Report No. FSD16078

London Borough of Bromley

PART 1 - PUBLIC

Decision Maker:	**Resources Portfolio Holder** **Council**
Date:	**For pre-decision scrutiny by Executive and Resources PDS Committee on 23rd November 2016** **Council 12th December 2016**
Decision Type:	Non-Urgent Executive Non-Key
Title:	**TREASURY MANAGEMENT - QUARTER 2 PERFORMANCE 2016/17 & MID-YEAR REVIEW**
Contact Officer:	James Mullender, Principal Accountant Tel: 020 8313 4292 E-mail: james.mullender@bromley.gov.uk
Chief Officer:	Director of Finance
Ward:	All

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1. Reason for report

1.1. This report summarises treasury management activity during the second quarter of 2016/17. The report also includes a Mid-Year Review of the Treasury Management Strategy Statement and Annual Investment Strategy (Annex A). The report ensures that the Council is implementing best practice in accordance with the CIPFA Code of Practice for Treasury Management. Investments as at 30th September 2016 totalled £290.3m (excluding the balance of the Heritable investment) and there is no outstanding external borrowing. For information and comparison, the balance of investments stood at £285.2m as at 30th June 2016 and £282.6m as at 30th September 2015, and, at the time of writing this report (10th November 2016) it stood at £325.4m.

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2. RECOMMENDATION(S)

2.1. The Executive and Resources PDS Committee and the Resources Portfolio Holder are requested to:

(a) note the Treasury Management performance for the second quarter of 2016/17, and

(b) recommend that Council approve the 2016/17 prudential indicators as set out in Annex B1.

2.2. Council is requested to note the report and approve changes to the 2016/17 prudential indicators, as set out in Annex B1.

Corporate Policy

1. Policy Status: Existing policy. To maintain appropriate levels of risk, particularly security and liquidity, whilst seeking to achieve the highest rate of return on investments.

2. BBB Priority: Excellent Council.

Financial

1. Cost of proposal: N/A

2. Ongoing costs: N/A.

3. Budget head/performance centre: Interest on balances

4. Total current budget for this head: £3.491m (net) in 2016/17; £250k surplus currently projected

5. Source of funding: Net investment income

Staff

1. Number of staff (current and additional): 0.25 fte

2. If from existing staff resources, number of staff hours: 9 hours per week

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Legal

1. Legal Requirement: Non-statutory - Government guidance.

2. Call-in: Call-in is applicable

Customer Impact

1. Estimated number of users/beneficiaries (current and projected): n/a

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Ward Councillor Views

1. Have Ward Councillors been asked for comments? N/A.

2. Summary of Ward Councillors comments:

3. COMMENTARY

3.1. General

3.1.1. Under the requirements of the CIPFA Code of Practice on Treasury Management, the Council is required, as a minimum, to approve an annual treasury strategy in advance of the year, a mid-year review report and an annual report following the year comparing actual activity to the strategy. In practice, the Director of Finance has reported quarterly on treasury management activity for many years, as well as reporting the annual strategy before the year and the annual report after the year-end.

3.1.2. This report includes details of investment performance in the second quarter of 2016/17. The 2016/17 annual treasury strategy, including the MRP (Minimum Revenue Provision) Policy Statement and prudential indicators, was originally approved by Council in February 2016. The annual report for financial year 2015/16 was submitted to the Executive and Resources PDS Committee on 7th July 2016 and Council on 26th September 2016.

3.1.3. Recent changes in the regulatory environment place a much greater onus on Members to undertake the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the actual position for treasury activities and highlights compliance with the Council's policies previously approved by Members.

3.1.4. The Council has monies available for Treasury Management investment as a result of the following:

(a) Positive cash flow;
(b) Monies owed to creditors exceed monies owed by debtors;
(c) Receipts (mainly from Government) received in advance of payments being made;
(d) Capital receipts not yet utilised to fund capital expenditure;
(e) Provisions made in the accounts for liabilities e.g. provision for outstanding legal cases which have not yet materialised;
(f) General and earmarked reserves retained by the Council.

