been in use.

### Current Investment Strategy

- 4.11 The Council continues to ensure that cash balances are utilised to its maximum advantage. Given the very low level of interest available on invested balances this involves using cash balances to replace planned external borrowing to support the capital programme and keeping cash balances to a minimum level. A minimum level of investments of £10m is required for the Council to maintain its 'opted up' professional status under the new MIFID II arrangements which began on 3 January 2018.

### Municipal Bonds Agency

- 4.12 During the first and second investment phases in the formation of the Municipal Bonds Agency (MBA), the Council purchased a total of 100,000 subscription shares at a cost of £1 per share, representing a total investment of £100,000.
- 4.13 On 8 December 2016 the Audit Committee endorsed the detail contained within the local authority financing framework agreement issued by the Agency, setting out the terms for loans from the MBA to local authorities.
- 4.14 The MBA is currently preparing for its first 'proof of concept' bond issue with a cohort of four Councils. This follows the agency being assigned a credit rating from Moody's of Aa3 with a stable outlook. This rating reflects the strong credit quality of the four authorities involved in this first pool, together with the high level of control and monitoring of local authorities by central government, institutional frameworks and statutory codes of practice. The launch of this bond is expected in the next few months.

### Treasury Management Strategy

- 4.15 The Council receives regular briefings from Link Asset Services, the Council's external expert treasury management advisors, on the economic outlook for the UK and other key economies. These are used to inform treasury management decisions relating to future investment and borrowing strategies. Link's current views on the economy and future forecasts are summarised in the paragraphs that follow.
- 4.16 Economic growth in the UK has picked up since quarter 1's increase of 0.1%, with quarter 2 at 0.4% and quarter 3 at 0.6% despite the uncertainties around the UK's withdrawal from the European Union. The Bank of England has indicated that base rates could move in either direction depending on the nature of the UK's departure.
- 4.17 The UK economy has seen wage inflation at a post financial crisis high of 3.3% in October as a consequence of historic low levels of unemployment. With inflation at 2.3% and on a falling trend this has meant that consumers have seen their real incomes increase and therefore able to support the economy by increasing expenditure. In the latest inflation report from the Bank of England, inflation is expected to remain slightly above the 2% target as inflationary pressures remain in the UK economy.
- 4.18 The UK faces political risks around not only Brexit but the stability of the current Conservative government. If there is a general election in 2019 this could result in a potential loosening of monetary and fiscal policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation.
- 4.19 Global markets have been particularly volatile this quarter in the light of fears over the Federal reserve's monetary tightening policy, the US - China trade dispute and prospects for global economic growth with China and Europe both looking at slowing down. The financial markets have reacted by fleeing risk assets such as equities into the safe haven of government bonds and this has led to the fall in long term gilt yields at the end of quarter 3. This period of volatility is expected to continue into 2019 as markets respond to the latest economic indicators.

4.20 The Council continues to utilise Link Asset Services' creditworthiness methodology, with the following individual investment limits assigned to individual counterparties according to a colour coding system:

- Yellow (AAA rated Government debt or its equivalent) up to 5 years;
- Purple £20m, up to 2 years;
- Blue £20m, up to 1 year (only applies to nationalised or semi nationalised UK banks);
- Orange £17.5m, up to 1 year;
- Red £15m, up to 6 months;
- Green £12.5m up to 100 days;
- No colour - not to be used.

#### Interest rates

4.21 The Monetary Policy Committee (MPC) increased the Bank Rate from 0.50% to 0.75% at the start of August 2018 and has remained unchanged since then. The MPC have stated that any increases in bank rate will be gradual and limited. Link Asset Services current forecast for base rates is a rise to 1.00% in June 2019 and further increases to 1.25% in March 2020, 1.50% in December 2020, 1.75% in June 2021 and 2.00% in March 2022. These forecasts are subject to the type of Brexit that takes place. They are based on the assumption that the UK will reach an agreed exit that is passed by UK Parliament and the EU parliamentary processes, and a cautious view has been taken on the subsequent rate of GDP growth.

#### Heritable Bank

4.22 In August 2015 the Council received the fifteenth instalment of the recovery of the £5.5m funds invested with Heritable Bank. Total funds recovered stands at just over £5.4m, representing around 98p in the pound. It is still not clear whether this is a final dividend. The administrators have retained a reserve to provide for legal costs and expenses until the conclusion of the administration. They do not intend to make further distributions to unsecured creditors until all outcomes are fully known. There is still no further news on this position.

4.23 The Council has initiated a claim against Landisbanki, the parent company of Heritable Bank. The claim is dependant on the conclusion of the administration of Heritable, after which no further dividend payments will be made to creditors. If the Council receives any further amounts from Heritable, these will be offset against the subsequent claim against Landisbanki.

## **5 Impacts and Implications**

### Financial

5.1 The financial implications are addressed within the report.

### Legal

5.2 There are no legal issues arising from this report.

## 6 Appendices and Background Documents

Appendix letter	Title
A	Quarter 3 - Performance against Prudential Indicators
B	Council cash available for investment

Background documents
Ernst and Young Progress Report on the Administration of Heritable Bank
Municipal Bond Agency Framework Agreement

Audit Trail		
Version	Final	Date: 02 May 2019
Consultation with other officers		
Finance	Yes	Lyndsey Gamble
Legal	No	N/A
Equality Impact Assessment required	No	N/A