London Borough of Hammersmith & Fulham **CABINET** **4 DECEMBER 2017**	h&f hammersmith & fulham
TREASURY MID-YEAR REVIEW REPORT 2017/18	
Report of the Member for Finance – Councillor Max Schmid	
Open Report	
Classification – For decision **Key Decision: Yes**	
Consultation	
Wards Affected: ALL	
Accountable Director: Hitesh Jolapara, Strategic Finance Director	
Report Author: Halfield Jackman Treasury Manager	**Contact Details:** Tel: 020 7641 4354 E-mail: hjackman@westminster.gov.uk

1. EXECUTIVE SUMMARY

1.1. The purpose of this report is to:

- ➢ update Members on the delivery of the 2017/18 Treasury Management Strategy approved by Council on 22 February 2017; and
- ➢ note the Annual Treasury Strategy 2017-18 Mid-Year Review.

1.2. Treasury management comprises:

- ➢ managing the Council's borrowing to ensure funding of the Council's future capital programme is at optimal cost;
- ➢ Investing surplus cash balances arising from the day to day operations of the Council to obtain an optimal return while ensuring security and liquidity.

1.3. This report complies with CIPFA's Code of Practice on Treasury Management, and covers the following:

- a review of the Council's investment portfolio for 2017/18 to include the treasury position as at 30 September 2017.
- a review of the Council's borrowing strategy for 2017/18.
- a review of compliance with Treasury and Prudential Limits for the first six months of 2017/18.
- an economic update for the first part of the 2017/18 financial year.

1.4. The Council has complied with all elements of the Treasury Management Strategy Statement (TMSS).

2. RECOMMENDATIONS

2.1. To note the Annual Treasury Strategy 2017-18 Mid-Year Review.

2.2 To approve the Council's intention to opt up to Professional Client status under MiFID II.

3. REASONS FOR DECISION

3.1. This report presents the Council's Mid-Year Treasury Report for 2017/18 in accordance with the Council's Treasury Management Practices. It is a regulatory requirement for this report to be presented to the Council.

4. TREASURY POSITION AS AT 30 SEPTEMBER 2017

4.1. As at 30 September 2017 net cash invested was £137m, an increase of £35m on the position at 31 March 2017 as shown below:

	30 September 2017 £m	31 March 2017 £m	31 March 2016 £m
Total borrowing	217	225	232
Total cash invested	(354)	(327)	(299)
Net cash invested	**(137)**	**(102)**	**(67)**

4.2. The increase reflects the forecast pattern of the Authority's cash flows and largely relates to the timing of grants, council tax and business rates received.

Investments

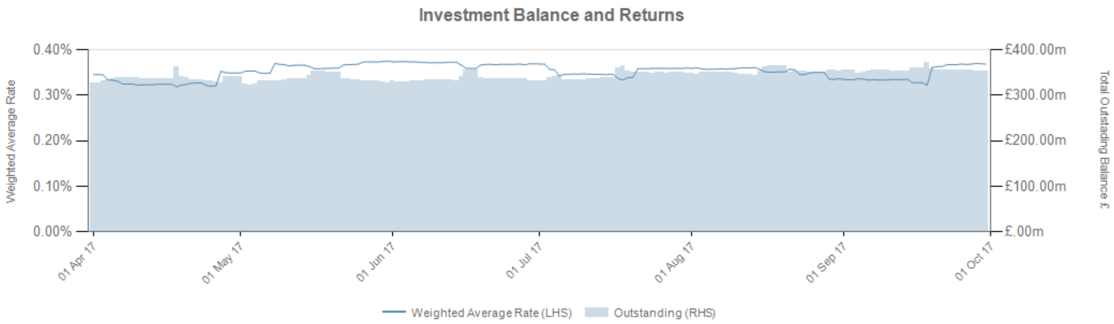
4.3. The Council's Annual Investment Strategy which forms part of the annual Treasury Management Strategy Statement (TMSS) for 2017-18 was approved by the Council on the 22 February 2017. The Council's policy objective is the prudent investment of balances to achieve optimum returns on investments subject to maintaining adequate security of capital and a level of liquidity appropriate to the Council's projected need for funds over time.