3.1.5. Some of the monies identified above are short term and investment of these needs to be highly "liquid", particularly if it relates to a positive cash flow position, which can change in the future. Future monies available for Treasury Management investment will depend on the budget position of the Council and whether the Council will need to substantially run down capital receipts and reserves. Against a backdrop of unprecedented cuts in Government funding (which will require the Council to make revenue savings to balance the budget in future years), there is a likelihood that such actions may be required in the medium term, which will reduce the monies available for investment.

3.1.6. The Council has also identified an alternative investment strategy relating to property investment. To date, this has resulted in actual and planned acquisitions which generated £3m income in 2015/16, and is projected to achieve £4.3m in 2016/17 with full-year income of £4.4m. This is based on a longer term investment timeframe of at least 3 to 5 years and ensures that the monies available can attract higher yields over the longer term. A further two properties were approved for purchase by Executive on 1st November 2016 which will generate a further £897k full-year income.

3.1.7. A combination of lower risk investment relating to Treasury Management and a separate investment strategy in the form of property acquisitions (generating higher yields and risks) provides a balanced investment strategy. Any investment decisions will also need to consider the likelihood that interest rates will increase at some point. The available resources for the medium term, given the ongoing reductions in Government funding, will need to be regularly reviewed.

3.2. Treasury Performance in the quarter ended 30th September 2016

3.2.1. **Borrowing:** The Council's healthy cashflow position continues and, other than some short-term borrowing at the end of 2015/16, no borrowing has been required for a number of years.

3.2.2. **Investments:** The following table sets out details of investment activity during the second quarter of 2016/17 and 2016/17 year to date:-

	Qtr ended 30/09/16		2016/17 year to date	
	Deposits £m	**Ave Rate %**	**Deposits £m**	**Ave Rate %**
Balance of "core" investments b/f	215.50	1.47	240.50	1.42
New investments made in period	30.00	0.89	40.00	1.04
Investments redeemed in period	-45.00	1.24	-80.00	1.19
"Core" investments at end of period	200.50	1.44	200.50	1.47
Money Market Funds	24.80	para 3.13	24.80	para 3.13
Santander 180 day notice account	30.00	para 3.14	30.00	para 3.14
CCLA Property Fund	25.00	para 3.15	25.00	para 3.15
Diversified Growth Funds	10.00	para 3.15	10.00	para 3.15
Total investments at end of period	**290.30**	**n/a**	**290.30**	**n/a**

3.2.3. Details of the outstanding investments at 30th September 2016 are shown in maturity date order in Appendix 3 and by individual counterparty in Appendix 4. An average return of 1% was assumed for new investments in the 2016/17 budget in line with the estimates provided by the Council's external treasury advisers, Capita, and with officers' views. The return on the four new "core" investment placed during the second quarter of 2016/17 was 0.89%, compared to the average LIBID rates of 0.20% for 7 days, 0.31% for 3 months, 0.43% for 6 months and 0.65% for 1 year. The improved rate (compared to 1 year LIBID) earned on the new investments is due to the longer (3 year) period on the £10m invested with Lloyds Bank at a rate of 1.34%, and a rate of 0.75% for the £20m with Goldman Sachs International Bank.

3.2.4. Reports to previous meetings have highlighted the fact that options with regard to the reinvestment of maturing deposits have become seriously limited in recent years following bank credit rating downgrades. Changes to lending limits and eligibility criteria agreed in October 2014 (an increase in the lending limits of both Lloyds and RBS from £40m to £80m and an increase in the maximum period from 2 years to 3 years) have alleviated this to some extent, but there are still not many investment options available other than placing money with instant access accounts at relatively low interest rates.

3.2.5. At its meeting on 26th September 2016, Council approved the following changes to the treasury management strategy:

- A reduction to the sovereign rating criteria to AA-;
- A reduction to the individual counterparty rating criteria to BBB+;
- An increase to the maximum investment period with Banks 1C category from 6 months to 1 year;
- The inclusion of investments with Housing Associations; and
- The inclusion of Variable Net Asset (VNAV) Money Market Funds.

