Report No.
FSD17075

London Borough of Bromley

PART 1 - PUBLIC

Decision Maker:	**Resources Portfolio Holder**
Date:	**For pre-decision scrutiny by Executive and Resources PDS Committee on 7th September 2017**
Decision Type:	Non-Urgent Executive Non-Key
Title:	**TREASURY MANAGEMENT - QUARTER 1 PERFORMANCE 2017/18**
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 first quarter of 2017/18. 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 June 2017 totalled £292.3m and there was no external borrowing. For information and comparison, the balance of investments stood at £269.9m as at 31st March 2017 and £285.2m as at 30th June 2016, and, at the time of writing this report (22nd August 2017) it stood at £329.6m.

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2. RECOMMENDATION(S)

2.1. The Resources Portfolio Holder is requested to:

(a) note the Treasury Management performance for the first quarter of 2017/18; and

(b) delegate authority to the Director of Finance to apply to opt-up to elective professional status under MiFID II as detailed in para 3.5.6.

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: £2.891m (net) in 2017/18; £500k 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

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 first quarter of 2017/18. The 2017/18 annual treasury strategy, including the MRP (Minimum Revenue Provision) Policy Statement and prudential indicators, was originally approved by Council in March 2017. The annual report for financial year 2016/17 was submitted to the Executive and Resources PDS Committee on 14th June 2017 and Council on 26th June 2017, and included the following changes to the 2017/18 strategy:

- Inclusion of a secured loan that helps deliver the Council's housing objectives;
- An increase to the limit for pooled investment schemes to £80m;
- A reduction to the counterparty rating criteria for Housing Associations to A-;
- A temporary increase in the counterparty limit with Lloyds bank.

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:

- Positive cash flow;
- Monies owed to creditors exceed monies owed by debtors;
- Receipts (mainly from Government) received in advance of payments being made;
- Capital receipts not yet utilised to fund capital expenditure;
- Provisions made in the accounts for liabilities e.g. provision for outstanding legal cases which have not yet materialised;
- 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, £4.6m in 2016/17, and is projected to achieve £5.6m in 2017/18. 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.

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 June 2017

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 first quarter of 2017/18:-

	Deposits £m	Ave Rate %
Balance of "core" investments b/f	193.00	1.42
New investments made in period	-	-
Investments redeemed in period	-	-
"Core" investments at end of period	193.00	1.42
Money Market Funds	29.30	para 3.4.1
Santander 180 day notice account	30.00	para 3.4.2
CCLA Property Fund	30.00	para 3.4.5.2
Diversified Growth Funds	10.00	para 3.4.5.3
Total investments at end of period	**292.30**	**n/a**

3.2.3. Details of the outstanding investments at 30th June 2017 are shown in maturity date order in Appendix 2 and by individual counterparty in Appendix 3.

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, as well as the introduction of pooled funds and housing associations 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. Despite this, the Council's treasury management performance compares very well with that of other authorities; the Council was in the top decile nationally for both 2014/15 and 2015/16 (the most recent CIPFA treasury management statistics available), and officers continue to look for alternative investment opportunities both within the current strategy and outside, for consideration as part of the ongoing review of the strategy.

3.2.6. 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.

3.2.7. 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 the budget 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, however, with the further inflation increases now being forecast, expectations are that rates will remain at this level until mid-2019 and then begin to slowly increase.

Date	LATEST FORECAST (Aug17)				PREVIOUS FORECAST (May17)			
	Base Rate	3 month Libid	6 month Libid	1 year Libid	Base Rate	3 month Libid	6 month Libid	1 year Libid
Jun-17					0.25%	0.30%	0.40%	0.60%
Dec-17	0.25%	0.30%	0.40%	0.70%	0.25%	0.30%	0.40%	0.70%
Jun-18	0.25%	0.30%	0.40%	0.80%	0.25%	0.30%	0.40%	0.80%
Dec-18	0.25%	0.40%	0.50%	0.90%	0.25%	0.40%	0.50%	0.90%
Jun-19	0.50%	0.60%	0.70%	1.10%	0.50%	0.60%	0.70%	1.10%
Dec-19	0.75%	0.80%	0.90%	1.30%	0.75%	0.80%	0.90%	1.30%

