TRAFFORD COUNCIL

Report to: **Accounts & Audit Committee - 6 December 2017**
Executive - 18 December 2017

Report for: **Information**

Report of: **The Executive Member for Corporate Resources and the Chief Finance Officer**

<u>Report Title</u>

Treasury Management 2017-18 Mid-Year Performance Report

Summary

This report has been prepared in accordance with the CIPFA Code of Practice and gives members a summarised account of the Treasury Management activities and outturn for the first half of the year together with an update of the world economic situation.

Debt Activity:-

- Debt interest costs are currently forecasted to be in line with those originally budgeted for of £5.7m,
- At 30 September the Council's external debt was £104.6m.

Investment Activity:-

- The annualised investment interest to be generated is forecasted to be in line with budget of £0.5m,
- Rate of Return achieved during the period April to September 2017 was;
  - i. short term investments 0.55%, or 0.44% / £(145)k above the comparable performance indicator of the average 7-day **L**ondon **I**nterbank **BID** interest rate of 0.11% and
  - ii. long term investments 5.13%,
- At 30 September the value of Council's investments was £72.4m.

Prudential Indicators:-

- During the first half of 2017/18 the Council complied with its legislative and regulatory requirements, including compliance with all treasury management prudential indicators which were updated to reflect those approved by Council in July 2017 which featured in the Capital Investment Fund report.

Recommendations

That the Accounts & Audit Committee & Executive be requested to:

1. Note the Treasury Management activities undertaken in the first half of 2017/18.

<u>Contact person for background papers and further information:</u>

Name: Graham Perkins
Extension: 4017 Background papers: None

Relationship to Policy Framework/Corporate Priorities	Value for Money
Financial	The projected level of the Council’s investment and debt interest for 2017/18 are currently forecasted to be in line with budget of £0.5m & £5.7m respectively.
Legal Implications:	All actions undertaken during this period were in accordance with legislation, CLG Guidance, CIPFA Prudential Code and CIPFA Treasury Management Code of Practice.
Equality/Diversity Implications	Not applicable
Sustainability Implications	Not applicable
Staffing/E-Government/Asset Management Implications	Not applicable
Risk Management Implications	The monitoring and control of risk underpins all treasury management activities and these factors have been incorporated into the treasury management systems and procedures which are independently tested on a regular basis. The Council’s in-house treasury management team continually monitor interest forecasts and actual market interest rate movements to ensure that any exposure to adverse fluctuations in interest rates are minimised and security of capital sums are maintained at all times.
Health and Safety Implications	Not applicable

1. BACKGROUND

1.1 In accordance with regulations issued under the Local Government Act 2003 local authorities are required by regulation to have regard to both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance (the Prudential Code) when undertaking its treasury management function. This Council has adopted both of these Codes and operates in compliance with them.

1.2 As part of the recommendations within the Code of Practice, regular reports are to be submitted to the Accounts & Audit Committee together with the Executive and Council as part of its Governance arrangements.

1.3 This report complies with this request and highlights the treasury management activities undertaken during the first half year of 2017/18 and includes;

- Economic Update (section 2)
- Treasury Position (section 3)
- Debt Activity (section 4)
- Investment Activity (section 5)
- Risk Benchmarking (section 6)
- Prudential and Performance Indicators (section 7)
- Other Activity Update (section 8)
- Recommendations (section 9)

1.4 A main feature of the treasury management function is to ensure that the Council's day to day cash flow requirements are appropriately planned and accounted for with any surplus monies being invested in low risk counterparties providing adequate liquidity before considering optimising investment return.

1.5 A further aspect of the treasury management function is to ensure that the Council's longer term capital funding requirements are also considered which may involve arranging long or short term loans.

2. ECONOMIC UPDATE

2.1 During the first half of 2017/18, the main economic headlines were as follows with a forecast of the main indicators for 2018, highlighted at Appendix B for reference:

<u>UK</u>

- Due to increases in inflation caused by the devaluation of sterling following the Brexit referendum Gross Domestic Product (GDP) in 2017 has been weaker than that encountered in 2016 with quarter 1 at +0.2% (+2.0% y/y) and quarter 2 +0.3% (+1.7% y/y).
- The bank rate remained unchanged at 0.25% during the first half of 2017/18 however the Monetary Policy Committee (MPC) at its September meeting surprised markets and forecasters by warning that bank rate may need to rise, possibly in November due to rising inflation.
- Consumer Price Index (CPI) was 3.0% in September which is 1% above the Government's target of 2.0%.
- Unemployment fell to 4.3%, the lowest level since 1975.