No investments have been made to date in these categories (other than continued investments with UK banks following the UK's sovereign rating downgrade to AA), and officers are continuing to explore investment opportunities in these areas.

3.2.6. As a result of these changes to the criteria, and the addition of the pooled funds described in section 3.4.3, the Council's treasury management performance compares very well with that of other authorities; the Council is in the top quartile of Capita's benchmarking group as at September 2016 (although this excludes pooled fund investments, so total portfolio performance could be higher), and in the top decile nationally for 2014/15 (the most recent CIPFA treasury management statistics available).

3.2.7. Active UK banks and building societies on the Council's list now comprise Lloyds, RBS, HSBC, Barclays, Santander UK, Goldman Sachs International Bank, Standard Chartered and Nationwide and Skipton Building Societies, and all of these have reduced their interest rates significantly in recent years. The Director of Finance will continue to monitor rates and counterparty quality and take account of external advice prior to any investment decisions.

3.2.8. The chart in Appendix 1 shows total investments at quarter-end dates back to 1st April 2004 and shows how available funds have increased steadily over the years. This has been a significant contributor to the over-achievement of investment income against budgeted income in recent years.

3.3. Interest Rate Forecast

3.3.1. On 4th August 2016, the Monetary Policy Committee of the Bank of England voted unanimously to reduce the Base Rate to 0.25% from 0.5% (the rate it has been since March 2009). Previous indications from markets were that a further cut wasn't ruled out, and the latest forecast by Capita Treasury Solutions still reflects this with a reduction to 0.1% before the end of the year. However, with the further inflation increases now being forecast, it seems likely that interest rates will now increase, and possibly sooner than previously projected. For comparison, Capita's latest two interest rate forecasts are shown below (the next forecast is due on 14th November, which should reflect the impact of inflation increases, and a verbal update can be provided at the meeting).

Date	LATEST FORECAST (Aug 16)				PREVIOUS FORECAST (May 16)			
	Base Rate	3 month Libid	6 month Libid	1 year Libid	Base Rate	3 month Libid	6 month Libid	1 year Libid
Dec-16	0.10%	0.20%	0.30%	0.50%	0.75%	0.80%	0.90%	1.20%
Jun-17	0.10%	0.20%	0.30%	0.60%	1.00%	1.00%	1.20%	1.50%
Dec-17	0.10%	0.20%	0.40%	0.70%	1.25%	1.30%	1.50%	1.80%
Jun-18	0.25%	0.30%	0.50%	0.70%	1.50%	1.50%	1.70%	2.00%
Dec-18	0.25%	0.40%	0.60%	0.80%	1.75%	1.80%	2.00%	2.30%
Jun-19	0.50%	0.60%	0.70%	0.90%	n/a	n/a	n/a	n/a

3.4. Other accounts

3.4.1. <u>Money Market Funds</u>

3.4.1.1. The Council currently has 6 AAA-rated Money Market Fund accounts, with Prime Rate, Ignis, Insight, Blackrock, Fidelity and Legal & General, all of which have a maximum investment limit of £15m. In common with market rates for fixed-term investments, interest rates on money market funds have fallen considerably in recent years, and, as their longer dated investments mature and are reinvested, are continuing to drop following the Bank of England Base rate cut in August 2016. The Ignis, Prime Rate and Legal & General funds currently offer the best rate at around 0.32%, compared to 0.43% in September, and 0.53% in June. The total balance held in Money Market Funds has varied during the quarter, moving from zero as at 1st April 2016 to £24.8m as at 30th September 2016, and currently stands at £39.9m (as at 9th October 2016). The Money Market Funds currently offer the lowest interest of all eligible investment vehicles with the exception of the Government Debt Management Account Deposit Facility (currently 0.10%), however they are the most liquid, with funds able to be redeemed up until midday for same day settlement.

