Report No.
FSD18068

London Borough of Bromley

PART 1 - PUBLIC

Decision Maker:	**Resources, Commissioning and Contracts Management Portfolio Holder**
Date:	**For pre-decision scrutiny by Executive, Resources and Contracts PDS Committee on 5th September 2018**
Decision Type:	Non-Urgent Executive Non-Key
Title:	**TREASURY MANAGEMENT - QUARTER 1 PERFORMANCE 2018/19**
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 2018/19. 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 2018 totalled £303.6m and there was no outstanding external borrowing. For information and comparison, the balance of investments stood at £284.8m as at 31st March 2018 and £320.1m as at 30th June 2017, and, at the time of writing this report (20th August 2018) it stood at £319.4m.

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2. RECOMMENDATION(S)

2.1. The Resources, Commissioning and Contracts Management Portfolio Holder is requested to note the Treasury Management performance for the first quarter of 2018/19.

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 2018/19; £170k 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. At its meeting on 5th July 2018, the Executive, Resources and Contracts PDS Committee discussed the option of not reporting on treasury management activity quarterly unless Officers felt that a matter should come before the Committee sooner. As Financial Regulations currently require quarterly reports, the mid-year review report will therefore request that the Portfolio Holder recommends that Council formally approves this change.

3.1.3. This report includes details of investment performance in the first quarter of 2018/19. The 2018/19 annual treasury strategy, including the MRP (Minimum Revenue Provision) Policy Statement and prudential indicators, was originally approved by Council in February 2018. The annual report for financial year 2017/18 was submitted to the Executive, Resources and Contracts PDS Committee on 5th July 2018 and Council on 16th July 2018.

3.1.4. 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.

3.1.5. 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.

3.1.6. 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.

3.1.7. 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 £5.4m in 2018/19 and £5.5m in a full year. 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.

3.1.8. 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 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 first quarter of 2018/19:-

	Qtr ended 31/06/18		
	Deposits	**Ave Rate**	**Ref para**
	£m	**%**	
Balance of "core" investments b/f	180.00	1.35	
New investments made in period	30.00	1.06	
Investments redeemed in period	-40.00	1.49	
"Core" investments at end of period	170.00	1.28	
Money Market Funds	51.30	0.49	3.4.1
CCLA Property Fund*	40.00	10.30	3.4.4.5
Diversified Growth Funds*	10.00	-0.07	3.4.4.7
Multi-Asset Income Funds*	30.00	7.45	3.4.4.11
Project Beckenham Loan	2.30	6.00	3.4.3.1
"Alternative" investments at end of period	133.60	5.04	
Total investments at end of period	**303.60**	**2.94**	

* The rates show n here are the total return i.e. dividend income received, plus change in capital value. A more detailed breakdow n of the rates for these investments in show n in the relevant paragraphs.

3.2.3. Details of the outstanding investments at 30th June 2018 are shown in maturity date order in Appendix 2 and by individual counterparty in Appendix 3. An average return of 1.0% was assumed for new investments in the 2018/19 budget in line with the estimates provided by the Council's external treasury advisers, Link Asset Services, and with officers' views. The return on the three new "core" investment placed during the first quarter of 2018/19 was 1.06%, compared to the average LIBID rates of 0.36% for 7 days, 0.55% for 3 months, 0.67% for 6 months and 0.84% 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 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 budgeted income in recent years.

3.3. Interest Rate Forecast

3.3.1. At its meeting on 2nd August, the Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate; the first increase above 0.5% since the financial crash in 2008. This removed the emergency cut in August 2016 after the EU referendum. Overall, the MPC was more hawkish than expected, i.e. this indicates a faster pace of increases than previously expected. The Link Asset Services forecast below includes increases in Bank Rate of 0.25% in August 2019, May 2020 and November 2020.

Date	LATEST FORECAST (Aug18)					PREVIOUS FORECAST (May18)			
	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%
Dec-18	0.75%	0.80%	0.90%	1.00%		0.75%	0.90%	1.00%	1.10%
Jun-19	0.75%	0.90%	1.00%	1.10%		0.75%	0.90%	1.00%	1.20%
Dec-19	1.00%	1.10%	1.20%	1.30%		1.00%	1.20%	1.40%	1.47%
Jun-20	1.25%	1.40%	1.50%	1.60%		1.25%	1.40%	1.50%	1.60%
Dec-20	1.50%	1.60%	1.70%	1.80%		1.50%	1.60%	1.70%	1.80%

3.4. Other accounts

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, Prime Rate, Insight and Legal & General funds currently offer the best rate at around 0.65%, which compares to around 0.48-0.50% in March, reflecting the effect of the base rate rise in August as maturities are re-invested.

