
Decision Maker: Resources, Commissioning and Contracts Management
Portfolio Holder
Council

Date: For pre-decision scrutiny by Executive, Resources and Contracts
Policy Development and Scrutiny Committee on 5 July 2018
Council 16th July 2018

Decision Type: Non-Urgent Executive Non-Key

Title: TREASURY MANAGEMENT - ANNUAL REPORT 2017/18

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Chief Officer: Director of Finance

Ward: All wards

1. Reason for report

- 1.1 This report summarises treasury management activity during the March quarter and includes the Treasury Management Annual Report for 2017/18, which is required to be reported to full Council. The report ensures that the Council is implementing best practice in accordance with the CIPFA Code of Practice for Treasury Management. Investments as at 31st March 2018 totalled £284.8m and there was no external borrowing. For information and comparison, the balance of investments stood at £310.6m as at 31st December 2017 and £269.9m as at 31st March 2017, and, at the time of writing this report (25th June 2018) it stood at £315.7m.
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2. **RECOMMENDATION(S)**

2.1 The Portfolio Holder and Council are asked to:

- (a) Note the Treasury Management Annual Report for 2017/18;
- (b) Approve the actual prudential indicators within the report.

Corporate Policy

1. Policy Status: Existing policy. To maintain appropriate levels of risk, particularly security and liquidity, whilst seeking to achieve the highest rates of return on investments.
 2. BBB Priority: Excellent Council.
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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 budget (net interest earnings) in 2017/18; surplus of £1.158m achieved in 2017/18. Budget for 2018/19 £3.491m
 5. Source of funding: Net investment earnings
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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
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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. This report includes details of investment performance in the final quarter of 2017/18 and the annual report for the whole of the financial year 2017/18.
- 3.1.2 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, and was subsequently amended following approval by Council in December 2017 to reflect an increase in the limit for pooled funds/collective investment vehicles to £100m.
- 3.1.3 Recent changes in the regulatory environment place a much greater onus on Members for 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 further 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, £5.6m in 2017/18 and is projected to achieve £5.6m for 2018/19. 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 and year ended 31st March 2018

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 third quarter of 2017/18 and the whole of the 2017/18 financial year:

	Qtr ended 31/03/18		2017/18 financial year		Ref para
	Deposits	Ave Rate	Deposits	Ave Rate	
	£m	%	£m	%	
Balance of "core" investments b/f	205.00	1.11	193.00	1.42	
New investments made in period	20.00	1.15	135.00	0.85	
Investments redeemed in period	-45.00	0.48	-148.00	1.40	
"Core" investments at end of period	180.00	1.00	180.00	1.00	
Money Market Funds	22.50	0.42	22.50	0.30	3.4.1.1
CCLA Property Fund*	40.00	8.21	40.00	7.00	3.4.4.6
Diversified Growth Funds*	10.00	-9.20	10.00	-0.81	3.4.4.8
Multi-Asset Income Funds*	30.00	-10.47	30.00	-1.86	3.4.4.12
Project Beckenham Loan	2.30	6.00	2.30	6.00	3.4.3.1
"Alternative" investments at end of period	104.80	-0.52	104.80	2.26	
Total investments at end of period	284.80	0.44	284.80	1.46	
* The rates shown here are the total return i.e. dividend income received, plus change in capital value.					
Only dividend income will be recognised during the year; the change in capital value is held in the Available for Sale Financial Assets reserve, and will be recognised on the sale of the investments.					
A more detailed breakdown of the rates for these investments is shown in the relevant paragraphs.					

3.2.3 Details of the outstanding investments at 31st March 2018 are shown in maturity date order in Appendix 2 and by individual counterparty in Appendix 3. An average return of 0.9% was assumed for new investments in the 2017/18 budget in line with the estimates provided by the Council's external treasury advisers, Link Asset Services (previously Capita), and with officers' views. The return on the two new "core" investment placed during the third quarter of 2017/18 was 0.48%, both of which were for 3 months. This compares to the average LIBID rates of 0.36% for 7 days, 0.44% for 3 months, 0.53% for 6 months and 0.74% for 1 year.

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 2014/15, 2015/16 and 2016/17 (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 on the Council's list now comprise only 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 budgeted income in recent years.

3.3 Interest Rate Forecast

- 3.3.1 As expected, the Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate at its meeting on 2 November. This removed the emergency cut in August 2016 after the EU referendum. The MPC also gave forward guidance that they expected to increase Bank rate only twice more by 0.25% by 2020 to end at 1.00%. The Link Asset Services forecast below includes increases in Bank Rate of 0.25% in November 2018, September 2019, June 2020 and November 2020.

