London Borough of Hammersmith & Fulham CABINET 16 JANUARY 2017	
MID-YEAR TREASURY REPORT 2016/17	
Report of the Cabinet Member for Finance – Councillor Max Schmid	
Open Report	
Classification – For Decision **Key Decision:** Yes	
Wards Affected: ALL	
Accountable Director: Hitesh Jolapara, Strategic Finance Director	
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1. EXECUTIVE SUMMARY

1.1. This report presents the Council's Mid-Year Treasury Report for 2016/17 in accordance with the Council's Treasury Management Practices. It is a regulatory requirement for this report to be presented to Council.

1.2 The report does not seek to make any changes to the approved investments allowed under the Council's strategy, but gives an overview of the implementation of the strategy to date.

1.3 There are two aspects of Treasury performance – debt management and cash investments. Debt management relates to the Council's borrowing and cash investments to the investments of surplus cash balances. This report covers:

- Treasury position as at 30 September 2016.
- Investment activity to 30 September 2016.
- Borrowing activity to 30 September 2016.
- Compliance with the treasury limits and prudential indicators and
- The UK economy and interest rates.

The borrowing amounts outstanding and cash investments for the 30 September period are as follows:

	30 September 2016 £m	31 March 2016 £m
Total Borrowing	227	232
Total Cash Balances	(344)	(299)
Net Surplus	**(117)**	**(67)**

2. RECOMMENDATIONS

2.1. To note the Council's borrowing and investment activity up to the 30 September 2016.

3. REASONS FOR DECISION

3.1. This report presents the Council's Treasury Management Mid-Year Report to the 30 September 2016 in accordance with the Council's Treasury Management Practices.

3.2 The CIPFA Code of Practice on Treasury Management has been adopted by the Council. This Mid-Year review has been prepared in compliance with the Code of Practice. The primary requirements of the Code are as follows:

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

- Receipt by the full Council of an Annual Treasury Management Strategy Statement, including the Annual Investment Strategy, for the year ahead, a Mid-Year Review Report (this report) and an Annual Report covering activities during the previous year.

3.3 This Council delegates the scrutiny of Treasury Management Strategy and policies to the Audit, Pensions and Standards Committee.

4. TREASURY POSITION AT 30 SEPTEMBER 2016

Investment

4.1. The table below provides a schedule of the cash deposits, together with comparisons with 31st March 2016.

	30 September 2016		31 March 2016	
	Balance £m	**Yield (%)**	**Balance £m**	**Yield (%)**
Call Accounts	1	0.25	1	0.25
Money Market Funds (Constant NAV)	115	0.32	34	0.52

Total Liquid Investments	**116**	**0.32**	**34**	**0.40**
Notice Account	15	0.60	20	0.60
Term Deposit	20	1.05	40	1.05
Tradable securities (Cost value)	193	0.45	205	0.58
Total other Investments	**228**	**0.50**	**265**	**0.65**
Grand Total/ Average Yield	**344**	**0.44**	**299**	**0.63**

4.2. The average level of funds available for investment in the first six month of 2016/17 was £333 million. The average rate of return on the investments was 0.56%. The rate of interest earn is expected to fall in the second half of the year.

4.3 All investments during the first six months of the year have been in line with the strategy.

4.4 Liquid investments are managed through the Call accounts and Money Market Funds which offer same day liquidity. The Council has £115m invested in four money market funds run by Federated Investors, Insight, Goldman Sachs and Blackrock. The funds return an average of 0.32%, are rated AAA by at least one of the three main credit rating agencies.

4.5 The Council has a 35 day Notice Account with Handelsbanken which currently returns 0.60%.

4.6 The Council has two fixed term deposit loans for £10m invested with Lloyds Bank at 1.05% which both loans will mature in October 2016.

4.7 Tradable securities are highly rated short term investments that are held by Northern Trust (Custodian). Investments include UK Treasury Bills and bonds issued by Network Rail (Government guaranteed), Svenska Handelsbanken bonds, Supra national banks and European Agencies. The average return of the Tradable securities was 0.45%.

4.8 The shaded area in the chart below[1] shows the daily investment balance during the first half year. The line shows the return of the investment portfolio, which has decreased from 0.63% at the start of the year to 0.44% at the 30th September.

