Report to Audit Committee

Treasury Management Half Year Review 2018/19

Portfolio Holder: Councillor Jabbar MBE, Deputy Leader and Cabinet Member for Finance and Corporate Resources

Officer Contact: Anne Ryans, Director of Finance

Report Author: Lee Walsh, Finance Manager

Ext. 6608

10 January 2019

Purpose of Report

The report advises the Audit Committee of the performance of the Treasury Management function of the Council for the first half of 2018/19, and provides a comparison of performance against the 2018/19 Treasury Management Strategy and Prudential Indicators.

Executive Summary

The Council is required to consider the performance of the Treasury Management function in order to comply with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management Revised Code of Practice. This report therefore sets out the key Treasury Management issues for Members' information and review and outlines:

- An economic update for the first six months of 2018/19;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure (prudential indicators);
- A review of the Council's investment portfolio for 2018/19;
- A review of the Council's borrowing strategy for 2018/19;

- Why there has been no debt rescheduling undertaken during 2018/19; and
- A review of compliance with Treasury and Prudential Limits for 2018/19.

The report at Appendix 1 is presented to the Audit Committee to enable it to have the opportunity to review the 2018/19 Half Year Review report. It should be noted that due to the timing of the committee the report has already been approved by Cabinet on 19 November 2018 and Council on 12 December 2018.

Recommendation

That Members of the Audit Committee consider and comment upon the Half Year Review report for 2018/19.

Appendix 1

Report to Council

Treasury Management Mid-Year Review Report 2018

Portfolio Holder: Cllr Abdul Jabbar MBE, Deputy Leader and Cabinet Member for Finance and Corporate Resources

Officer Contact: Anne Ryans, Director of Finance

Report Author: Lee Walsh, Finance Manager (Capital & Treasury)
Ext. 6608

12 December 2018

Reason for Decision

The report advises Council of the performance of the Treasury Management function of the Council for the first half of 2018/19, and provides a comparison of performance against the 2018/19 Treasury Management Strategy and Prudential Indicators.

Executive Summary

The Council is required to consider the performance of the Treasury Management function in order to comply with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017). This report therefore sets out the key Treasury Management issues for Members' information and review and outlines:

- An economic update for the first six months of 2018/19;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators);
- A review of the Council's investment portfolio for 2018/19;
- A review of the Council's borrowing strategy for 2018/19;
- Why there has been no debt rescheduling undertaken during 2018/19;
- A review of compliance with Treasury and Prudential Limits for 2018/19.

The Treasury Management Half Year Review 2018/19 report was presented to and approved by Cabinet on 19 November 2018. Cabinet commended the report to Council. It will also be considered by Audit Committee at its meeting of 10 January 2019.

Recommendations

That Council approves and Council the:

a) Treasury Management activity for the first half of the financial year 2018/19 and the projected outturn position

b) Amendments to both Authorised Limit and Operational Boundary for external debt as set out in the table at Section 2.4.5 of the report.

c) Amendments to the Capital Financing Requirement (CFR) as set out in the table at section 2.4.5

d) Addition to the Treasury Management Strategy 2018/19 with regards to specified investments as presented at Appendix 3.

Treasury Management Strategy Mid-Year Review Report 2018/19

1 Background

1.1 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations is to ensure this cash flow is adequately planned, with surplus monies being invested with low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

1.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.3 As a consequence treasury management is defined as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

1.4 In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. A key requirement of the revised code is that from 2019/20, all Local Authorities will be required to prepare a Capital Strategy which is intended to provide the following:

a) a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services

b) an overview of how the associated risk is managed

c) the implications for future financial sustainability

The Council already prepares a Capital Strategy but the 2019/20 report will be revised to ensure that any new requirements are addressed. A report setting out the Capital Strategy will be presented to the 2019/20 Budget Cabinet and Budget Council meetings.

2 Current Position

2.1 Requirements of the Treasury Management Code of Practice

2.1.1 Treasury Management reports must be prepared in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).

2.1.2 The primary requirements of the Code are as follows:

a) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

b) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

c) Receipt by the full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a **Mid-year Review Report** and an Annual Report (stewardship report) covering activities during the previous year.

d) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions. In Oldham, this responsibility is delegated to the Director of Finance.

e) Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. In Oldham, the delegated body is the Audit Committee.

2.1.3 This mid-year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- An economic update for the first six months of 2018/19;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure (prudential indicators);
- A review of the Council's investment portfolio for 2018/19;
- A review of the Council's borrowing strategy for 2018/19;
- Why there has been no debt rescheduling undertaken during 2018/19;
- A review of the compliance with Treasury and Prudential Limits for 2018/19;

2.2 Economic Performance for the First Six Months of the Year

The United Kingdom (UK)

2.2.1 The first half of 2018/19 has seen UK economic growth post a modest performance, but sufficiently robust for the Monetary Policy Committee, (MPC), to unanimously (9-0) vote to increase Bank Rate on 2 August from 0.5% to 0.75%.

