REPORT FOR:	**Governance, Audit, Risk Management and Standards Committee**
Date of Meeting:	17 July 2018
Subject:	**INFORMATION REPORT - Treasury Management Outturn 2017/18**
Responsible Officer:	Dawn Calvert, Director of Finance
Exempt:	No
Wards affected:	All
Enclosures:	Appendix 1 – Legislation and Regulations Impacting on Treasury Management Appendix 2 – Treasury Management Delegations and Responsibilities Appendix 3 – Counterparties Appendix 4 – Prudential Indicators 2017/18 Outturn

Section 1 – Summary and Recommendations

Summary

This report sets out the summary of treasury management activities for 2017/18.

Recommendation

The Committee are asked to:

- Review the outturn position for treasury management activities for 2017/18.

Reasons

(a) To promote effective financial management and comply with the Local Authorities (Capital Finance and Accounting) Regulations 2003 and other relevant guidance.

(b) To keep Committee Members informed of treasury management activities and performance.

Section 2 – Report

1. INTRODUCTION

1.1 Cabinet Consideration

1. At its meeting on 21 June 2018 Cabinet noted the outturn position for treasury management activities for 2017/18 and referred the report to Governance, Audit, Risk Management and Standards Committee for review.

1.2 Background

2 The Chartered Institute of Public Finance and Accountancy (CIPFA) defines Treasury Management 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."

The Council has adopted this definition.

3. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. The first main function of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested with approved counterparties or instruments commensurate with the Council's current investment strategy, providing adequate liquidity initially before considering investment return.

4. The second main function of the Treasury Management service is the funding of the Council's capital programme. This programme provides a guide to the borrowing need of the Council, essentially the longer term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans or using longer term cash flow surpluses. On occasion, any debt previously drawn may be restructured to meet Council risk or cost objectives.

5 The Local Government Act 2003 and supporting regulations require the Council to 'have regard to' the Prudential Code (The Prudential Code for Capital Finance in Local Authorities [CIPFA 2017 Edition]) and Treasury Management Code (Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes [CIPFA 2017 Edition]), in setting Treasury and Prudential Indicators for the next three years and in ensuring that the Council's capital investment programme is affordable, prudent and sustainable.

6. The Act, the Codes and Ministry for Communities Housing and Local Government Investment Guidance (2018) require the Council to set out its Treasury Strategy for Borrowing and to prepare an Annual Investment Strategy that establishes the Council's policies for managing its

investments and for giving priority to the security and liquidity of those investments. A summary of the relevant legislation, regulations and guidance is included as Appendix 1.

7. The budget for each financial year includes the revenue costs that flow from capital financing decisions. Under the Treasury Management Code, increases in capital expenditure should be limited to levels whereby increases in interest charges and running costs are affordable within the projected income of the Council for the foreseeable future.

8. The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

9 The Council recognises that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

1.1 Reporting Requirements

10 As introduced above, the Council and/or Cabinet are required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

Treasury Management Strategy Statement report - The first, and most important report is presented to the Council in February and covers:

- the capital programme (including Prudential Indicators);
- the MRP Policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- the Investment Strategy (the parameters on how investments are to be managed).

Mid-year Review report – This is presented to Cabinet in the autumn and updates Members on the progress of the capital position, reporting on Prudential Indicators and recommending amendments when necessary and identifying whether the treasury strategy is meeting the objectives or whether any policies require revision.

Treasury Management Outturn report (this report) – This is presented to Cabinet in June and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the Strategy.

Scrutiny - The above reports are required to be adequately scrutinised, normally before being recommended to Cabinet / Council, with the role being undertaken by the Governance, Audit, Risk Management and Standards Committee (GARMSC). The Council has complied with the Code to the extent that all Treasury Management reports have been properly scrutinised though the efficient conduct of the Council's business has sometimes necessitated consideration by GARMSC subsequent to consideration by Cabinet / Council. Member training on Treasury Management issues is scheduled for 24 July 2018 in order to support Members' scrutiny role.

11. The Council has delegated responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Section 151 officer. The Section 151 Officer chairs the Treasury Management Group (TMG), which monitors the treasury management activity and market conditions monthly.