Money Market Funds	**Date Account Opened**	**Actual balance 31/03/16 £m**	**Actual balance 30/09/16 £m**	**Ave. Rate H1 2016/17 %**	**Latest Balance 09/11/16 £m**	**Ave. Daily balance to 09/11/16 £m**	**Latest Rate 09/11/16 %**
Prime Rate	15/06/2009	0.0	7.1	0.48	14.4	8.0	0.46
Ignis	25/01/2010	0.0	15.0	0.48	15.0	3.7	0.46
Insight	03/07/2009	0.0	0.0	0.47	0.0	3.8	0.45
Legal & General	23/08/2012	0.0	2.7	0.47	10.5	1.9	0.44
Blackrock	16/09/2009	0.0	0.0	0.37	0.0	-	0.35
Fidelity	20/11/2002	0.0	0.0	0.39	0.0	-	0.37
TOTAL		0.0	24.8		39.9	17.4	

3.4.1.2. A chart showing money market fund interest rates is provided in Appendix 2, which highlights how the rates have fallen during 2016/17, and are continuing to fall.

3.4.2. Santander 180 Day Notice Account

3.4.2.1. In November 2015, £10m was placed with Santander UK in their 180 day notice account at a rate of 1.15%. This is a very good rate for (potentially) 6 month money, but notice was given in May 2016 to ensure that this did not breach the one year maximum permitted with Santander. Although Santander had notified the Council that the rate would reduce to 0.90% from September 2016 (a reduction of 0.25% matching the Bank of England base rate reduction), the rate was still very good comparatively, so the Council deposited a further £20m in the notice account during August 2016.

3.4.3. Pooled Investment Schemes

3.4.3.1. In September 2013, the Portfolio Holder and subsequently Council approved the inclusion of collective (pooled) investment schemes as eligible investment vehicles in the Council's Investment Strategy with an overall limit of £25m and a maximum duration of 5 years. The limit was subsequently increased to £40m by Council in October 2015. Such investments would require the approval of the Director of Finance in consultation with the Resources Portfolio Holder.

CCLA Property Fund

3.4.3.2. Following consultation between the Director of Finance and the Resources Portfolio Holder, an account was opened in January 2014 with the CCLA Local Authorities' Property Fund and an initial deposit of £5m was made, followed by further deposits of £5m in July 2014, £5m in March 2015 and £10m in October 2015. The investment in the CCLA Fund is viewed as a medium to long-term investment and dividends are paid quarterly. The investment returned 5.25% net of fees in 2014/15, 5.02% in 2015/16, and 4.88% and 4.59% in the first two quarters of 2016/17 (4.73% for 2016/17 to date).

Diversified Growth Funds

3.4.3.3. In October 2014, the Council approved the inclusion of investment in diversified growth funds in the investment strategy and, in December 2014, £5m was invested with both Newton and Standard Life. The Funds both performed very well in just over three months to 31st March 2015, however performance was not so impressive in 2015/16. Performance has picked up again for the first half of 2016/17, resulting in cumulative returns of 7.12% and 0.08% for Newton and Standard Life funds respectively, as shown in the table below.

Annualised return	Newton %	Standard Life %
22/12/14 - 31/03/15	21.46	21.85
01/04/15 - 31/03/16	0.85	-5.04
01/04/16 - 30/06/16	17.81	-5.24
01/07/16 - 30/09/16	5.91	2.07
Cumulative return	7.12	0.08

3.4.3.4. The downturn in performance during 2015/16 echoes that seen in the Pension Fund's Diversified Growth Funds (and Global Equities Funds). It should be noted that these types of investments should be considered as longer term investments over a three to five year period.

3.4.3.5. Officers are currently liaising with the Fund managers to obtain a breakdown of the performance of the funds by asset class and counterparty ratings and this will be included in the next report.

3.4.3.6. In accordance with the Council decision, interest equivalent to 27% of the total dividend is transferred to the Parallel Fund, set up in 2014/15 with an opening balance of £2.7m to mitigate the potential revenue impact of future actuarial Pension Fund valuations.