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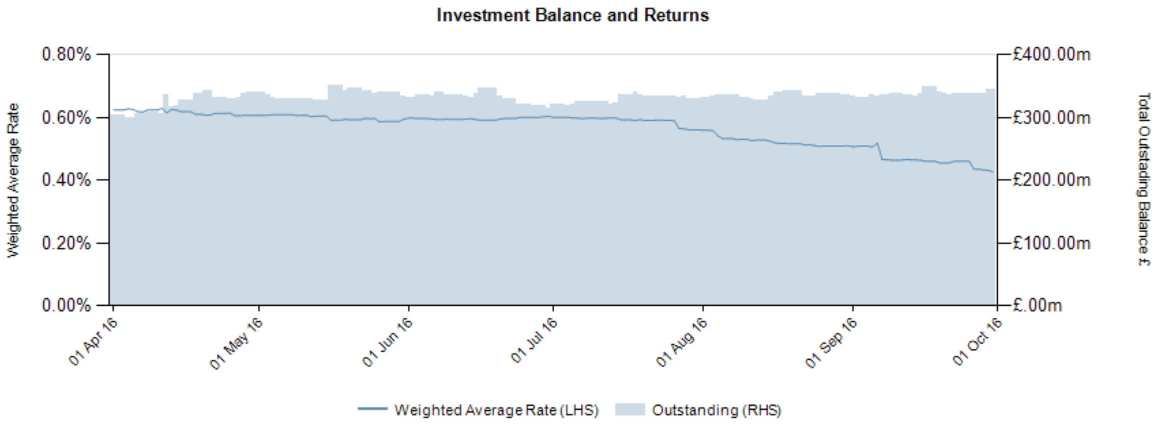
[1] Data Source: Public Sector Live
LHS Left Hand Scale (Weighted Average rate) and RHS Right Hand Scale (Total outstanding balance).



4.9 As a consequence of the referendum vote in June to leave the European Union, the Bank of England's Monetary Policy Committee (MPC) voted at its August meeting to reduce bank rate from 0.50% to 0.25%. This led to a subsequent fall in the other UK money market rates. For example, the Debt Management Office (DMO) rate reduced from 0.25% to 0.15% and the six month Treasury Bills which were trading at 0.599% at the end of June were 0.245% at the end of September.

4.10 All investment limits specified in the 2016/17 investment strategy have been adhered to. The table below shows the limits and exposures as at the 30th September 2016. Data provided below from Public Sector Live.

Category	**£ Limit per counterparty**	**Duration Limit**	**Counterparty Name**	**Exposure at 30/9/16 £m**	**Average Interest Rate (%)**	**Weighted Average Maturity Days (WAM)**
UK Government	unlimited	unlimited	UK Government Treasury Bills	46.4	0.41	84
Supra national	£100m	5 years	European Investment Bank	77.8	0.40	234
			International Bank of Reconstruction & Development	12.7	0.63	88
			Council of Europe Development Bank(COE)	10. 1	0.34	80
European Agencies	£100m	5 years	Kreditanstalt fur Wiederaufbau (KfW)	25.8	0.49	277
Network Rail	£200m	37 years	Network Rail Infrastructure PLC	5.0	0.31	77
Money Market Funds	£30m per fund. £200m in total	n/a	Goldman Sachs	30.0	0.30	Instant
			Federated Investor	30.0	0.37	Instant
			Blackrock	30.0	0.32	Instant
			Insight	24.7	0.30	Instant

UK Bank Deposit / Certificate of Deposit /Short Dated Bonds (or UK Government ownership of greater than 25%) AA-/Aa3/AA-	£70m	5 years	Royal Bank of Scotland Plc (National Westminster Bank)	0.5	0.25	Instant
UK Bank Deposit / Certificate of Deposit /Short Dated Bonds A-/A3/A-	£50m	3 years	Lloyds Bank Plc	20.0	1.05	11
Non-UK Bank AA-/Aa3/AA-	£50m	1 years	Svenska Handelsbanken	14.9 16.3	0.60	Instant
Total/ WAM				**344.2**	**0.44**	**110**

4.11 Officers circulate a listing of all investments on a weekly basis to the Cabinet Member for Finance and Strategic Finance Director and monthly meetings are held to discuss the treasury strategy.

Borrowing

4.12 The Council's forecast capital financing requirement (CFR) for 2016/17 per the Capital Programme was £273.9 million. The CFR denotes the Council's underlying need to borrow for capital purposes. The outstanding debt as at 30th September 2016 was £227 million.

4.13 Where the CFR exceeds borrowing the Council may choose to cover the difference by borrowing either from the Public Works Loan Board (PWLB) or the market (external borrow) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.

4.14 As anticipated in the strategy, to date the Council has undertaken no new borrowing due to the high level of cash holdings. It is anticipated that no borrowing will be undertaken during the financial year. However, officers are monitoring market conditions and may choose to borrow at current low rates if a requirement is identified for the general fund or the Housing Revenue Account (HRA).