2.2.2 Although growth looks as if it will only be modest at around 1.5% in 2018, the Bank of England's August Quarterly Inflation Report forecast that growth will pick up to 1.8% in 2019, albeit there were several caveats – mainly related to whether or not the UK achieves an orderly withdrawal from the European Union in March 2019.

2.2.3 Some MPC members have expressed concerns about a build-up of inflationary pressures, particularly with the pound falling in value again against both the US dollar and the Euro. The Consumer Price Index (CPI) measure of inflation rose unexpectedly from 2.4% in June to 2.7% in August due to increases in volatile components, but is expected to fall back to the 2% inflation target over the next two years given a scenario of minimal increases in Bank Rate.

2.2.4 The MPC has indicated Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track. Financial markets are currently pricing in the next increase in Bank Rate for the second half of 2019.

2.2.5 As for the labour market, unemployment has continued at a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high in July, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff.

2.2.6 It was therefore not surprising that wage inflation picked up to 2.9%, (3 month average regular pay, excluding bonuses) and to a one month figure in July of 3.1%. This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 0.4%, near to the joint high of 0.5% since 2009. (The previous high point was in July 2015.)

2.2.7 Given the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC were right to start on a cautious increase in the Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy. However, the MPC will need to tread cautiously before increasing the Bank Rate again, especially given all the uncertainties around Brexit.

2.2.8 In the political arena, there is a risk that the current Conservative minority government may be unable to muster a majority in the Commons over Brexit. However, it is expected that Prime Minister May's government will endure, despite various setbacks, along the route to Brexit in March 2019. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

United States of America (USA)

2.2.9 President Trump's massive easing of fiscal policy is fueling a (temporary) boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2, but also an upturn in inflationary pressures.

2.2.10 With inflation moving towards 3%, the US Federal Reserve (Fed) increased rates another 0.25% in September to between 2.00% and 2.25%, this being four increases in 2018, and indicated that it would expect to increase rates four more times by the end of 2019. The dilemma, however, is what to do when the temporary boost to consumption wanes, particularly as the recent imposition of tariffs on a number of countries' exports to the US, (China in particular), could see a switch to US production of some of those goods, but at higher prices. Such a scenario would invariably make any easing of monetary policy harder for the Fed in the second half of 2019.

European Union (EU)

2.2.11 Growth was unchanged at 0.4% in quarter 2, but has undershot early forecasts for a stronger economic performance in 2018.

2.2.12 In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of 2% for 2018, the horizon is less clear than it seemed just a short while ago.

China and Japan

2.2.13 Chinese economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

2.2.14 Japan has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

2.3 Interest Rate Forecast

2.3.1 The Council's treasury advisor, Link Asset Services, has provided the following forecast of interest rates over the period from September 2018 to March 2021:

Link Asset Services Interest Rate View											
	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%
3 Month LIBID	0.75%	0.80%	0.80%	0.90%	1.10%	1.10%	1.20%	1.40%	1.50%	1.60%	1.60%
6 Month LIBID	0.85%	0.90%	0.90%	1.00%	1.20%	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%
12 Month LIBID	1.00%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%	1.60%	1.70%	1.80%	1.80%
5yr PWLB Rate	2.00%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
10yr PWLB Rate	2.40%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%

2.3.2 The flow of generally positive economic statistics after the end of the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% (to 0.75%) since the financial crash.

2.3.3 However, the MPC emphasised again, that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years' time but they declined to give a medium term forecast.

2.3.4 Link Asset Services advised that it does not think that the MPC will increase the Bank Rate in February 2019, ahead of the deadline in March for Brexit. Link also considers that the MPC is more likely to wait until August 2019, than May 2019, before the next increase, to be followed by further increases of 0.25% in May and November 2020 to reach 1.5%. However, the cautious pace of even these limited increases is dependent on a reasonably orderly Brexit.

The balance of risks to the UK

2.3.5 The overall balance of risks to economic growth in the UK is probably neutral.

2.3.6 The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

Downside risks to current forecasts for UK gilt yields and Public Works Loan Board PWLB) rates

2.3.7 There are a number of downside risks to current forecasts for UK gilt yields and PWLB rates as follows:

- The Bank of England monetary policy takes action too quickly to raise Bank Rate over the next three years and causes UK economic growth, and increases in inflation, to be weaker than currently anticipated.