3.4.4. Investment with Heritable Bank

3.4.4.1. Members will be aware from regular updates to the Resources Portfolio Holder and the Executive that the Council had £5m invested with the Heritable Bank, a UK subsidiary of the Icelandic bank, Landsbanki. In October 2008, the bank was placed in administration and the investment was frozen. To date, a total of £4,985k has been received (98% of the total claim of £5,087k), leaving a balance of £102k (2%). Officers and the Council's external advisers remain hopeful of a full recovery.

3.4.5. External Cash Management

3.4.5.1. As reported to the Executive and Resources PDS Committee on 3rd February 2016, the contract with Tradition UK Ltd was terminated in December 2015, and the two remaining investments are due to mature in March 2017.

3.5. Mid-Year Review of Treasury Management Strategy Statement and Annual Investment Strategy for 2016/17

3.5.1. The CIPFA Code of Practice on Treasury Management requires the Council to receive a mid-year review report on performance against the approved strategy. The Annual Investment Strategy was originally approved by Council in February 2016 and was updated in September 2016. A mid-year review, including comments on the economic background during the first half of 2016/17 and on the outlook, is included at Annex A.

3.6. Regulatory Framework, Risk and Performance

3.6.1. The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;

- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing that may be undertaken (although no restrictions have been made to date);

- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;

- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;

- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;

- Under the Act, the CLG has issued Investment Guidance to structure and regulate the Council's investment activities;

- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007, the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007.

3.6.2. The Council has complied with all of the above relevant statutory and regulatory requirements, which limit the levels of risk associated with its treasury management activities. In particular, its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means that its capital expenditure is prudent, affordable and sustainable and its treasury practices demonstrate a low risk approach.

4. POLICY IMPLICATIONS

4.1 In line with government guidance, the Council's policy is to seek to achieve the highest rate of return on investments whilst maintaining appropriate levels of risk, particularly security and liquidity.