4.15 The table below shows the Council's external borrowing (as at 30 September 2016) is £227m split between General Fund and HRA at an interest rate of 5.06%. Principal repayments of £ 4.5 million pounds have reduced the average interest rates in both portfolios by 0.05%.

	30th September 2016		31st March 2016	
	Principal Outstanding £m	**Average Rate %**	**Principal Outstanding £m**	**Average Rate %**
General Fund	38.8	5.06	39.6	5.11
HRA	188.6	5.06	192.3	5.11
Total	**227.4**	**5.06**	**231.9**	**5.11**

4.16 Early repayment of debt is an option but, depending on the view taken over future movements in interest rates, the Council would pay such large premia, in effect penalties, for early redemption that it does not appear to constitute value for money.

5. COMPLAINCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

5.1. During the first six months of the financial year the Council operated within its treasury limits and Prudential Indicators as set out in the Council's Treasury Management Strategy Statement.

External debt indicator	Approved limit (£m)	Maximum borrowing	Days exceeded
Authorised limit	320	247	None
Operational boundary	270	247	None

5.2 The Authorised Limit is a level for which the external borrowing cannot be exceeded without reporting back to Full Council. It therefore provides sufficient headroom such that in the event that the planned capital programme required new borrowing to be raised over the medium term, if interest rates were deemed favourable and a thorough risk analysis determined the cost of carry was appropriate, this borrowing could be raised ahead of when the spend took place.

5.3 The Operational Boundary is set at a lower level and should take account of the most likely level of external borrowing. Operationally, in accordance with CIPFA best practice for Treasury Risk Management, a liability benchmark is used to determine the point at which any new external borrowing should take place. As a result of the significant level of cash balances, it is deemed unlikely that any new borrowing will be required in the foreseeable future.

5.4 The maturity structure of borrowing shows the proportion of loans maturing in each time bucket. The purpose of this indicator is to highlight any potential refinancing risk that the authority may be facing if any one particular period had a disproportionate level of maturing loans. The maturity structure as at 30th September 2016 was well within the limits set and does not highlight any significant issues.

	Upper Limit	**Lower Limit**	**Actual as at 30 September 2016**
Under 12 months	15%	0%	4.4%
12 months and within 24 months	15%	0%	-
24 months and within 5 years	60%	0%	11.3%
5 years and within 10 years	75%	0%	11.3%
10 years and above	100%	0%	73.0%

5.5 The purpose of the interest rate exposure indicators is to demonstrate the extent of exposure to the authority from any adverse movements in interest rates. The limits for 2016/17 were set to contain the exposure to rising interest rates which would have adverse implications for the cost of borrowing.

Upper limits on interest rate exposure	**Approved maximum limit**	**Actual as at 30 September 2015**
Borrowing		
Fixed interest rate exposures	100%	100%
Variable interest rate exposures	20%	0%

5.6 All borrowing undertaken is at fixed rates and therefore reduces exposure to rising interest costs. However, the Council is also exposed to interest rate risk within its investment portfolio and therefore the greatest contributor to net interest risk arises from this portfolio. As part of the strategic review of the investments outlined in Section 4 of this report and in recognition of a key risk management objective to reduce interest rate exposures, the mis-match between fixed and variable investment returns will be re-balanced in order to reduce interest rate risk to the organisation.