- There could be a resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a government which has focused on anti-austerity. This is likely to lead to friction with the EU when setting the target for the fiscal deficit in the national budget. Unsurprisingly, investors have taken a dim view of this and so Italian bond yields have been rising.

- In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position.

- The challenges from a range of political developments could put considerable pressure on the cohesion of the EU and could spill over into impacting the euro, EU financial policy and financial markets.

- The imposition of trade tariffs by President Trump could negatively impact world growth. President Trump's specific actions against Turkey pose a particular risk to its economy which could, in turn, negatively impact Spanish and French banks which have significant exposures to loans to Turkey.

- There is weak capitalisation of some European banks.

- Rising interest rates in the US could negatively impact emerging countries which have borrowed heavily in dollar denominated debt, so causing an investor flight to safe havens e.g. UK gilts.

- There are geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates

2.3.8 Upside risks to current forecasts of UK gilt yields and PWLB rates include:

- President Trump's fiscal plans to stimulate economic expansion causing a significant increase in inflation in the US and causing further sell offs of government bonds in major western countries.

- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of Quantitative Easing (QE), which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.

- The Bank of England being too slow in its pace and strength of increases in Bank Rate and, therefore, allowing inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.

- UK inflation, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

2.4 Treasury Management Strategy Statement and Annual Investment Strategy Update

2.4.1 The Treasury Management Strategy Statement (TMSS) for 2018/19 was approved at the Council meeting on 28 February 2018. The underlying TMSS approved previously now requires revision in the light of economic and operational movements during the year. The proposed changes and supporting detail for the changes are set out in the next sections of this report.

2.4.2 A decrease is required to both the overall Authorised Limit (the “affordable borrowing limit” required by Section 3 of the Local Government Act 2003 above which the Council does not have the power to borrow) and Operational Boundary (the expected borrowing position of the Council during the year) for external debt. This indicator is made up of external borrowing and other long term liabilities, Private Finance Initiatives (PFI) and Finance Leases. The revision to the limits aligns to the reduction in the Capital Financing Requirement as outlined at paragraph 2.4.4 and 2.4.5 below.

2.4.3 The Council has the following PFI and Public Private Partnership (PPP) Schemes each contributing to the Other Long Term Liabilities element of the Authorised Limit and the Operational Boundary:

- Gallery Oldham and Library
- Sheltered Housing (PFI2)
- Radclyffe and Failsworth Secondary Schools
- Chadderton Health & Well Being Centre
- Street Lighting
- Housing (PFI4)
- Blessed John Henry Newman RC College (Building Schools for the Future)

2.4.4 It will be necessary to decrease the Capital Financing Requirement (CFR) by £22.584m. Whilst approved capital expenditure/ funding carry forwards from 2017/18 of £1.342m caused an initial increase, this is more than offset by estimated re-phasing and re-alignment and other anticipated adjustments in the 2018/19 capital programme resulting in the reduced CFR.

2.4.5 Members are therefore requested to approve the key changes to the 2018/19 prudential indicators as set out in the table below which show the original and recommended revised figures:

Prudential Indicator 2018/19	Original £'000	Recommended Revised Prudential Indicator £'000
Authorised Limit	570,000	550,000
Operational Boundary	545,000	525,000
Capital Financing Requirement	542,041	519,457

2.5 **The Council's Capital Position (Prudential Indicators)**

2.5.1 This section of the report presents the Council's capital expenditure plans and their financing, the impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow together with compliance with the limits in place for borrowing activity.

Prudential Indicator for Capital Expenditure

2.5.2 The table below shows the half year position and the revised budget for capital expenditure (as per table 2 of the month 6 Capital Investment Programme monitoring report). It therefore highlights the changes that have taken place and are forecast since the capital programme was agreed at the Council meeting on 28 February 2018.

Capital Expenditure by Service	2018/19 Original Estimate £'000	2018/19 Current Position £'000	2018/19 Forecast Estimate £'000
Corporate and Commercial Services	25,445	8,035	14,174
Health and Wellbeing*	4,426	-	-
Community Health & Social Care Services*	-	667	1,880
Reform*	-	33	197
People and Place	52,152	8,851	31,864
Funds yet to be allocated	4,862	-	311
General Fund Services	**86,885**	**17,585**	**48,426**
Housing Revenue Account	2,773	330	1,097
Total	**89,658**	**17,915**	**49,523**

*- since the 2018/19 Capital Programme was approved, the Council had an organisational restructure which has resulted in the creation on 2 new Directorates - Community Health & Social Care Services and Reform. The functions of the former Health and Wellbeing Directorate have been realigned into Community Health & Social Care Services, Reform and People and Place.