12. Further details of responsibilities are given in Appendix 2.

1.3 Matters covered in report

13. The main matters covered in the report are:

- Treasury management outturn (Paragraph 2)
- Treasury position as at 31 March 2018 (Paragraph 3)
- Strategy for 2017/18 (Paragraph 4)
- Borrowing outturn (Paragraph 5)
- Investment outturn (Paragraph 6)
- Compliance with treasury limits and Prudential Indicators (Paragraph 7)
- Minimum Revenue Provision (Paragraph 8)
- Economic background (Paragraph 9)

1.4 Options considered

14. For the reasons discussed above no other options were considered.

2. TREASURY MANAGEMENT OUTTURN

15. There was a favourable variance of £0.7m on the revised capital financing budget of £6.6m as detailed in the following table:

Table 1: Outturn Summary

2017-18	Original Budget	Revised Budget	Outturn	Variation	
	£000	£000	£000	£000	%
Cost of Borrowing	8,073	8,045	7,316	-729	-9.06%
Investment Income	-1,397	-1,400	-1,360	40	2.86%
Total	**6,676**	**6,645**	**5,956**	**-689**	**-10.37%**

Income was lower than budgeted due to the reduction in Council cash balances and in low interest rates available. The cost of borrowing was lower than usual due to deferring external borrowing through use of Council cash balances.

16. The returns from the investment portfolio are benchmarked by the treasury management adviser, Link Asset Services. The need to maintain liquidity to fund the capital programme meant that the average returns of 0.23% were below the London and National average. As a result of holding low cash balances in liquid investments, the opportunities for achieving a higher return were limited.

3. TREASURY POSITION AS AT 31 MARCH 2018

17. The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting and through officer activity detailed in the Council's Treasury Management Practices. At the end of 2017/18 the Council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

Table 2: Outstanding Borrowings and Investments

	31 March 2018	Average Rate at 31 March 2018	Average Life	31 March 2017	Average Rate at 31 March 2017	Average Life
	£m	%	Years	£m	%	Years
Fixed Rate Borrowing						
Public Works Loans Board (PWLB)	218.5	4.09	33.2	218.5	4.09	34.2
Market	105.8	4.29	37.3	115.8	4.53	35.0
Total Debt	**324.3**	**4.15**	**34.5**	**334.3**	**4.24**	**34.5**
Investments						
In-House	16.9	0.23	4.15	65.2	0.59	11 days
Total Investments	**16.9**	**0.23**	**4.15**	**65.2**		

The above analysis assumes loans structured as LOBOs (see paragraph 22 below for definition and further details) mature at the end of the contractual period. If the first date at which the lender can reset interest rates was used as the maturity date, the average life for market loans would be 18 years and for the whole debt portfolio approximately 25 years

4. STRATEGY FOR 2017-18

18 In the Treasury Management Strategy Statement agreed by Council on 23 February 2017 it was stated that for the next three years the capital programme would continue to be funded to a large extent from grants and revenue resources but that substantial borrowing was also likely to be required. The only other foreseen circumstance in which new long term

borrowing in the next three years might be needed would be if part of the LOBO portfolio had to be refinanced early.

19. Neither of the circumstances necessitating additional borrowing arose. No new long-term borrowing was taken.

20. Investments continued to be dominated by low counterparty risk considerations resulting in low returns compared to borrowing rates.

21. No rescheduling was done during the year as the average differential between PWLB new borrowing rates and premature repayment rates made it unviable.

5. BORROWING OUTTURN

22. There was no additional borrowing but three higher interest loans were repaid on maturity. The table below sets out the borrowing maturity profile.

Table 3: Borrowing Maturity Profile (Assuming Full Term Maturity for LOBOS)

	31st March 2018		**31st March 2017**	
	£m	**%**	**£m**	**%**
Under 12 Months	10.0	3.1	10.0	3.0
12 Months and under 24 Months	12.0	3.7	10.0	3.0
24 Months and within 5 years	5.0	1.5	12.0	3.6
5 years and within 10 years	5.0	1.5	5.0	1.5
10 years and within 20 years	50.0	15.4	45.0	13.5
20 years and within 30 years	0.0	0.0	10.0	3.0
30 years and within 40 years	80.0	24.7	80.0	23.9
40 years and within 50 years	128.5	39.6	128.5	38.4
50 years and above	33.8	10.4	33.8	10.1
Total	**324.3**	**100.0**	**334.3**	**100.0**

23 In aggregate there are £50.8m of Lender Option Borrower Option (LOBO) structured loans shown in the table above as having maturities of between 42 and 60 years. In exchange for an interest rate that was below that offered on long term debt by the PWLB the lenders are permitted to reset interest rates five years after the loan is drawn and either semi-annually or annually thereafter. Should interest rates on these loans increase, the Council has the option to repay at no cost. The table below restates the maturity profile by including LOBO loans at their first interest reset date.