Date	LATEST FORECAST (May18)					PREVIOUS FORECAST (Nov17)			
	Base Rate	3 month Libid	6 month Libid	1 year Libid		Base Rate	3 month Libid	6 month Libid	1 year Libid
Jun-18	0.50%	0.60%	0.70%	0.80%		0.50%	0.40%	0.50%	0.80%
Dec-18	0.75%	0.90%	1.00%	1.10%		0.75%	0.60%	0.80%	1.00%
Jun-19	0.75%	0.90%	1.00%	1.20%		0.75%	0.60%	0.80%	1.10%
Dec-19	1.00%	1.20%	1.40%	1.47%		1.00%	0.90%	1.00%	1.30%
Jun-20	1.25%	1.40%	1.50%	1.60%		1.00%	1.00%	1.10%	1.40%
Dec-20	1.50%	1.60%	1.70%	1.80%		1.25%	1.20%	1.30%	1.50%

3.4 Other Investments

3.4.1 Money Market Funds

- 3.4.1.1 The Council currently has 7 AAA-rated Money Market Fund accounts, with Prime Rate, Ignis, Insight, Blackrock, Fidelity, Morgan Stanley 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. The Ignis and Prime Rate funds currently offer the best rate at around 0.53%. The total balance held in Money Market Funds has varied during the year, moving from £6.9m as at 31st March 2017 to £29.3m as at 30th June 2017, £14.1m as at 30th September 2017, £23.3m at 31st December 2017 and £22.5m as at 31st March 2018. 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	Ave. Rate 2017/18	Ave. Daily balance 2017/18	Actual balance 31/03/18	Latest Balance 25/06/18	Latest Rate 25/06/18
		%	£m	£m	£m	%
Prime Rate	15/06/2009	0.29	11.4	-	15.0	0.53
Ignis	25/01/2010	0.29	13.2	15.0	15.0	0.53
Insight	03/07/2009	0.28	3.0	7.5	14.9	0.52
Legal & General	23/08/2012	0.28	4.5	-	14.5	0.51
Blackrock	16/09/2009	0.17	-	-	-	0.42
Fidelity	20/11/2002	0.22	-	-	1.2	0.43
Morgan Stanley		0.24	-	-	-	0.45
TOTAL			32.1	22.5	60.6	

3.4.2 Housing Associations

- 3.4.2.1 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 1.30% and 1.60% respectively.

3.4.3 Loan to Project Beckenham

3.4.3.1 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.

3.4.4 Pooled Investment Schemes

3.4.4.1 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, £80m in June 2017 and £100m in December 2017. Such investments would require the approval of the Director of Finance in consultation with the Resources Portfolio Holder.

3.4.4.2 Until March 2018, accounting rules required that the change in capital value of these investments be held in the Available for Sale Financial Assets Reserve, and only recognised in revenue on the sale of the investment. In year projections for interest on balances therefore only reflected the dividends from these investments.

3.4.4.3 However, from 2018/19 onwards, local authorities have to account for financial instruments in accordance with IFRS9. One of the results of this is that changes in the capital value of pooled fund investments would have to be recognised in revenue in-year.

3.4.4.4 To mitigate the effect of this, and to smooth the volatility in these investments, interest/dividend earnings above 2.5% (£1,086k) during 2017/18 relating to the CCLA Property Fund and Fidelity Multi-Asset Income Fund were set aside in an Income Equalisation earmarked reserve. There is the potential that the effect of this change in accounting will be nullified by a statutory override; however at the time of writing MHCLG have yet to issue a consultation on this, and the new requirements remain in place.

CCLA Property Fund

3.4.4.5 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, £5m in October 2016 and £10m in October 2017. The investment in the CCLA Fund is viewed as a medium to long-term investment and dividends are paid quarterly. A breakdown of the dividend earned and capital growth is provided in the table below.

Annualised net return	Dividend %	Capital Growth %	Total return %
01/02/14 - 31/03/14	4.29	-29.64	-25.35
01/04/14 - 31/03/15	5.03	3.44	8.47
01/04/15 - 31/03/16	5.02	1.63	6.65
01/04/16 - 31/03/17	4.55	-2.50	2.05
01/04/17 - 31/03/18	4.59	2.41	7.00
Cumulative return	4.71	0.58	5.29

- 3.4.4.6 The negative “growth”, particularly in the first two months, was mainly a result of the bid-offer spread that is inherent in property funds when the original and subsequent investments were made. This has less of an effect over the longer term that these investments are expected to be held, and overall there has been modest capital growth of 0.6%.

Diversified Growth Funds

- 3.4.4.7 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.

- 3.4.4.8 The Funds both performed very well in just over three months to 31st March 2015, with returns over 21%. Performance has not so impressive since, with net returns of -1.98% in 2015/16, 1.25% in 2016/17, 0.76% in 2017/18, with overall net returns since inception of 1.30%, as shown in the table below.