2.5.3 The above table shows a decrease in the capital programme of £40.135m to the month 6 budgeted position with current forecast spend of £49.523m. The original estimate was initially increased by slippage of £1.342m brought forward into the 2018/19 programme from the previous year. During the summer months the Council undertook the Annual Review of the Capital Programme in line with practice of recent years. The review identified a requirement for significant re-profiling across a number of schemes with expenditure being re-profiled to 2022/23 which is outside the originally approved 4 year planning timescale. The majority of the re-phasing moved significant expenditure (£76.5m) from 2019/20 into the later years of the capital programme. The budget variations largely relate to a revision to the Oldham Coliseum and Heritage Centre, Town Centre Masterplan, and the re-phasing of the Schools Capital Programme, mainly due to planning related issues.

Changes to the Financing of the Capital Programme

2.5.4 The table below draws together the main strategy elements of the capital expenditure plans (above) highlighting the original supported (£48.994m) and unsupported elements i.e. requiring borrowing (£40.664m), and the expected financing (revised position) arrangements of this capital expenditure. The borrowing need element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

2.5.5 The overall net reduction in the capital programme has resulted in a change in the mix of funding sources required in 2018/19; a decrease in all financing types reducing the forecast borrowing need by £13.669m from £40.664m to £26.995m.

Capital Expenditure	2018/19 Original Estimate £'000	2018/19 Current Position £'000	2018/19 Forecast Position £'000
General Fund Services	86,885	17,585	48,426
Housing Revenue Account	2,773	330	1,097
Total spend	**89,658**	**17,915**	**49,523**
Financed by:			
Capital receipts	(17,347)	(4,540)	(5,793)
Capital grants	(28,718)	(3,801)	(16,647)
Revenue	(786)	(75)	(88)
HRA	(2,143)	-	-
Total financing	(48,994)	(8,416)	(22,528)
Borrowing need	**40,664**	**9,499**	**26,995**

Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary

2.5.6 The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. As previously mentioned in paragraph 2.4.4 the CFR needs to decrease by £22.584m. It also shows the expected debt position over the period (the Operational Boundary). This indicator has decreased to reflect the revisions to the forecast year end position of the capital programme.

	2018/19 Original Estimate £'000	2018/19 Revised Estimate £'000
Prudential Indicator – Capital Financing Requirement		
CFR – non housing	542,041	519,457
CFR – housing	-	-
Total CFR	**542,041**	**519,457**
Net movement in CFR		**(22,584)**
Prudential Indicator – External Debt / the Operational Boundary		
Borrowing	300,000	280,000
Other long term liabilities	245,000	245,000
Total debt 31 March	**545,000**	**525,000**

Limits to Borrowing Activity

2.5.7 The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose.

2.5.8 Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

2.5.9 The CFR calculation is shown in the table below and the Director of Finance reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator as there is £124.520m headroom between total debt and the CFR.

	2018/19 Original Estimate £'000	2018/19 Revised Estimate £'000
Gross borrowing	180,350	148,647
Plus other long term liabilities*	245,992	246,291
Total Debt	**426,342**	**394,938**
CFR* (year end position)	542,041	519,457
Headroom	**115,699**	**124,520**

*- includes on balance sheet PFI schemes and finance leases

2.5.10 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. Presented in the table below is the original and the revised Authorised Limit.

Authorised limit for external debt	2018/19 Original Indicator	2018/19 Revised Indicator
Borrowing	320,000	300,000
Other long term liabilities*	250,000	250,000
Total	**570,000**	**550,000**

* - Includes on balance sheet PFI schemes and finance leases.

2.6 **Investment Portfolio 2018/19**

2.6.1 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in Section 2.3, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the 0.75% Bank Rate which prevailed towards the end of quarter 2. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk short term strategy. Given this risk environment and the fact that increases in Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

2.6.2 The Council held £93.350m of investments, including property funds as at 30 September 2018 (£73.650m at 31 March 2018). A full list of investments as at 30 September is included at Appendix 1. A summary of investments by type is included in the table below.

2.6.3 The Council ensures enough funds are kept in either instant access accounts and/ or on-call accounts to meet its short term liquidity requirements. As at 30 September the Council held £24.350m in Money Market Funds and £17.500m in Notice Accounts that range from 32 to 95 day notice period.