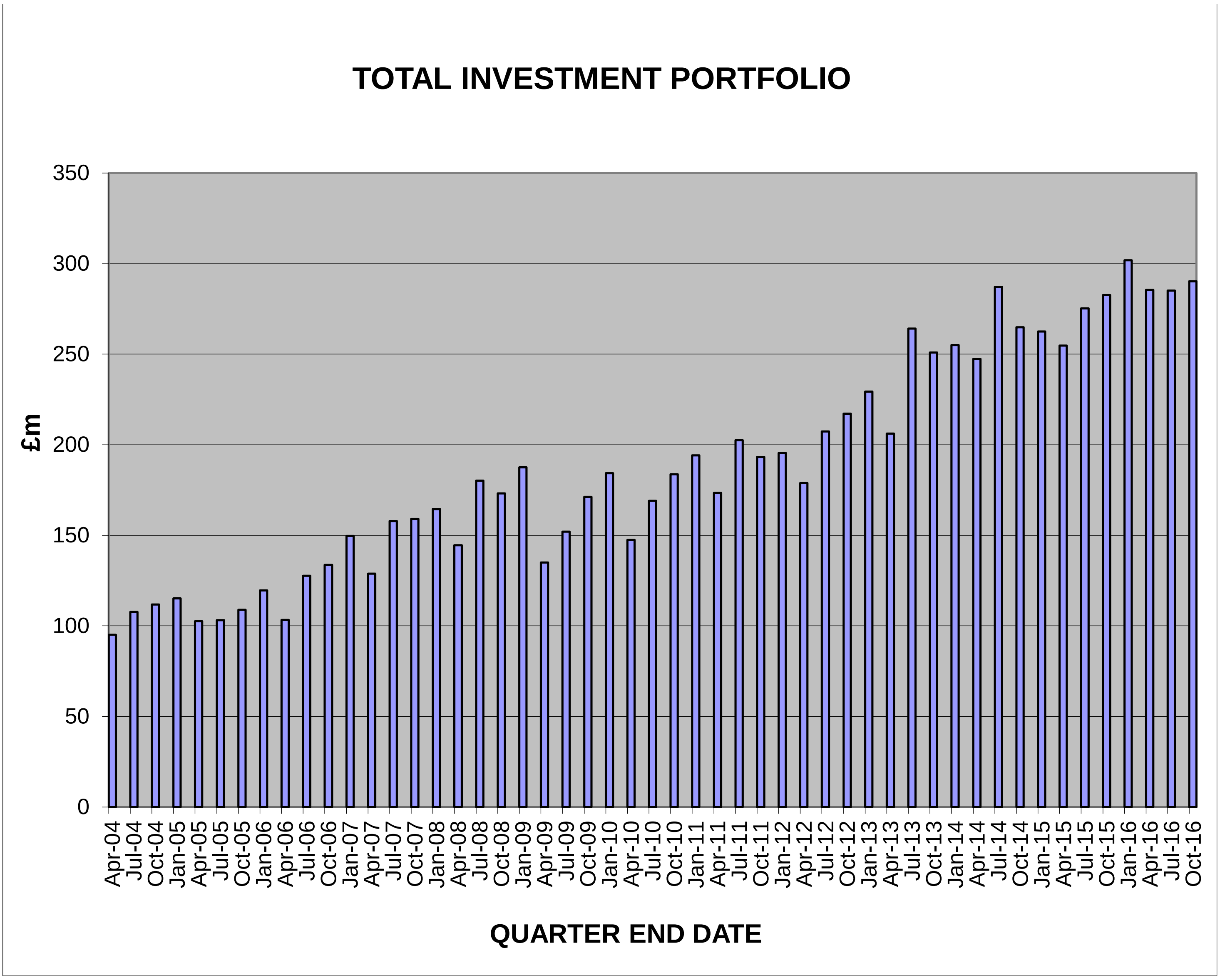
5. FINANCIAL IMPLICATIONS

5.1 At the time of setting the 2016/17 budget, there was still no sign of interest rates improving, so an average rate of 1% was again been prudently assumed for interest on new fixed term deposits, in line with the estimates provided by the Council's external treasury advisers, Capita, earlier in the year and with officers' views. There have been no improvements to counterparty credit ratings, as a result of which the restrictions to investment opportunities that followed ratings downgrades in recent years have still been in place. However, the increases in the limits for the two part-nationalised banks (Lloyds and RBS) approved by the Council in October 2014, together with higher rates from longer-term deals placed with other local authorities, higher average balances than anticipated and the strong performance of the CCLA Property Fund enabled the 2016/17 budget to be increased to £3.49m, after allowing for foregone interest earnings as a result of further property acquisitions.

5.2 Following the Bank of England base rate cut in August 2016, the Council has seen a significant reduction in the rates offered for new fixed-term deposits as well as overnight money market funds. Despite this, a surplus of £250k is currently projected for the year, mainly due to the increased balances available for investment.

Non-Applicable Sections:	Legal, Personnel & Procurement Implications, Impact on Vulnerable Adults and Children
Background Documents: (Access via Contact Officer)	CIPFA Code of Practice on Treasury Management CIPFA Prudential Code for Capital Finance in Local Authorities CLG Guidance on Investments External advice from Capita Treasury Solutions