4.4. The table below provides a breakdown of investments, together with comparisons for the last financial year end.

	30 September 2017 £m	31 March 2017 £m	31 March 2016 £m
Money Market Funds	37	38	34
Call Accounts	0	3	1
Notice Accounts	93	33	20
Term Deposits	65	45	40
Tradable Securities	99	208	204
Enhanced Cash Funds	60	0	0
Total cash invested	**354**	**327**	**299**

4.5. Liquidity is managed through the use of Call Accounts and Money Market Funds providing same day liquidity. The average level of funds available for investment in the first 6 months of 2017-18 was £344m.

4.6. Daily investment balances have steadily increased from £327m at year end to £354m at the 30 September, as shown on the shaded area in the chart below. At the same time average returns have increased from 0.36% to 0.38% as shown by the solid line in the chart. The rate of return of the enhanced cash funds (ECF) has not been included in the graph because they are classed as Variable Net Asset Value (VNAV)[1] and dividends are paid quarterly. However the ECF return is expected to be approximately 0.50% which increases the overall investment return to 0.43%.



4.7. All investment limits specified in the 2017/18 investment strategy have been complied with.

4.8. Appendix 1 provides a full list of the Council's investment limits and exposures as at 30 September 2017.

[1] The NAV of a fund that uses this form of accounting will change due to the changing value of the assets or in the case of accumulating funds (where any interest is capitalised back into the fund instead of being paid out as an income) by the amount of interest earned.

Borrowing

4.9. At £217m the Council's borrowing was well within the Prudential Indicator for external borrowing (namely that borrowing should not exceed the capital financing requirement[2] (CFR) for 2017/18) of £279m.

4.10. Currently the Council is "under borrowed" by £62m because it has used internal resources to fund capital expenditure.

4.11. As anticipated in the TMSS for 2017/18, to date the Council has undertaken no new borrowing due to the high level of cash holdings.

4.12. The table below shows the details around the Council's external borrowing as at 30th September 2017, split between the General Fund and HRA.

External borrowing	30 September 2017		31 March 2017	
	Balance	Rate	Balance	Rate
	£m	%	£m	%
General Fund	37	4.86	38	5.01
HRA	180	4.86	186	5.01
Total borrowing	**217**	**4.86**	**225**	**5.01**

4.13. No new borrowing was incurred in the first half of 2017-18. General Fund external borrowing reduced by £1.3m and HRA borrowing has reduced by £6.1m through repaying the principal on annuity loans.

5. COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

5.1. During the financial year to September 2017, the Council operated within the Treasury Limits and Prudential Indicators set out in the TMSS and Budget approved by Council on 22 February 2017 as set out below.

[2] The CFR measures the Council's underlying need to borrow for capital purposes.

PI ref	Indicator	2017/18 indicator	2017/18 actual	Indicator met?
1	Net financing need	£20m	£19m	Met
2	Capital Financing Requirement (CFR)	£279m	£281m	Met
3	Net debt vs CFR	£62m underborrowing	£64m underborrowed	Met
4	Ratio of financing costs to revenue stream	GF (1.3%) HRA 12.2%	Nil	Met
5	Incremental impact of new capital investment decisions on council tax	£1.09 decrease in Band D council tax charge per annum	Nil	Met
6	Impact of new capital investment decisions on housing rents	£0.76 increase in average rent per week	Nil	Met
7a	Authorised limit for external debt	£345m	£217m	Met
7b	Operational debt boundary	£290m	£217m	Met
7c	HRA debt limit	£254m	£180m	Met
8	Working capital balance	£205m	£205m	Met
9a	Upper limit for fixed interest rate borrowing	£385m	£217m	Met
9b	Upper limit for variable rate	£0m	£0m	Met
9c	Limit on surplus funds invested for more than 364 days (i.e. non-specified investments)	£120m	£0m	Met
10	Maturity structure of borrowing	Upper limit under 12 months - 15% Lower limit 10 years and above -	4.4% 74%	Met Met

Capital expenditure and borrowing limits

5.2. Capital expenditure to 30 September 2017 was £21m for both the General Fund and the HRA against a forecast for the whole year of £127m.

5.3. External borrowing was well within the Capital Financing Requirement, Authorised Borrowing Limit and the Operational Boundary as shown in the table above:

- 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.

- 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 purpose of the maturity structure of borrowing indicator is to highlight any potential refinancing risk that the Council may be facing if any one particular period there was a disproportionate level of loans maturing. The table below shows that the maturity structure of the Council's borrowing as at 30 September 2017 was within the limits set and does not highlight any significant issues.