Investment Type	Total at 30 September 2018
Property	15,000
Fixed (Term Deposits) Bank / Building Society	26,000
Fixed (Term Deposits) LA's / Public Bodies	10,500
Notice Accounts	17,500
Money Market Funds	24,350
Total	**93,350**

2.6.4 The Director of Finance confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2018/19.

2.6.5 The Council's investment strategy looks to achieve a return on its investment of London Interbank Bid Rate (LIBID) plus a 5% mark up. The Council will maintain sufficient cash reserves to give it its necessary liquidity and may place investments up to 5 years if the cash flow forecast allows and the credit rating criteria is met. Performance against this benchmark was as follows:

Benchmark	Benchmark Return LIBID +5%	Council Performance
7 days	0.46%	0.55%
1 month	0.49%	0.65%
3 months	0.64%	0.73%
6 months	0.75%	0.76%
1 year	0.99%	1.07%
Return first 6 months		**0.69%**

2.6.6 The Council's performance on its cash investments exceeded its target on all benchmarks as can be seen in the table above.

2.6.7 It is important to be able to maximise investment income to support the overall financial position of the Council. During the year the Council has been continually looking at alternative investment opportunities within treasury management to provided additional income. At this moment in time no deal has passed the due diligence process but opportunities will continue to be assessed. It is important to note that any investments are only undertaken after an appropriate due diligence exercise and having regard to the Treasury Management principles of security, liquidity, yield and ethical investments.

2.6.9 It is essential to have flexibility to be able to take advantage of opportunities for new investments that may become available. Therefore, a revision to the specified investment category within the Treasury Management Strategy is proposed and as set out at Appendix 3.

Property Fund

2.6.10 In the first six months of the year the Councils investment within the CCLA property fund has generated a return of (4.47%) and it is anticipated that this revenue return will continue throughout the year. As advised within the TMSS, due to the anticipated fluctuations in price this is an investment with a minimum time horizon of 5 years.

2.6.11 Following the Brexit decision, in the initial months property funds saw a small decline in the value due mainly to valuer caution rather than any significant increase in pressure to sell properties. In contrast, occupier trends continued to strengthen. This initial decline in value has started to unwind and prices are now at the same levels prior to the Brexit decision.

2.6.12 The current investment counterparty criteria selection approved in the TMSS and included at Appendix 3 is meeting the requirement of the treasury management function.

2.7 Borrowing

2.7.1 It is proposed in this report that the Council's CFR for 2018/19 is revised to £519.457m and this denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.

2.7.2 The table within paragraph 2.5.9 shows the Council has expected year end borrowings of £394.938m and will have utilised £124.520m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

2.7.3 The Council has not undertaken any borrowing in the first half of the year, and did not undertake any debt rescheduling during the first half of 2018/19. Due to current cash balances it is not anticipated that any borrowing will be undertaken in the rest of 2018/19, unless there is a further decline in interest rates attached to borrowing. In October 2018, the Council was notified that it had been successful in its certainty rate reduction application. This entitles the Council to receive a 20 basis point rate reduction on the prevailing rate of PWLB on any borrowing undertaken from 1 November 2018 to 31 October 2019.

2.7.4 Current PWLB certainty rates are set out in the following table and show for a selection of maturity periods over the first half of 2018/19, the range (high and low points) in rates and the average rates over the period. In addition, Appendix 2 tracks the movement in the PWLB certainty rate over the period April to September 2018 across the same range of loan terms as is used in the table below.

Maturity Rates	1 Year	5 Year	10 Year	25 Year	50 Year
03/04/18	1.48%	1.84%	2.22%	2.55%	2.27%
30/09/18	1.55%	1.93%	2.33%	2.74%	2.56%
Low	1.28%	1.67%	2.09%	2.50%	2.25%
Date	01/06/18	29/05/18	20/07/18	20/07/18	29/05/18
High	1.57%	1.99%	2.43%	2.83%	2.64%
Date	17/04/18	25/09/18	25/04/18	25/09/18	25/09/18
Average	1.46%	1.84%	2.25%	2.64%	2.41%

2.8 Debt Rescheduling

2.8.1 Debt rescheduling opportunities have been very limited in the current economic climate given the consequent structure of interest rates, and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

2.9 **Overall Position at the Mid –Year 2018/19**

2.9.1 The position at the mid-year 2018/19 shows that the Council is continuing to follow recommended practice and manage its treasury affairs in a prudent manner.

2.10 **Other Key Issues**

<u>UK Banks - Ringfencing</u>

2.10.1 The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as “ring-fencing”. Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

2.10.2 Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and “riskier” activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity’s core activities are not adversely affected by the acts or omissions of other members of its group.

2.10.3 While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

IFRS 9 Accounting Standard

2.10.4 This Accounting Standard came into effect from 1 April 2018. It means that the category of investments valued under the available for sale category will be removed and any potential fluctuations in market valuations may impact onto the Surplus or Deficit on the Provision of Services as presented in the Statement of Accounts, rather than being held on the balance sheet. This change is unlikely to materially affect the commonly used types of treasury management investments but more specialist types of investments, (e.g. property funds, third party loans, commercial investments such as the Councils shareholding in the Manchester Airports Group), are likely to be impacted. The impact of this on the financial position of the Council is currently being assessed.