Table 4: Borrowing Maturity Profile (Assuming Earliest Repayment for LOBOS)

	31st March 2018		31st March 2017	
	£m	%	£m	%
Under 12 Months	60.8	18.8	80.8	24.2
12 Months and under 24 Months	12.0	3.7	10.0	3.0
24 Months and within 5 years	5.0	1.5	12.0	3.6
5 years and within 10 years	5.0	1.5	5.0	1.5
10 years and within 20 years	50.0	15.4	45.0	13.4
20 years and within 30 years	0.0	0.0	10.0	3.0
30 years and within 40 years	80.0	24.7	60.0	18.0
40 years and within 50 years	98.5	30.4	98.5	29.4
50 years and above	13.0	4.0	13.0	3.9
Total	**324.3**	**100.0**	**334.3**	**100.0**

24. The approach to funding capital expenditure, as discussed in past strategy statements, is to use internal funds wherever possible in recognition of the unfavourable gap between investment returns and borrowing costs. Consideration continues to be given as to the cost and benefits of the premature repayment of debt and the premium which would be incurred. However, in view of the cost and the estimated future requirements of the capital programme, which could necessitate further borrowings, it was not felt to be appropriate to make any premature repayments during 2017/18.

6. INVESTMENT OUTTURN

25. Deposit rates continued into the start of 2017/18 at previous depressed levels due, in part, to a large tranche of cheap financing being made available under the Term Funding Scheme to the banking sector by the Bank of England; this facility ended on 28.2.18. The Bank of England base rate was duly raised from 0.25% to 0.50% on 2.11.17 and remained at that level for the rest of the year. However, further increases are expected over the next few years.

26. The Council manages its investments in-house and invests with the institutions listed in the Council's approved Counterparty list. The treasury strategy permits investments for a range of periods from overnight to three years, dependent on the Council's cash flows, its interest rate view and the interest rates on offer. Further details of the credit quality of counterparties are given in Appendix 3.

27. As at 31 March 2018, most of the investment portfolio (69%) was invested with two banks, Lloyds (36%) and RBS (33%). The counterparty policy permits up to 50% to be invested with Lloyds / HBOS and 60% with RBS.

28. All of the cash investments were held for less than seven days by year-end. The investment portfolio achieved an average return of 0.23%. reflecting the short duration of investments and the low level of deposit rates during the year

29. The table below sets out the investment balances as at 31 March 2018.

Table 5: Investment Balances

	31st March 2018		31st March 2017	
	£m	**%**	**£m**	**%**
Specified Investments				
Banks & Building Societies	0	0	11.3	17.3
Money Market Funds	1.6	9.5	1.6	2.5
Local Authority	0.0	0.0	0.0	0.0
Non –Specified Investments				
Banks & Building Societies	15.1	89.6	52.1	80.0
Enhanced Money Market Funds	0.2	0.9	0.1	0.2
Total	**16.9**	**100.0**	**65.1**	**100.0**

Investment balances have reduced due to the progress made on agreed initiatives and priorities. Average balances above £30 million were maintained during the year. Included in the above balances are Pension Fund balances of £1.1m. In aggregate 6% of interest earned is allocated to internal funds.

7. COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

30. The prudential framework for local authority capital investment was introduced through the Local Government Act 2003. The prudential system provides a flexible framework approach within which capital assets can be procured, managed, maintained and developed. Under this framework, individual authorities are responsible for deciding the level of their affordable borrowing for the Council's capital investment plans that is demonstrated to be affordable, prudent and sustainable.

31. The Act and the supporting regulations require the Council to have regard to the Prudential Code and to set Prudential Indicators for the next three years. The indicators for 2017/18 were approved by the Council on 23 February 2017. During the financial year the Council operated within the treasury limits and Prudential Indicators as shown in Appendix 4.

32 In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued a revised Treasury Management Code and Cross Sectoral Guidance Notes, and a revised Prudential Code. A particular focus of these revised codes was how to deal with local authority investments which are not treasury type investments e.g. by investing in purchasing property in order to generate income for the Authority at a much higher level than can be attained by treasury investments. One recommendation was that local authorities should produce a new report to members to give a high level summary of the overall Capital Strategy and to enable members to see how the cash resources of the Authority have been

apportioned between treasury and non-treasury investments. The Capital Strategy must be implemented in readiness for the development of the 2019/20 Treasury Management Strategy Statement. This will be reported to GARMSC prior to reporting to Cabinet and Council in February 2019,

33 **Markets in Financial Instruments Directive II (MiFID II)**
The EU set the date of 3 January 2018 for the introduction of regulations under MIFID II. These regulations govern the relationship that financial institutions conducting lending and borrowing transactions will have with local authorities from that date. This has had little effect on this Authority apart from having to fill in forms sent by each institution dealing with this Authority for each type of investment instrument we use, apart from for cash deposits with banks and building societies.