3.4.1.2. The total balance held in Money Market Funds has varied during the quarter, moving from £22.5m as at 31st March 2018 to £51.3m as at 30th June 2018, and currently stands at £57.1m (as at 20th August 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, or shorter dated (less than three months) fixed term investments; 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 31/03/18	Actual balance 30/06/18	Ave. Rate Q1 2017/18	Latest Balance 20/08/18	Ave. Daily balance to 20/08/18	Latest Rate 20/08/18
		£m	£m	%	£m	£m	%
Prime Rate	15/06/2009	-	15.0	0.50	15.0	13.5	0.65
Ignis	25/01/2010	15.0	15.0	0.51	12.1	14.9	0.62
Insight	03/07/2009	7.5	14.9	0.49	15.0	13.6	0.65
Legal & General	23/08/2012	-	6.4	0.48	15.0	12.7	0.65
Blackrock	16/09/2009	-	-	0.40	-	-	0.57
Fidelity	20/11/2002	-	-	0.41	-	3.8	0.52
Morgan Stanley		-	-	0.43	-	-	0.59
TOTAL		22.5	51.3		57.1	58.5	

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. More recently, a deposit of £5m was placed with Metropolitan Housing Trust (A+) in April 2018 for two years at a rate of 1.75%.

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 which MHCLG are currently consulting on.

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	-25.34
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
01/04/18 - 30/06/18	4.48	5.82	10.30
Cumulative return	4.68	1.10	5.78

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 1.10%.

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, -0.81% in 2017/18 and -0.07% in the first quarter of 2018/19, with overall net returns since inception of 1.21%, as shown in the table below.

Annualised 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	-0.81
01/04/18 - 30/06/18	9.20	-9.74	-0.07
Cumulative return	2.54	-0.13	1.21

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, Commissioning and Contracts Management Portfolio Holder. The fund return for the quarter to 30th June 2018 was capital growth of 3.49% and dividends paid of 3.96%, resulting in a total return of 7.45%. Since inception, dividends paid have totalled 4.31%, partly offset by a reduction of 3.81% to the capital value, resulting in a total return of 0.50%, as shown in the table below.

Annualised net return	Dividend %	Capital Growth %	Total return %
12/07/17 - 31/03/18	4.42	-6.27	-1.85
01/04/18 - 30/06/18	3.96	3.49	7.45
Cumulative return	4.31	-3.81	0.50

3.4.5. 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. Regulatory Framework, Risk and Performance

3.5.1. 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.