- Uncertainty around Brexit negotiations remain making it too early to be confident about how the next two years will pan out.

U.S.

- Growth in the American economy continues to be volatile with quarter 1 coming in at only 1.2% however quarter 2 rebounded to 3.0%, resulting in an overall annualised figure of 2.1% for the first half year.
- Since December 2016, the Federal Bank (Fed) has increased rates three times and there remains a possibility of a further rate rise before the end of 2017 which would then take the central rate to 1.25 – 1.50%.
- Unemployment in the US has also fallen to the lowest level for many years, reaching 4.3%,
- CPI rose by 0.1% in September 2017 to 0.5%.

Eurozone

- European Central Bank (ECB) has maintained the deposit facility rate at -0.4% and the main refinancing rate at 0% with little prospect of any upswing in rates until possibly 2019.
- Following several years of slow economic growth, signs are now appearing that growth generated in 2016 appears to be continuing in 2017 as growth of 0.5% in quarter1 (2.0% y/y) and 0.6% in quarter (2.3% y/y) have been recorded.
- CPI was 1.4% in September below the ECB target of 2%.
- The 3 month unemployment rate continues its downward trend falling to 9.1% for the period ending August.

Other Countries

- Japan's economy continues to struggle to stimulate consistent significant growth in order to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus provided by the central bank.
- China's economy has been weakening over successive years, despite repeated rounds of central bank actions.

2.2 The Council's treasury management advisors Link, provide interest rate forecasts periodically through-out the year and the table below outlines the latest average forecasted rates received (November 2017):

	2017-18 Original Forecast %	2017-18 Revised Forecast %	2018-19 Revised Forecast %	2019-20 Revised Forecast %
Bank Rate	0.25	0.35	0.63	0.88
Investment Rates				
3 month	0.20	0.35	0.50	0.75
1 Year	0.65	0.65	0.90	1.15
PWLB Loan Rates				
5 Year	1.63	1.50	1.70	1.95
25 Year	2.95	2.80	3.00	3.25

2.3 Market forecasters were originally indicating that the Monetary Policy Committee (MPC) wouldn't start to increase the Bank of England's Bank Rate from 0.25% to 0.50% until the 2nd quarter of 2019 rising to 0.75% by the end of March 2020. At its meeting on the 2 November 2017 however, the MPC increased bank rate from 0.25% to 0.50%, the first increase in over 10 years responding to record-low unemployment, resilient consumer confidence and rising global economic growth. With regards to gilt yields and PWLB rates, these are set to rise from their current levels as indicated above.

2.4 In accordance with the current economic and interest rate forecasts outlined above, the Council will continue its policy to take a cautious approach when undertaking any money market transaction.

3. TREASURY POSITION

3.1 The Council's investment and debt positions at the beginning and midway through the current financial year were as follows:

	31 March 2017		30 September 2017	
	Principal £m	**Interest Rate %**	**Principal £m**	**Interest Rate %**
DEBT				
Fixed rate:				
PWLB –fixed rate	43.5	5.95	43.3	5.93
PWLB – variable rate	0.0	0.00	0.0	0.00
Market – fixed rate*	26.8	3.76	26.3	3.83
Market – variable rate	35.0	6.17	35.0	6.21
Total debt	**105.3**	**5.47**	**104.6**	**5.50**
INVESTMENTS				
- Fixed rate	58.4	0.62	54.0	0.54
- Variable rate	19.3	0.31	13.6	0.21
- Other CCLA (net of fees)	4.7	4.47	4.8	4.47
Total Investments	**82.4**	**0.77**	**72.4**	**0.79**
NET POSITION- DEBT / (INVESTMENT)	**22.8**		**32.2**	

*Includes Salix loan £5.8m (31 March) & £5.3m (30 September) @ 0%.

3.2 When referring to the above table, it is important to note that the levels of investments fluctuate daily as a result of timing issues from monies being received ahead of spend requirement and are therefore available on a temporary basis to invest.