2.10.5 The Ministry of Housing, Communities and Local Government (MHCLG), is currently conducting a consultation for a temporary override to allow English local authorities time to adjust their portfolio of investments. Members will be updated when the result of this consultation is known.

Claim against Barclay Bank

2.10.6 The Council is currently involved in legal action against Barclays Bank with regards to certain Lender Option Borrower Option (LOBO) transactions. This is based on the Bank's involvement in manipulation of the LIBOR benchmark rate and the subsequent impact on the Council's financial position. This matter is on-going.

3 Options/Alternatives

3.1 In order that the Council complies with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management the Council has no option other than to consider and approve the contents of the report. Therefore no options/alternatives have been presented.

4 Preferred Option

4.1 As stated above the preferred option is that the contents of the report are approved.

5 Consultation

5.1 Consultation has taken place with Link Asset Services (the Councils Treasury Management Advisors), and senior officers. The report was presented to and approved by Cabinet on 19 November 18. Cabinet also commended the report to Council for approval. It should be noted that the report will also be presented to the Audit Committee for scrutiny at its meeting of 10 January 2019.

6 Financial Implications

6.1 All included within the report.

7 Legal Services Comments

7.1 None.

8 Co-operative Agenda

8.1 The Council ensures that any Treasury Management decisions comply as far as possible with the ethos of the Cooperative Council.

9 Human Resources Comments

9.1 None.

10 Risk Assessments

10.1 There are considerable risks to the security of the Authority's resources if appropriate treasury management strategies and policies are not adopted and followed. The Council has established good practice in relation to treasury management which has previously been acknowledged in both Internal and the External Auditors' reports presented to the Audit Committee.

11 IT Implications

11.1 None.

12 Property Implications

12.1 None.

13 Procurement Implications

13.1 None.

14 Environmental and Health & Safety Implications

14.1 None.

15 Equality, community cohesion and crime implications

15.1 None.

16 Equality Impact Assessment Completed?

16.1 No.

17 Key Decision

17.1 Yes

18 Key Decision Reference

18.1 FCR -18-18

19 Background Papers

19.1 The following is a list of the background papers on which this report is based in accordance with the requirements of Section 100(1) of the Local Government Act 1972. It does not include documents, which would disclose exempt or confidential information as defined by that Act.

File Ref:	Background papers are contained with Appendices 1, 2 & 3.
Officer Name:	Anne Ryans
Contact No:	0161 770 4902

20 Appendices

Appendix 1	Investments as at 30 September 2018
Appendix 2	Borrowing as at 30 September 2018
Appendix 2A	PWLB Certainty Rate Variations 2018/19
Appendix 2B	Comparison of Borrowing parameters to actual external borrowing - Table
Appendix 2C	Comparison of Borrowing parameters to actual external borrowing - Graph
Appendix 3	Investment Counterparty Criteria