8. MINIMUM REVENUE PROVISION (MRP)

34. Under the statutory regulations the Council must determine for the current financial year an amount of minimum revenue provision (MRP) which it considers to be prudent. The MRP is the means by which capital expenditure which is financed by borrowing or credit arrangements is funded by the revenue account over the useful life of the asset, (the period during which assets such as land, building, plant and machinery are used to provide services).

9. ECONOMIC BACKGROUND

35. The Council has engaged Link (previously Capita) Asset Services, Treasury Solutions as its external treasury management adviser. A short commentary follows, provided by Link in April 2018 summarising their views on developments in the world economy and interest rates during 2017/18.

During the calendar year of 2017, there was a major shift in expectations in financial markets in terms of how soon Bank Rate would start on a rising trend. After the UK economy surprised on the upside with strong growth in the second half of 2016, growth in 2017 was disappointingly weak in the first half of the year which meant that growth was the slowest for the first half of any year since 2012. The main reason for this was the sharp increase in inflation caused by the devaluation of sterling after the EU referendum, feeding increases into the cost of imports into the economy. This caused a reduction in consumer disposable income and spending power as inflation exceeded average wage increases. Consequently, the services sector of the economy, accounting for around 75% of GDP, saw weak growth as consumers responded by cutting back on their expenditure. However, growth did pick up modestly in the second half of 2017. Consequently, market expectations during the autumn, rose significantly that the MPC would be heading in the direction of imminently raising Bank Rate. The minutes of the MPC meeting of 14 September indicated that the MPC was likely to raise Bank Rate very soon. The 2 November MPC quarterly Inflation Report meeting duly delivered by raising Bank Rate from 0.25% to 0.50%.

The 8 February MPC meeting minutes then revealed another sharp hardening in MPC warnings on a more imminent and faster pace of increases in Bank Rate than had previously been expected.
Market expectations for increases in Bank Rate, therefore, shifted considerably during the second half of 2017-18 and resulted in investment rates from 3 – 12 months increasing sharply during the spring quarter.

PWLB borrowing rates increased correspondingly to the above developments with the shorter term rates increasing more sharply than longer term rates. In addition, UK gilts have moved in a relatively narrow band this year, (within 25 bps for much of the year), compared to US treasuries. During the second half of the year, there was a noticeable trend in treasury yields being on a rising trend with the Fed raising rates by 0.25% in June, December and March, making six increases in all from the floor. The effect of these three increases was greater in shorter terms around 5 year, rather than longer term yields.

10. IMPLICATIONS OF THE RECOMMENDATIONS

36. The recommendations are asking the Cabinet mainly to note the position on treasury management activities. They do not affect the Council's staffing / workforce and have no equalities, procurement, data protection or community safety impact.

11. PROCUREMENT IMPLICATIONS

37. There are no procurement implications arising from this report.

12. LEGAL IMPLICATIONS

38. The report has been reviewed by the Legal Department and comments received are incorporated into the report.

13. FINANCIAL IMPLICATIONS

39. In addition to supporting the Council's revenue and capital programmes the Treasury Management revised budget of £6.1m discussed in paragraph 14 is an important part of the General Fund budget. Any savings achieved, or overspends incurred, have a direct impact on the achievements of the budgetary policy. There is no direct financial impact of paying the London living Wage (LLW) in relation to the treasury management strategy.

14. PERFORMANCE ISSUES

40. The Council meets the requirements of the CIPFA Code of Practice for Treasury Management and therefore is able to demonstrate best practices for the Treasury Management function.

41. As part of the Code the Council must agree a series of prudential indicators and measure its performance against them. These indicators and performance are detailed in Appendix 4

15. ENVIRONMENTAL IMPACT

42. There are no direct environmental impacts.

16. RISK MANAGEMENT IMPLICATIONS

43. The identification, monitoring and control of risk are central to the achievement of the treasury objectives. Potential risks are included in the Directorate risk register and are identified, mitigated and monitored in accordance with treasury practice notes approved by the Treasury Management Group.

17. EQUALITIES IMPLICATIONS/PUBLIC SECTOR EQUALITY DUTY

44. There is no direct equalities impact.

18. CORPORATE PRIORITIES

45. This report deals with the Treasury Management Strategy which plays a significant part in supporting the delivery of all the Council's corporate priorities.

Section 3 - Statutory Officer Clearance

Name:Dawn Calvert Date: 2nd July 2018	x	Chief Financial Officer
Name: David Hodge Date: 2nd July 2018	x	on behalf of the Monitoring Officer

Ward Councillors notified:	**NO**

Section 4 - Contact Details and Background Papers

Contact: **Iain Millar** (Treasury and Pensions Manager) Tel: 020-8424-1432 / Email: iain.millar@harrow.gov.uk

Background Papers: None