Maturity structure of borrowing	Upper Limit (%)	Lower Limit (%)	Actual as at 30 September 2017 (%)
Under 12 months	15	0	0
12 months and within 24 months	15	0	2
24 months and within 5 years	60	0	10
5 years and within 10 years	75	0	14
10 years and above	100	0	74

5.5. The purpose of the interest rate exposure indicators is to demonstrate the extent of exposure to the Council from any adverse movements in interest rates. The table at paragraph 5.1 shows that the Council is not subject to any adverse movement in interest rates as it only holds fixed interest borrowing.

5.6. The average rate on the fixed interest borrowing is 4.86% with an average redemption period of 22 years. This reflects the historical legacy of borrowing taken out some years ago which is now higher than PWLB interest rates for comparable loans if they were taken out now. Officers have considered loan re-financing but premiums for premature redemption are prohibitively high making this option poor value for money.

5.7. The rates are comparable with loans for similar durations provided by the PWLB. There is some re-financing risk associated with these loans because of the lender option to increase interest rates.

Investment limits

5.8. Investments in non-specified investments are currently at nil which is within the limit of £120m. Officers continue to seek appropriate longer term investment opportunities.

5.9. Whilst the short duration is within approved limits, there is scope within the Investment Strategy to extend the duration of investments for up to 5 years. Using longer duration investments and possibly marginally lower credit ratings is likely to increase the yield the Council earns from its investments by up to £2m in a full year.

6. THE ECONOMY AND INTEREST RATES

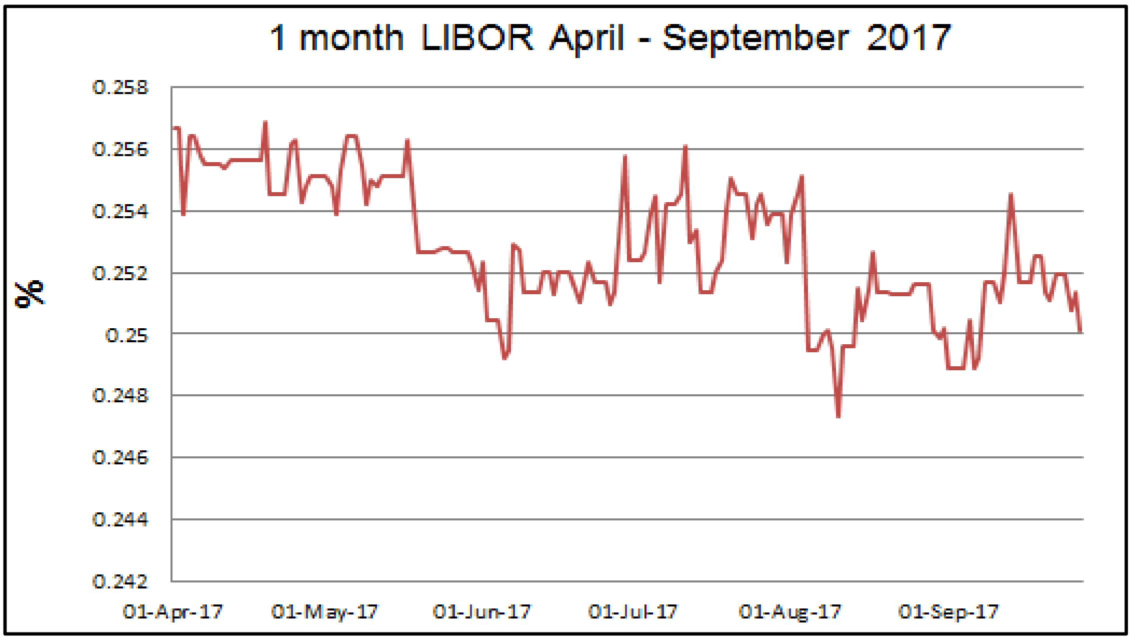
6.1. UK Gross Domestic Product (GDP) rose in the first quarter of the financial year, showing a 1.7% year on year increase. This is however the slowest rate of growth since June 2016. Following the referendum vote to leave the European Union, the Organisation for Economic Cooperation and Development (OECD) initially reduced its forecast for growth in 2017 to 1%. However, the OECD now predicts that growth for the year will be 1.6%, with a forecast of 1% growth for 2018.

6.2. Consumer Price Inflation (CPI) is running at 2.6% year on year (0.6%, Q2 2016), rising above the Monetary Policy Committee's (MPC) 2% target sooner than the 2018 prediction, with expectations it will stay this way for the next two years. This has been mainly due to the recent fall in the value of Sterling having filtered through following the referendum result.