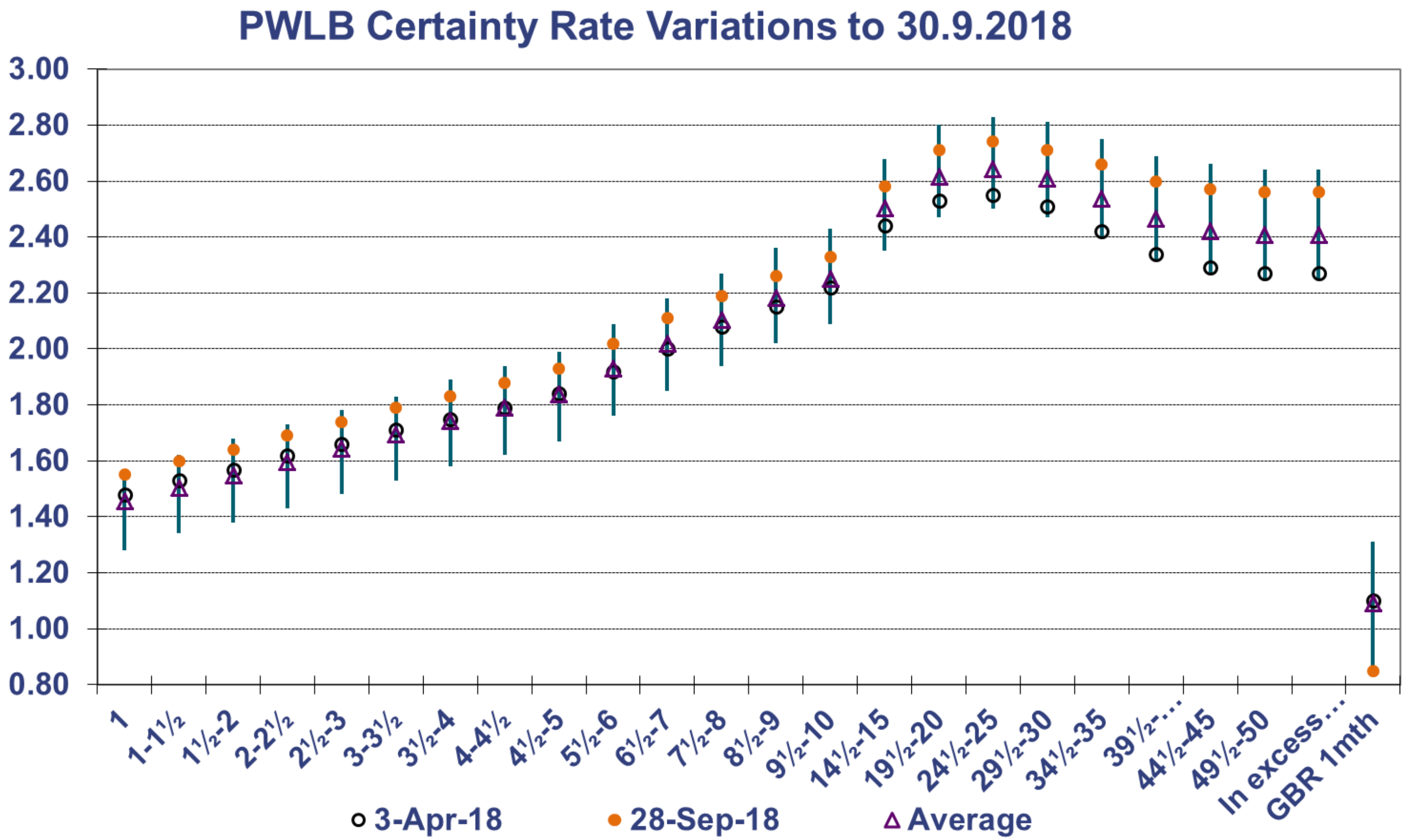
Appendix 1 Investments as at 30 September 2018

Investments	Type	At 30 Sept. 2018 £'000	Interest Rate	Date of Investment	Date of Maturity
CCLA Property Fund	Property	15,000	4.51%	Prior Years	open
Total Property Fund		**15,000**			
Standard Chartered	Fixed	5,000	0.90%	20/04/2018	19/10/2018
Surrey Heath Borough Council	Fixed	3,000	0.70%	24/05/2018	26/11/2018
Santander UK Plc	Fixed	5,000	0.90%	14/08/2018	14/11/2018
Natwest Bank PLC	Fixed	5,000	0.81%	15/08/2018	15/11/2018
London Borough of Barking & Dagenham	Fixed	5,000	0.82%	30/08/2018	30/11/2018
Goldman Sachs International Bank	Fixed	2,500	0.88%	10/07/2018	10/01/2019
Barclays Bank PLC	Fixed	3,000	0.75%	10/07/2018	10/01/2019
Standard Chartered	Fixed	2,500	0.80%	16/07/2018	16/01/2019
Close Brothers Ltd	Fixed	3,000	0.80%	19/07/2018	21/01/2019
Thurrock Council	Fixed	2,500	1.07%	27/09/2018	26/09/2019
Total Fixed Investments		**36,500**			
Bank of Scotland plc	32 day call	10,000	0.82%	08/12/2017	open
Bank of Scotland plc	95 day call	2,500	0.95%	05/01/2018	open
Santander	35 day call	5,000	0.75%	22/05/2018	open
Total Investments on call		**17,500**			
Federated Sterling Liquidity 3	MMF	1,450	0.69%	26/09/2018	01/10/2018
Standard Life Sterling Liquidity	MMF	12,900	0.66%	28/09/2018	01/10/2018
Federated Cash Plus Fund	MMF	10,000	0.77%	28/09/2018	01/10/2018
Total MMF		**24,350**			
Total		**93,350**			