4. DEBT ACTIVITY

4.1 The Council's under borrowed position as at 31 March 2017, was £38.8m due to the total Capital Financing Requirement (CFR), the underlying need to borrow for capital purposes, of £144.0m being higher than the actual level of external debt of £105.2m.

4.2 The Council's under borrowed position of £38.8m reflects previous years decisions to apply its own funds (cash supporting reserves & balances) to fund the capital borrowing requirement instead of taking on any new debt. This approach, which continues to be adopted by Councils, is in response to the high “cost of carry” i.e. the difference between long-term debt interest rates and short-term investment interest rates.

4.3 During the first half of 2017/18, no new long term loans were taken due to the cost of carry. However should any new borrowing opportunities become available permitting loans to be taken which will assist in financing the Council’s capital investment programme and without placing any additional financial burden on the revenue budget, then these will be pursued.

4.4 The table below highlights the level of debt transactions incurred during the first half of 2017/18;

Loans	Balance 31 March 2017 £m	Borrowed £m	Debt Repaid £m	Balance 30 September 2017 £m
Short Term (Cash flow purposes)	0.0	2.0	2.0	0.0
Long Term (Capital purposes)	105.2	0.0	0.6	104.6
Total	**105.2**	**2.0**	**2.6**	**104.6**

4.5 As highlighted in the table above, temporary borrowing totalling £2m was required to be undertaken for a period of 5 days in April to assist fund the Council’s day to day cash flow requirement. Members can be assured that every endeavour is taken to ensure that sufficient funds are available to cover such instances thereby avoiding the need to undertake any temporary borrowing. Due to the need for several multi million pounds transactions to be made at very short notice, i.e. Greater Manchester Pension Fund (3 years upfront employer pension contributions - £36.3m) and Transport for Greater Manchester (first contribution for the Metrolink extension to the Trafford Centre - £7m) in addition to the normal day to day requirements including year-end transactions, cover in the form of maturing investments were not able to be placed in time. The total cost incurred for this temporary borrowing was £61.

4.6 Of the Council’s 27 loans, 24 of these are at fixed rates of interest with 1 loan being subject to quarterly interest rate fixings using a recognised market indicator.

4.7 As a consequence of the persistent low interest rates, debt rescheduling opportunities continue to be uneconomic to carry out due to the high breakage penalty (premium) costs which would be incurred. During the first half of the year no debt restructuring has been undertaken however the situation will continue to be monitored for the remainder of the year.

5. INVESTMENT ACTIVITY

5.1 In accordance with the Council’s Annual Investment Strategy as approved by Council in February 2017, states that the Council’s priorities when placing any temporary surplus funds with any approved counterparty continues to be that as adopted in previous years of security of capital, liquidity and then an appropriate level of return.

5.2 The table below highlights the level of investment transactions carried out during the first half of 2017/18;

Investments	**Balance 31 March 2017 £m**	**Made £m**	**Repaid £m**	**Balance 30 September 2017 £m**
Short Term	77.7	252.5	262.6	67.6
Long Term*	4.7	0.0	0.0	4.8
Total	**82.4**	**252.5**	**262.6**	**72.4**

* reflects movement in valuation of the CCLA Property Fund investment.

5.3 The net £10.1m downward movement in short-term investments from 31 March 2017 to 30 September 2017 reflects the day to day cash flow movements as highlighted at paragraph 4.5 and monies received ahead of spend.

5.4 All investments placed with any of the Council's approved counterparties and which matured during the first half of the financial year, were repaid on time without any difficulties and the list of institutions in which the Council invests continues to be kept under review.

5.5 Prior to the start of 2017/18, the Council had placed 5 investments totalling £10m with the Qatar National Bank (a bank which features on the Council's approved list of investment counterparties) and these were set to mature in July and August. In response to the hostile situation between Qatar and several of its neighbouring countries, a decision was taken by the Council's in-house treasury management team that upon maturity, these investments would be repaid. Whilst both the bank and Country continue to be deemed financially solvent and their credit ratings remain strong, all funds due to the Council were fully repaid in full and on time and that nothing is currently placed with the bank on a direct basis.