APPENDIX 1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£m
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50
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200
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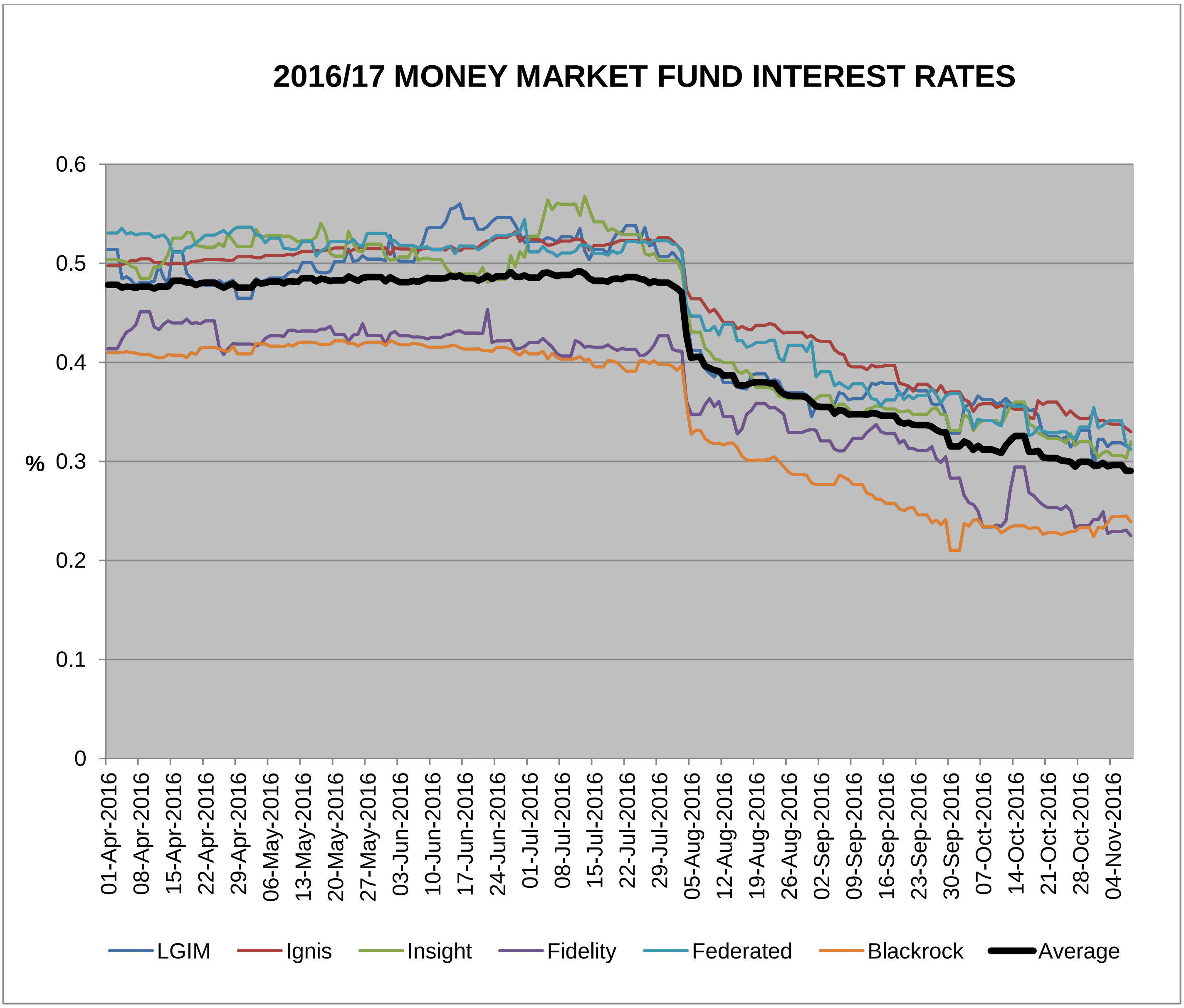
QUARTER END DATE

APPENDIX 2



2016/17 MONEY MARKET FUND INTEREST RATES
%
0.6
0.5
0.4
0.3
0.2
0.1
0
01-Apr-2016
08-Apr-2016
15-Apr-2016
22-Apr-2016
29-Apr-2016
06-May-2016
13-May-2016
20-May-2016
27-May-2016
03-Jun-2016
10-Jun-2016
17-Jun-2016
24-Jun-2016
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07-Oct-2016
14-Oct-2016
21-Oct-2016
28-Oct-2016
04-Nov-2016
LGIM
Ignis
Insight
Fidelity
Federated
Blackrock
Average