3.4. Other accounts

3.4.1. Money Market Funds

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 and Prime Rate and Legal & General funds currently offer the best rates at around 0.2%, which compares to around 0.4% in August 2016 and 0.5% in June 2016. The total balance held in Money Market Funds has varied during the year, moving from £6.9m as at 1st April 2017 to £29.3m as at 30th June 2017, and currently also stands at £29.3m (as at 22nd August 2017). 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 31/03/17 £m**	**Actual balance 30/06/17 £m**	**Ave. Rate Q1 2017/18 %**	**Latest Balance 22/08/17 £m**	**Ave. Daily balance to 22/08/17 £m**	**Latest Rate 22/08/17 %**
Prime Rate	15/06/2009	-	14.3	0.24	14.3	8.9	0.21
Ignis	25/01/2010	6.9	15.0	0.25	15.0	14.1	0.22
Insight	03/07/2009	-	-	0.22	-	0.6	0.20
Legal & General	23/08/2012	-	-	0.24	-	8.1	0.20
Blackrock	16/09/2009	-	-	0.13	-	-	0.10
Fidelity	20/11/2002	-	-	0.15	-	-	0.14
TOTAL		6.9	29.3		29.3	31.7	

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 was a very good rate for (potentially) 6 month money, and 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.

3.4.2.2. Since then, Santander standardised the rates for its notice accounts (the Council's rates were above those available to other customers), and bringing them more in line with market rates. As a result, the rate would decrease to 0.55% from 1st June 2017, so the Council gave notice to withdraw the full £30m, which will be returned at the start of October 2017.

3.4.3. Housing Associations

3.4.3.1. Following the reduction of the counterparty rating criteria to A- for Housing Associations approved by Council in June 2017, deposits of £10m each were placed with Hyde Housing Association (A+) and Places for People Homes (A) for two years at rates of 1.3% and 1.6% respectively.

3.4.4. Loan to Project Beckenham

3.4.4.1. At the same meeting, Council also approved the inclusion in the strategy of the secured loan to Project Beckenham relating to the provision of temporary accommodation for the homeless that had previously been agreed to be advanced from the Investment Fund. This loan was made in June 2017, at a rate of 6%, although that may increase to 7.5% if the loan to value ratio exceeds a specified value.

3.4.5. Pooled Investment Schemes

3.4.5.1. 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, and then to £80m in June 2017. Such investments would require the approval of the Director of Finance in consultation with the Resources Portfolio Holder.

CCLA Property Fund

3.4.5.2. 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, £10m in October 2015 and £5m in October 2016. 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, 4.55% in 2016/17 and 4.05% in the first quarter of 2017/18.

Diversified Growth Funds

3.4.5.3. In October 2014, 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. In accordance with the Council decision, 27% of the total return will be 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.

3.4.5.4. The Funds both performed very well in just over three months to 31st March 2015, with returns over 21%. Performance was not so impressive in 2015/16 and 2016/17, with net returns of 0.85% and 2.23% respectively for the Newton Fund, and -5.04% and 0.37% respectively for the Standard Life Fund; however they are both over 4% for the first quarter

of 2017/18. The overall net returns since inception have been 4.03% and 0.93% for the 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 - 30/03/17	2.23	0.37
01/04/17 - 30/06/17	4.56	4.14
Cumulative return	4.03	0.93

3.4.5.5. The downturn in performance echoes that seen in the Pension Fund's DGFs (and Global Equities Funds to an extent) during 2015/16 and subsequent rebound during 2016/17. However, it should be noted that these types of investments should be considered as longer term investments over a three to five year period.

3.4.5.6. As reported in the Treasury Management Annual Report 2016/17, to reflect the changes to the Pension Fund asset allocation strategy, and on the basis of Multi-Asset Income Funds being a better income related investment with low volatility, it is currently intended that the DGF investments will be sold and the funds invested in Multi-Asset Income Funds. A decision on which fund to invest in is currently on hold until the outcome of the tender for Pension Fund mandate.

Multi-Asset Income Fund

3.4.5.7. Following the approval by Council in June 2017, the limit for pooled investment schemes was increased to £80m, and an investment of £30m was made in July 2017 in the Fidelity Multi-Asset Income Fund following the agreement of the Resources Portfolio Holder. Performance data for this investment will be included in future reports.

3.5. MiFID II – Opt-Up to Professional Client Status

3.5.1. The Markets in Financial Instruments Directive II (MiFID II), which comes into force on 3rd January 2018 requires investment firms to assess the categorisation of their clients for investment purposes, except for 'simple' investments such as term deposits with banks and building societies, directly owned properties and a few other types of investments are outside the scope of MiFID II.