5.6 The movement in the Council's temporary investments as at 31 March 2017 compared to 30 September 2017 is shown below for reference:

Sector	**31 March 2017 £m**	**30 September 2017 £m**
UK Banks	15.9	33.2
UK Building Societies	7.5	5.3
Money Market Funds	19.3	13.6
Non UK Banks	27.0	15.5
Local Authority	8.0	0.0
Other - CCLA	4.7	4.8
Total	**82.4**	**72.4**

The maturity structure of the investment portfolio was as follows:

Period	31 March 2017 £m	30 September 2017 £m
Instant Access	19.3	13.6
Up to 3 Months	22.0	12.8
3 to 6 Months	24.1	29.9
6 to 9 Months	7.8	4.9
9 to 12 months	4.5	6.4
Over 1 year	4.7	4.8
Total	**82.4**	**72.4**

5.7 During the first half of the year, a total of 95 short term temporary investments were undertaken by the Council's in-house treasury management team in an environment of continuing historically low interest rates. The table below highlights the results of these activities and this clearly illustrates the Council outperforming the 7day LIBID benchmark, a recognised market performance indicator, by 0.44% on its short term investments whilst ensuring that all risk was kept to a minimum during this period.

Average level of Investments (ex CCLA) 1 April to 30 Sept £m	Average interest rate earned %	Average 7 day LIBID rate %	Additional interest earned against 7 day LIBID £k
66.1	0.55	0.11	145

5.8 In September 2015, the Council invested £5m in the Local Authority Property Investment fund, managed by the Church Commissioners Local Authority, (CCLA), and this enabled 1,643,872 units to be purchased in the fund. This fund is only accessible to Local Authorities and the objective of it is to generate long-term growth in the amount originally invested whilst generating returns in the form of annual dividends by investing in commercial property throughout the UK.

5.9 This investment was undertaken in September 2015 on the understanding that funds would be placed with CCLA for a minimum period of 5 years enabling capital growth to be generated following the deduction of entry costs totalling £0.3m and this situation remains unchanged.

5.10 At 31 March 2017 the Council's investment was worth £4.7m and this has now risen to £4.8m as at 30 September 2017. Based on current property growth forecasts there are no concerns on the security and liquidity associated with this investment, which remains within the limits approved for this type of investment.

5.11 Market uncertainty regarding how the UK commercial property will react following Brexit, makes it difficult to forecast when the value of the Council units will reach its original value of £5m. Based on current forecasts it is expected that the value of this investment will reach its original level in a further 8 years.

5.12 Despite this however the level of dividends received continues to be strong as a result of the high rental returns being achieved. For reference the annualised level of return generated for the first half of 2017/18 was 5.13%

gross of fees and it is expected to continue around this level for the forthcoming 12 months.

5.13 It is currently forecasted that the level of investment interest which will be generated from all of the Council's investments during the year will be in-line with that budgeted for of £0.5m.

5.14 As outlined at Section 2 above, worldwide events continue to have an adverse effect on the money markets and the potential for earning a respectable level of interest whilst keeping the Council's risk exposure to a minimum remains difficult. In order to reduce any potential risk aspect to a minimum whenever the Council undertakes an investment, a low risk strategy will continue to be adopted with returns set to remain low.

5.15 Appendix A details the Council's investments, as at 30 September 2017.

6. RISK BENCHMARKING

6.1 In accordance with the Code and CLG Investment Guidance, appropriate security and liquidity benchmarks are used by the in-house treasury management team to monitor the current and future potential risk conditions enabling any corrective action to the strategy to be applied if required.

6.2 These benchmarks are simple guides to maximum risk (not limits) and so may be breached from time to time, depending on movements in interest rates and counterparty criteria.

6.3 During the first half of 2017/18 the Chief Finance Officer can confirm that no benchmarks, which were set in the Strategy report in February 2017, were breached as shown from the information below;

Indicator	Target	Actual
Security – potential default rate of the Council's investment portfolio based on rates issued by the 3 main credit rating agencies.	Max 0.07%	Max 0.02%
Liquidity – investments available within 1 week notice	£10m min.	Achieved apart from 1 week in April as outlined at para 4.5.
Liquidity – Weighted Average Life of investments (ex CCLA Property Fund)	6 months	This was not breached and as at 30 September was 3.8 months.
Yield – Investment interest return to exceed 7 day **L**ondon **I**nterbank **BID** rate	0.11% (Avg. 7 day LIBID)	0.86% (All Investments)
Origin of investments placed - maximum investments to be directly placed with non-UK counterparties.	UK institutions 100% Non UK institutions 40%	Achieved apart for 1 week in April when maximum position for Non UK institutions was 44%.