Annualised net return	Newton %	Standard Life %	Combined %
22/12/14 - 31/03/15	21.25	21.64	21.44
01/04/15 - 31/03/16	0.81	-4.77	-1.98
01/04/16 - 31/03/17	2.08	0.37	1.25
01/04/17 - 31/03/18	-2.23	0.71	-0.76
Cumulative return	1.99	0.62	1.30

- 3.4.4.9 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 and 2017/18. However, it should be noted that these types of investments should be considered as longer term investments over a three to five year period.

- 3.4.4.10 As previously reported, 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 further Multi-Asset Income Funds.

Multi-Asset Income Fund

- 3.4.4.11 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 on 12th July 2017 in the Fidelity Multi-Asset Income Fund following the agreement of the Resources Portfolio Holder. The fund return for the quarter to 31st March 2018 was capital growth of -14.73% and dividends paid of 3.98%, resulting in a total return of -10.47%. Since inception, dividends paid have totalled 4.44%, with a reduction of -6.30% to the capital value, resulting in a total return of -1.86%. The capital value has since recovered somewhat, and there was a total return since inception of 0.25% as at 30th April 2018.

Investment with Heritable Bank

- 3.4.5.1 Members will be aware from previous 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.

3.5 Actual prudential indicators for 2017/18

3.5.1 The old capital control system was replaced in April 2004 by a prudential system based largely on self-regulation by local authorities themselves. At the heart of the system is The Prudential Code for Capital Finance in Local Authorities, developed by CIPFA. The Code requires the Council to set a number of prudential indicators designed to monitor and control capital expenditure, financing and borrowing. The indicators for 2017/18 were approved by the Executive and the Council in March 2017 and were revised and updated in December 2017. Appendix 4 sets out the actual performance in 2017/18 against those indicators.

3.6 Economic Background during 2017/18 (provided by Link Asset Services)

3.6.1 UK: The outcome of the EU referendum in June 2016 resulted in a gloomy outlook and economic forecasts from the Bank of England based around an expectation of a major slowdown in UK GDP growth, particularly during the second half of 2016, which was expected to push back the first increase in Bank Rate for at least three years. Consequently, the Bank responded in August 2016 by cutting Bank Rate by 0.25% to 0.25% and making available over £100bn of cheap financing to the banking sector up to February 2018. Both measures were intended to stimulate growth in the economy. This gloom was overdone as the UK economy turned in a G7 leading growth rate of 1.8% in 2016, (actually joint equal with Germany), and followed it up with another 1.8% in 2017, (although this was a comparatively weak result compared to the US and EZ).

3.6.2 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; quarter 1 came in at +0.3% (+1.7% y/y) and quarter 2 was +0.3% (+1.5% y/y), which meant that growth in the first half of 2017 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 in quarter 3 to 0.5% before dipping slightly to 0.4% in quarter 4.

3.6.3 Consequently, market expectations during the autumn rose significantly that the MPC would be heading in the direction of imminently raising Bank Rate. The MPC meeting of 14 September provided a shock to the markets with a sharp increase in tone in the minutes where the MPC considerably hardened their wording in terms of needing to raise Bank Rate very soon. The 2 November MPC quarterly Inflation Report meeting duly delivered on this warning by withdrawing the 0.25% emergency rate cut which had been implemented in August 2016. Market debate then moved on as to whether this would be a one and done move for maybe a year or more by the MPC, or the first of a series of increases in Bank Rate over the next 2-3 years. The MPC minutes from that meeting were viewed as being dovish, i.e. there was now little pressure to raise rates by much over that time period. In particular, the GDP growth forecasts were pessimistically weak while there was little evidence of building pressure on wage increases despite remarkably low unemployment. The MPC forecast that CPI would peak at about 3.1% and chose to look through that breaching of its 2% target as this was a one off result of the devaluation of sterling caused by the result of the EU referendum. The inflation forecast showed that the MPC expected inflation to come down to near the 2% target over the two to three year time horizon. So this all seemed to add up to cooling expectations of much further action to raise Bank Rate over the next two years.

3.6.4 Further information on the economic background is included as Appendix 5.

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 through 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 were expected to reduce the funds available for investment, and a reduction of £600k was included in the 2017/18 budget.

5.2 The final outturn for net interest on investments and borrowing in 2016/17 was £4,049k compared to the budget of £2,891k, 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.

- 5.3 To reflect the increased level of interest earnings from alternative investments as set out above, in part offset by an expected reduction in balances available for investment as a result of the utilisation of capital receipts and grants/contributions as well as earmarked revenue reserves, and an increase of £600k has been included in the 2018/19 budget.

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, 1 st March 2017 CIPFA Code of Practice on Treasury Management CIPFA Prudential Code for Capital Finance in Local Authorities CLG Guidance on Investments External advice from Link Asset Services