3.5.2. 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

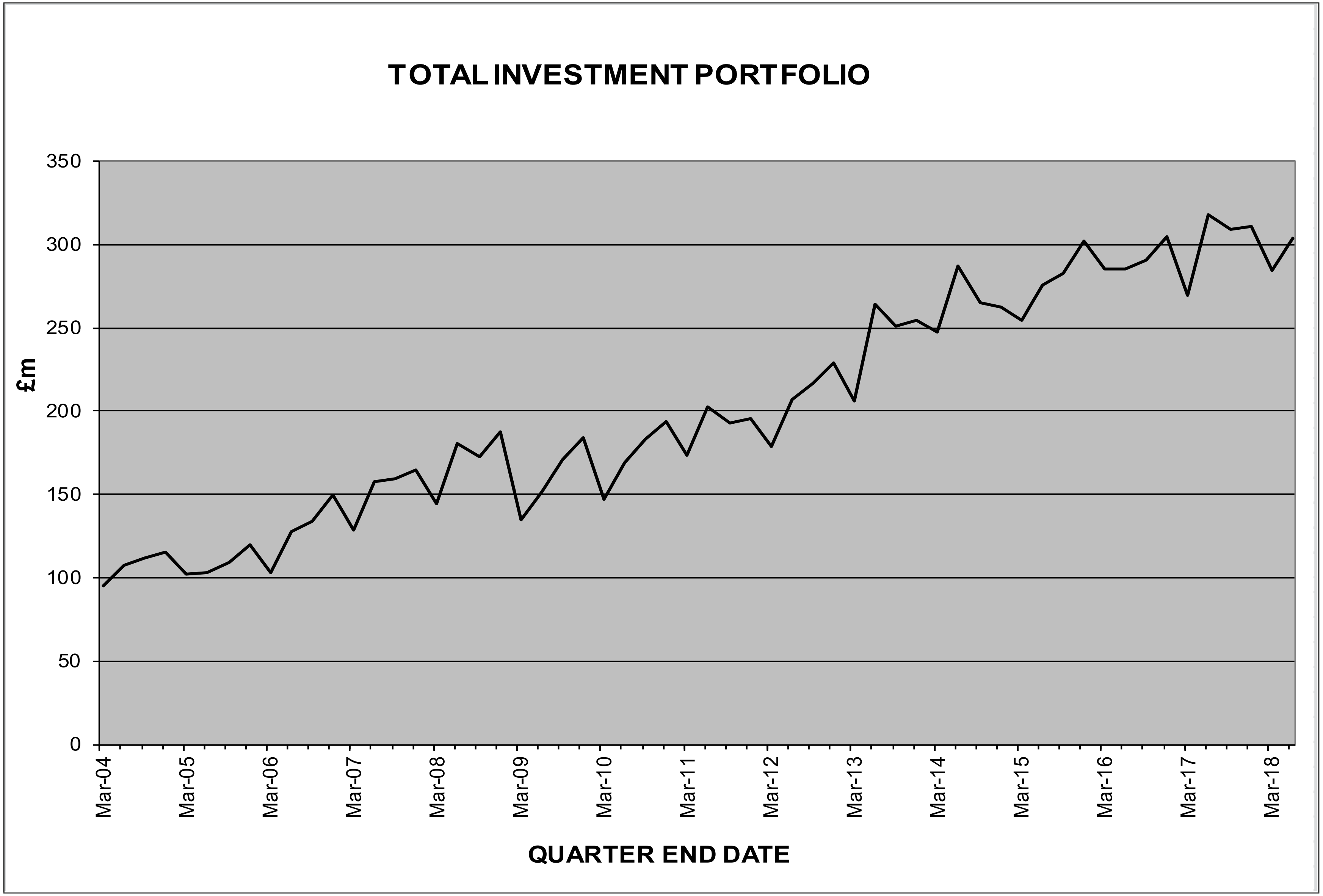
5.1 At the time of setting the 2018/19 budget, the Bank of England had recently increased the Base Rate to 0.50% from 0.25%, reversing the emergency cut in August 2016 following the EU referendum, and in line with the MPC's forward guidance, it was now anticipated by many "experts" that rates will increase slowly, with only two more increases by 2020, to 1.0%. As a result, an average rate of 1.0% was prudently assumed for interest on new fixed term deposits.

5.2 Despite the increase in the base rate, there has been very little impact on interest income from lending to banks. This is partly due to banks having the ability to borrow from the Bank of England at very low rates as well as the strengthening of 'balance sheets' reducing the need to borrow. In addition, utilisation of the Investment Fund and Growth Fund as well as the Highways Investment Scheme has reduced the resources available for treasury management investment. However, the treasury management strategy was revised in December 2017 to enable an increase in the limit for alternative investments to £100m which will generate additional income of around £2m compared with lending to banks. As a result, additional income of £600k was included in the 2018/19 budget.

5.3 At present, a surplus of £170k is projected for 2018/19 mainly as a result of the rates achieved on two of the fixed term investments made since the budget was set. However, it should be noted that despite the further increase in base rate as referred to in paragraph 3.3.1, rates have not increase by the same level (as counterparties had essentially already priced that in), so further maturities during the year may not achieve similar rates when subsequently re-invested.

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 Link Treasury Solutions

APPENDIX 1



TOTAL INVESTMENT PORTFOLIO
£m
350
300
250
200
150
100
50
0
Mar-04
Mar-05
Mar-06
Mar-07
Mar-08
Mar-09
Mar-10
Mar-11
Mar-12
Mar-13
Mar-14
Mar-15
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Mar-18
QUARTER END DATE