7. PRUDENTIAL AND PERFORMANCE INDICATORS

7.1 In accordance with CLG Guidance and the Code, a number of prudential indicators are in place ensuring that the Council's capital expenditure plans and borrowing remain robust, prudent and sustainable.

7.2 These indicators which were originally approved by Council in February 2017 for implementing in 2017/18 were subsequently revised and approved by Council at the July 2017 meeting as part of the Capital Investment Fund report.

7.3 All prudential indicators are monitored on a monthly basis and during the first half of 2017/18 it can be reported that no breaches occurred.

7.4 The Council's Audit & Assurance Service, as part of their 2017/18 audit plan, undertook a review of the treasury management process & activities undertaken in 2016/17. The objective of the review was to provide assurance on the operation of the key controls within the treasury management system. For the 11th year in succession a report was issued stating that the in-house treasury management service offered a High Level of Assurance (very good) and there were no recommendations required to be implemented.

8. OTHER ACTIVITY UPDATE

8.1 The main purpose of this report is to inform Members of the activities undertaken during 1 April 2017 to 30 September 2017 however since this period a number of events have taken place and these have been briefly highlighted for Members reference below;

- MPC at its meeting on 2 November increased the bank rate for the first time since July 2007 from 0.25% to 0.50% as referred to at para 2.3,
- New long term borrowing of £17m was taken from the PWLB at an interest rate of 2.48% at the start of November to finance the purchase of a property within the Council's Commercial Investment portfolio and all on-going costs will be funded from the revenues generated from this acquisition,
- Additional temporary borrowing of £2m was required on 30 October for 1 day to assist with cash flow funding incurring costs of £21,
- The Council's treasury management advisors Capita was sold to Link Group and commenced operating as Link Asset Services,
- On 10 November 2017, the DCLG published a consultation paper on proposed changes to the prudential framework of capital finance together with draft investment & Minimum Revenue Provision guidance. In addition to this, CIPFA are also in the process of producing an updated code of practice for Treasury Management. All these documents, will be carefully examined to determine the impact they will have on the Council's Treasury Management and Capital activities and all future reports will be produced incorporating these updates.

9. RECOMMENDATIONS

9.1 That the Accounts & Audit Committee & Executive be requested to;

- Note the Treasury Management activities undertaken in the first half of 2017/18.

<u>Other Options</u>

This report has been produced in order to comply with Financial Regulations and relevant legislation and provides an overview of transactions undertaken during the first half of 2017/18.

<u>Consultation</u>

Information for the period 1 April 2017 to 30 September 2017 was obtained from Link, the Council's external consultants.

<u>Reasons for Recommendation</u>

The report has been produced in order to meet the requirements of the Council's Financial Procedure Rules which incorporate the requirements of both the CIPFA Prudential Code for Capital Finance and the CIPFA Code of Practice on Treasury Management.

Finance Officer Clearance … NB**………**

Legal Officer Clearance **…** JK**………..**

DIRECTOR'S Signature Joanne Hyde

APPENDIX A

Breakdown of Investments as at 30 September 2017

Counterparty	Amount £m	Total £m
UK Institutions		
Banks		
Barclays	5.0	
Close Bros	5.0	
Goldman Sachs Investment Bank	4.5	
Lloyds	11.5	
Santander UK	7.2	33.2
Building Societies		
Coventry	2.5	
Nationwide	2.8	5.3
Money Market Funds		
Federated	4.6	
Invesco	0.8	
Legal & General	0.9	
Standard Life	7.3	13.6
Other		
Church Commissioners Local Authority	4.8	4.8
Sub-Total UK Institutions		**56,9**
Non UK Institutions		
Development Bank of Singapore	5.0	
National Bank of Abu Dhabi	7.5	
United Overseas Bank	3.0	15.5
Sub-Total Non UK Institutions		**15.5**
Grand Total		**72.4**

APPENDIX B

Major Economic Forecasts for Calendar Year 2018

Location	Gross Domestic Product	Unemployment Rate	Consumer Price Index	Bank Rate
UK	1.0%	5.3%	2.7%	0.50%
Euro Area	1.8%	8.9%	1.4%	0.05%
USA	2.4%	4.3%	2.2%	2.20%
China	6.4%	4.2%	2.0%	4.40%

Source of information OECD