6. THE ECONOMY AND INTEREST RATES

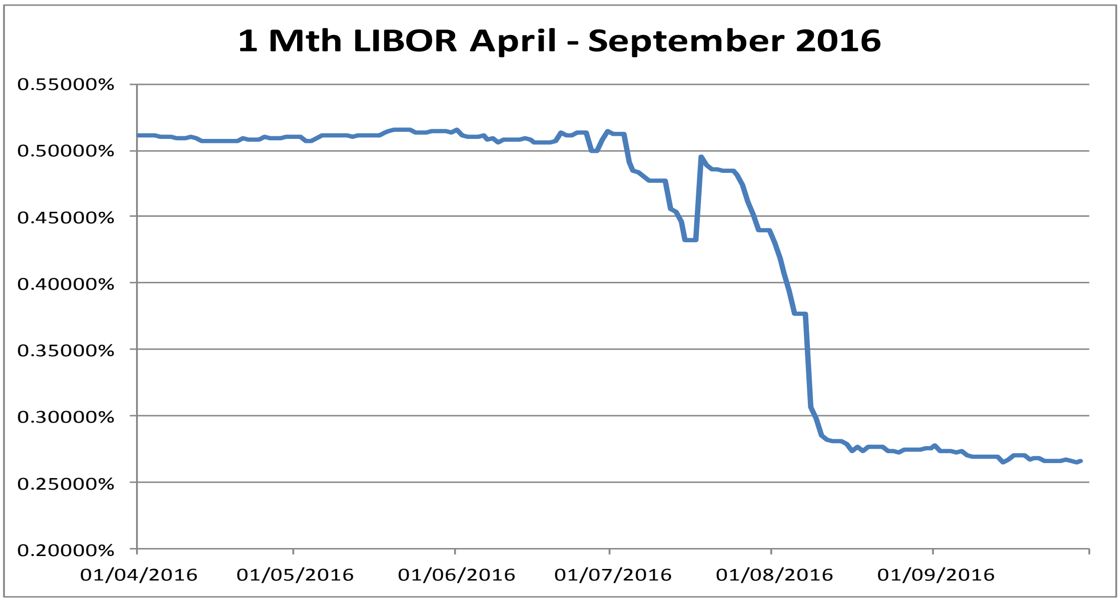
6.1 UK Gross Domestic Product (GDP) rose in the first quarter of the financial year, showing a 2.2 per cent year on year increase. Following the referendum vote to leave the European Union the Organisation for Economic Cooperation and Development (OECD) reduced its forecast for growth in 2017 to one per cent. However, the Office for National Statistics suggested the result had not had a major effect on the UK economy so far.

6.2 Consumer Price Inflation (CPI) is running at 0.6 per cent year on year. However the forecast is that inflation will rise over the next few years, rising above the Monetary Policy Committee's (MPC) 2 per cent target in 2018. This is mainly due to the recent fall in the value of Sterling following the referendum result.

6.3 Bank Rate remained at 0.5 per cent until the August meeting of the MPC when the committee voted to cut Bank Rate to 0.25 per cent and increase quantitative easing by £60 billion. This was in response to the immediate aftermath of the referendum result. The Governor of the Bank of England also indicated further measures would be taken if required.

6.4 The long term PWLB certainty maturity interest rates have fallen from 1st April 2016, 20yrs - 3.03%, 30yrs – 3.12% to 30th September 20yrs - 2.18%, 30yrs – 2.25% or around 85 basis points.

6.5 The chart below shows movements in the 1 month London Interbank Offer Rate during the first half of the financial year:



7. THE WAY FORWARD

7.1 Officers have been actively considering a variety of treasury initiatives, predominantly focusing on active risk management of the portfolio. Whilst the work is still in progress, there are a number of points that can be factored into the current and future years' portfolio management.

7.2 Long term cash flow forecasts have been developed and are being actively used to assist the authority's strategic decision making. These projections are able to be continually updated with the evolving spending plans of the organisation.

7.3 Furthermore, it has been determined that a balance of £100m needs to be retained on a liquid basis to meet peaks and troughs of cash flows. Therefore, there is an expected balance of over £100m that is not needed in the foreseeable future and can therefore be invested on a more strategic basis.

7.4 There are several options being explored for the use of this available cash balance, and some of these initiatives are yet to be concluded. However, it is clear investing for longer duration can lock in gains above short term rates. Furthermore this strategy would reduce interest rate risk and uncertainty as a lower proportion of the portfolio would need to be re-invested at unknown future rates.

7.5 Officers met with Members in October and are currently in discussion on potential changes to the current treasury policy and explore future opportunities for the Treasury Management Strategy for 2017/18. These will be included in the TMSS for 2017/18.

7. EQUALITY IMPLICATIONS

7.1 There are no equality implications as a result of this report.

8. LEGAL IMPLICATIONS

8.1 There are no direct legal implications arising from this report.

Implications completed by: Rhian Davies, Chief Solicitor (Litigation and Social Care) 020 7641 2729

9. FINANCIAL IMPLICATIONS

9.1 This report is wholly of a financial nature.

10. IMPLICATIONS FOR BUSINESS

10.1 The Council's borrowing and investment activity up to the 30th September 2016. This represents significant expenditure within the Borough and consequently where supplies are sourced locally changes in borrowing or investment may impact either positively or negatively on local contractors and sub-contractors. Where capital expenditure increase, or is brought forward, this may have a beneficial impact on local businesses; conversely, where expenditure decreases, or is slipped, there may be an adverse impact on local businesses.

Implications verified/completed by: Antonia Hollingsworth, Principal Business Investment Officer, tel. 0208 753 1698

11. BACKGROUND PAPERS USED IN PREPARING THIS REPORT

No.	Description of Background Papers	Name/Ext of holder of file/copy	Department/ Location
	None		

LIST OF APPENDICES: None