MMF – Money Market Fund

Appendix 2 Borrowing as at 30 September 2018

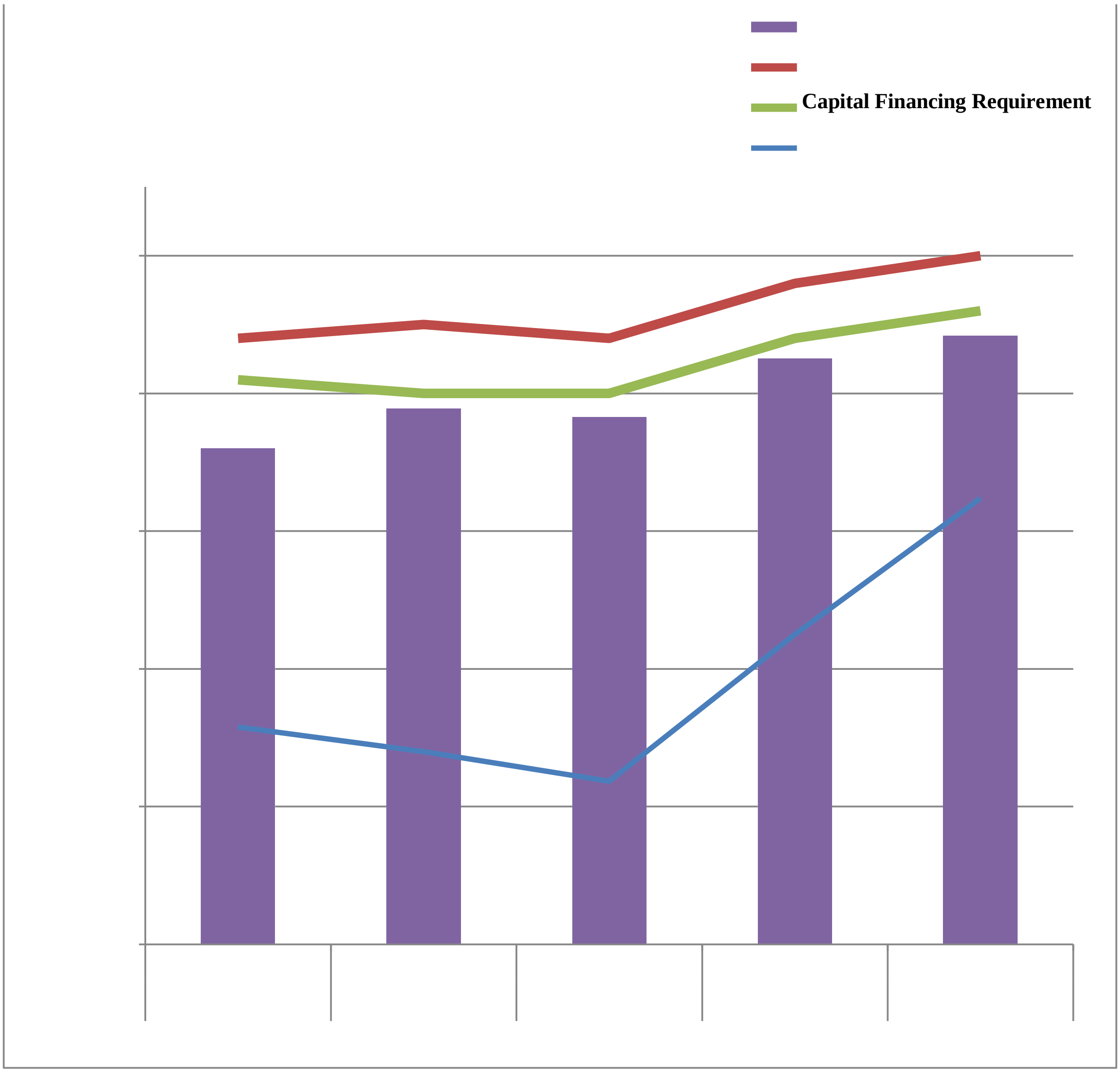
2A) PWLB Certainty Rate Variations 2018/19



2B) Comparison of borrowing parameters to actual external borrowing (Table)

Actual / Expected	2017/18 £'000	Revised 2018/19 £'000	2019/20 £'000	2020/21 £'000	2021/22 £'000
Authorised Limit	545,000	550,000	545,000	565,000	575,000
Operational Boundary	530,000	525,000	525,000	545,000	555,000
Capital Financing Requirement	505,049	519,457	516,425	537,699	545,973
External Debt	403,966	394,938	384,260	437,585	486,957

2C) Comparison of borrowing parameters to actual external borrowing (Graph)



Appendix 3 Investment Counterparty Criteria

Amendment to Specified Investments: An additional Specified Investment category (as detailed in the table below) is to be added to the strategy to allow the Council to look at investments in GM Public Bodies other than GMCA for which approval already exists. This addition allows the Council to take advantage of the availability of investment from other Public Bodies. The current strategy highlights Local Authorities and specified organisations that satisfy the Treasury Management investment criteria, in accordance with the Treasury Management Strategy approved by full Council on 28 February 2018.

	LINK Colour Band and Long Term Rating where applicable	Maximum Duration	Maximum Principal Invested per Counterparty £
GM Public Bodies	Internal Due Diligence	5 Years	£30m