6.3. Bank Rate has remained at 0.25% for the year to date, with quantitative easing unchanged at £435bn. Following the recent inflation rises, the Bank of England (BoE) has signalled a potential increase in the Bank Rate. The minutes of the September BoE meeting stated "some withdrawal of monetary stimulus would be appropriate if inflationary pressures continued".

6.4. Long term interest rates have risen marginally, with 20 to 30 year Public Works Loan Board rates higher by around 15 basis points. If inflationary pressures continue and the Bank of England does raise interest rates, it will increase the Council's cost of borrowing. This is potentially significant as the Council is currently well below its near term capital financing requirement having delayed borrowing due to current surplus cash reserves. The Council may wish to consider taking on new long term borrowing should the threat of significant long term interest rate rises increase

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



7. MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE II (MiFID II)

7.1 MiFID II was published in 2014 and comes into force on 3 January 2018. It aims to 'improve the functioning of financial markets'.

7.2 In July 2017 the Financial Conduct Authority (FCA) published its final advice on the requirement for UK local authorities under MiFID II

7.3 Under current MiFID regulations there are three categories of client:

- Retail Clients – individuals and small businesses, which are expected to have the least knowledge of financial markets and therefore need the most protection
- Professional Clients – large businesses, which can be expected to employ professional staff with greater knowledge and therefore need less protection
- Eligible counterparties – firms that deal in financial markets as their main activity and therefore need least protection

7.4 These categories will not be changed under the new rules. Currently local Authorities are categorised as professional clients, but can opt up or down as they see fit. Under the new Directive all UK local authorities will be classified as retail clients, and will have to opt up to professional status

7.5 Not all financial instruments are regulated under MiFID II e.g. simple term deposits with banks, building societies or the Debt Management Office. However, any use of brokers to place deposits, Money Market Funds, Enhanced Money Funds or instruments that can be classified as available for sale and held by a custodian would require professional status to allow continued use.

7.6 The Council will be seeking to opt up to Professional Client status where necessary.

8. EQUALITY IMPLICATIONS

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

9. LEGAL IMPLICATIONS

9.1. There are no legal implications arising from this report.

9.2. Implications completed by: Rhian Davies, Chief Solicitor (Litigation and Social Care)

10. FINANCIAL IMPLICATIONS

10.1. This report is wholly of a financial nature.

11. IMPLICATIONS FOR BUSINESS

11.1 The Council's borrowing and investment activity up to the 30th September 2017. 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.

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

12. 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:

Appendix 1 - Investment Limits and Exposures at 30 September 2017.

Appendix 1 – Limits and exposures as at 30 September 2017

Category	Limit per Counterparty (£m)	Duration Limit	Counterparty Name	Current Exposure (£m)
European Agencies	£100m	5 years	European Investment Bank	20.5
			Kreditanstalt fur Wiederaufbau	3.7
Network Rail	£200m	Oct-52	Network Rail Infrastructure PLC	7
Supra-national Banks	£100m	5 years	International Bank of reconstruction and Development	23.1
UK Local Authorities	£20m per local authority; £100m in aggregate	3 years	Fife Council	10
			London Borough of Islington	10
			Cheshire East Council	5
			Wrexham County Borough Council	5
			Rhondda Cynon Taff Council	10
Money Market Funds	£30m per fund. £200m Total	Up to three day notice	Federated Sterling Liquidity Fund	30
			BlackRock ICS Institutional Liquidity Hertitage Dis	6.6
Enhanced Cash Funds	£20m per fund. £60m in total	Up to seven day notice	Payden & Rygel Sterling Reserve	20
			Royal London Asset Mgmt Cash Plus	20
			Federated Prime Rate Cash Plus	19.9
Transport for London (TFL)	£100m	3 years	Transport for London	14.9
UK Banks (A-/ A3/ A-)	£50m	3 years	Barclays Bank Plc	25
			Lloyds Bank	25
			Goldman Sachs Intl Bank	20
UK Banks (AA-/ Aa3/ AA-) or UK Government ownership greater than 25%	£70m	5 years	Royal Bank of Scotland	30
			National Westminster Bank	0.3
Non-UK Banks (AA-/ Aa2/ AA-)	£50m	3 years	Svenska Handelsbanken AB	47.5
Total				**353.5**