3.5.2. Following the release of a new Policy Statement by the Financial Conduct Authority (FCA) on 3rd July 2017, Local Authorities will be classed as 'Retail' investors by default. This would result in the authority being limited to investments in instruments defined by the FCA as 'non-complex'. Retail investors may also have to pay higher fees for an equivalent investment than professional investors. It is therefore likely that being classed as a Retail investor would result in an overall reduction to the investment return the Council achieves.

3.5.3. However, under the Directive, retail clients are provided more protection than professional clients, such as a suitability report, assessment of appropriateness, level of information provided, services of the Financial Ombudsman Service, the Financial Services Compensation Scheme (although this would not apply to the Council) . It should be noted that the Council is currently classed as a per-se professional client, so doesn't currently have these protections.

3.5.4. To be classed as a professional client for the purposes of treasury management activities the Council must satisfy both a quantitative test and a qualitative test, the criteria for which are set out below:

- Quantitative: a minimum portfolio size of £10m.

- Qualitative: either:
  - an average 10 significant size transactions per quarter over past 4 quarters in relevant market, or
  - the person carrying out transactions has at least 1 year experience in a professional position requiring knowledge of the services envisaged.

3.5.5. With a current portfolio of over £300m, and which has not been below £200m in the last 4 years, the quantitative criteria should not be an issue for the Council for the foreseeable future. However, other than for Money Market Funds, the first qualitative criteria is unlikely to be met, so the experience of the Principal Accountant and Director of Finance is required to satisfy the second criteria.

3.5.6. In order to opt-up to elective professional status, an assessment questionnaire/application must be submitted to all counterparties it does or may wish to invest with, including investment advisers. The Resources Portfolio Holder is requested to delegate authority to the Director of Finance to submit the relevant requests to opt-up to elective professional status.

3.5.7. A similar exercise will need to be carried out with regard to Pension Fund investments, although the qualitative criteria are slightly different, and the Pensions Investment Sub-Committee will be requested to make a similar delegation of authority to the Director of Finance at its meeting on 26th September 2017.

3.6. Economic Background (provided by Capita Treasury Solutions)

3.6.1. The UK GDP annual growth rates in each calendar year 2013 – 2016 of 1.9%, 3.1%, 2.2% and 1.8%, have all been the top rate, or near top rate, of any of the G7 countries in every year. It is particularly notable that the UK performance was repeated in 2016, a year in which the Bank of England had forecast in August 2016 that growth would be near to zero in the second half of the year due to the economic shock it expected from the result of the Brexit referendum in June. However, it has had to change its mind and in its February and May 2017 Inflation Reports, the Bank upgraded its forecasts for growth (May Report - 2017 1.9%, 2018 and 2019 1.9%). However over these years, it also expects inflation to accelerate towards nearly 3% as increases in costs as a result of the fall in the value of sterling since the referendum, gradually feeds through into the economy, though it should fall back to 2.2% in 2019. Provided those cost pressures do not feed through into significantly higher domestically generated inflation within the UK, the MPC is expected to 'look though' this one off blip upwards in inflation. Wage inflation, which is a key driver of domestically generated price pressures, is currently subdued. There is, though, a potential risk that the MPC might muster a majority to reverse the emergency 0.25% rate cut before embarking on a progressive trend of increases in Bank Rate at a later time.

3.6.2. Further commentary on the global economic background during the first quarter of 2017/18 and on the outlook is attached at Appendix 4.

3.7. Regulatory Framework, Risk and Performance

3.7.1. 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.

3.7.2. 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 2017/18 budget, there was still no sign of interest rates improving following the reduction to the Bank of England base rate and coupled with the ability of banks to borrow from the Bank of England at very low rates though its Term Funding Scheme, so an average rate of 0.9% was prudently assumed for interest on new fixed term deposits. In addition to this, further Investment Fund and Growth Fund expenditure, and the Highways Investment capital scheme are expected to reduce the funds available for investment, and a reduction of £600k was included in the 2017/18 budget.

5.2 Although the Council has seen a significant reduction in the rates offered for new fixed-term deposits as well as overnight money market funds, a surplus of £500k is currently projected for the year, mainly due to the continued high level of balances available for investment, as well as the further investment in pooled funds, and high level of interest earned on the pooled funds, housing association deposits and Project Beckenham loan.

Non-Applicable Sections:	Legal, Personnel & Procurement Implications, Impact on Vulnerable Adults and Children
Background Documents: (Access via Contact Officer)	Treasury Management - Annual Investment Strategy 2017/18, Council 1st March 2017 Treasury Management – Annual Report 2016/17, Council 26th June 2017 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