POLICY, RESOURCES & GROWTH COMMITTEE	Agenda Item 63 Brighton & Hove City Council

Subject:		**Treasury Management Policy Statement 2017/18 (including Annual Investment Strategy 2017/18) – Mid Year Review**	
Date of Meeting:		**30 November 2017** 14 December 2017 – Full Council	
Report of:		**Executive Director, Finance & Resources**	
Contact Officer:	**Name:**	**James Hengeveld**	**Tel: 01273 291242**
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Ward(s) affected:		**All**	

FOR GENERAL RELEASE

1. PURPOSE OF REPORT AND POLICY CONTEXT

1.1 The 2017/18 Treasury Management Policy Statement (TMPS), practices and schedules were approved by Policy, Resources & Growth Committee on 23 March 2017. The TMPS sets out the role of Treasury Management, whilst the practices and schedules set out the annual targets and methods by which these targets will be met.

1.2 The TMPS includes the Annual Investment Strategy (AIS) which sets out the key parameters for investing council cash funds and was approved by Full Council on 6 April 2017.

1.3 It is recommended good and proper practice that Members receive half yearly reports and review and endorse treasury management actions during the year. The purpose of this report is to advise of the action taken in the first half of 2017/18.

2. RECOMMENDATIONS:

Policy, Resources & Growth Committee

2.1 That Policy, Resources & Growth Committee endorses the key actions taken during the first half of 2017/18 to meet the treasury management policy statement and practices (including the investment strategy) as set out in this report.

2.2 That Policy, Resources & Growth Committee notes that the approved maximum indicator for investment risk of 0.05% has been adhered to and the authorised limit and operational boundary have not been exceeded in the first half of the year.

2.3 That Policy, Resources & Growth Committee recommends to full Council the approval of the amended Annual Investment Strategy 2017/18 as set out in Appendix 3 to this report.

2.4 That Policy, Resources & Growth Committee recommends to full Council the approval of the amended Minimum Revenue Provision (MRP) Policy 2017/18 as set out in Appendix 4 to this report.

Full Council

2.5 That full Council approve the amended Annual Investment Strategy 2017/18 as set out in Appendix 3 to this report;

2.6 That full Council approve the amended MRP Policy 2017/18 as set out in Appendix 4 to this report.

3. CONTEXT/ BACKGROUND INFORMATION

Overview of Markets

3.1 Preliminary estimates indicate that the UK grew faster than expected at 0.4% (1.5% annually) in Quarter 3 2017 compared to the estimate of 0.3%. Growth was driven by performance in the Services sector and in manufacturing.

3.2 The Bank of England's Monetary Policy Committee raised the official Bank Rate to 0.50% in its meeting of 2 November 2017 with a vote of 7-2. The rate rise was following the committee signalling a possible imminent rate increase in its previous meeting in response to growing economy and inflation concerns. Further rate rises are likely to be gradual, with the November 2017 Inflation report signalling two further 0.25% rate increases over the next two years. Bank of England governor, Mark Carney, commented that the Brexit negotiations were the single biggest factor for the next move on rates, with uncertainty of the outcome of the negotiations currently weighing on UK investment.

3.3 The indication of further rate rises being gradual resulted in a fall in sterling against both the dollar and the euro. Longer term investment rates have also eased as markets appeared to have previously expected a faster pace of bank rate increases.

3.4 Pressure on long term investment rates is expected to continue for the remainder of the year, whilst an increase in short term investment rates has been built into the Financing Costs projection to be reported in Targeted Budget Monitoring (TBM) month 7.

Treasury Management Strategy

3.5 A summary of the action taken in the 6 months to September 2017 is provided in Appendix 1 to this report and further information on borrowing and investment performance is shown in Appendix 2. The main points are:

- The council entered no new borrowing arrangements during the period;
- The highest risk indicator during the period was 0.041% which is below the maximum set of 0.050%;
- The return on investments by the in-house treasury team and cash manager has exceeded the target rates;
- The two borrowing limits approved by full Council have not been exceeded.

3.6 Treasury management activity in the half-year has focused on a short-term horizon as summarised in the table below:

	Amount invested 1 Apr 2017 to 30 Sep 2017			
	Fixed deposits	Money market funds & Call Accounts	Total	
Up to 1 week	-	£250.8m	£250.8m	82%
Between 1 week & 1 month	-	-	-	-
Between 1 month & 3 months	-	-	-	-
Over 3 months	£55.0m	-	£55.0m	18%
	£55.0m	**£250.8m**	**£305.8m**	**100%**

Summary of Treasury Activity April to September 2017

3.7 The following table summarises the treasury activity in the half year to September 2017 compared to the corresponding period in the previous year.

April to September	2016/17	2017/18
Long-term borrowing entered into	(£19.3m)	-
Long-term borrowing repaid	£3.4m	£0.5m
Short-term borrowing repaid	-	-
Investments made	£270.3m	£305.8m
Investments maturing	(£246.8m)	(£275.7m)

3.8 The Financing Costs budget reported a £0.069m underspend at Month 5 due to an increase in investment income resulting from an increase in cash balances. As a result of increased balances and an increase in Base Rate, the underspend at Month 7 has increased by £0.076m.

3.9 The following table summarises how the day-to-day cash flows in the first half-year have been funded compared to the same period in the previous year. The large increase in cash flow deficit compared to 2016/17 relates largely to one off grants paid in advance in 2017/18 as well as some timing differences in income.

April to September	2016/17	2017/18
Cash flow surplus – general	£7.2m	£30.7m
Net cashflow surplus	**£7.2m**	**£30.7m**
Represented by:		
Decrease in long-term borrowing	£15.9m	(£0.5m)
Decrease in short-term borrowing	-	-
Increase in investments	(£23.5m)	(£30.1m)
(Increase)/decrease in bank balance	£0.4m	(£0.1m)

Security of Investments

3.10 A summary of investments made by the in-house treasury team and outstanding as at 30 September 2017 in the table below shows that investments continue to be held in good quality, short term instruments. The funds invested in BBB institutions included in the table below are invested in the part-nationalised banks which are backed by Government guarantees in line with the AIS.

‘AAA’ rated money market funds	£14.83m	16%
‘AA’ rated institutions	£8.00m	9%
‘A’ rated institutions	£66.48m	71%
‘BBB’ rated institutions	£4.00m	4%
Total	**£93.31m**	**100%**
Period – less than one week	£14.83m	16%
Period – between one week and one month	£10.00m	11%
Period – between one month and three months	£10.50m	11%
Period – between three months and 1 year	£57.98m	62%
Total	**£93.31m**	**100%**

Risk

3.11 As part of the investment strategy for 2017/18 the Council agreed a maximum risk benchmark of 0.050% i.e. there is a 99.95% probability that the council will receive its investments back. The benchmark is a simple target that measures the risk based on the financial standing of counterparties and length of each investment based on historic default rates. The actual risk indicator has varied between 0.025% and 0.041% between April 2017 and September 2017. It should be remembered however that the benchmark is an average risk of default measure, and does not constitute an expectation of loss against a particular investment.

3.12 In October 2017, Internal Audit undertook an audit of the treasury management function. The audit concluded that “substantial assurance” is provided on the effectiveness of the control framework operating and mitigating risks for treasury management. No recommendations were provided.

Performance

3.13 The following table summarises the performance on investments compared with the budgeted position and the benchmark rate.

(*) Annualised rates	In-house investments		Cash manager investments	
	Average balance	Average rate (*)	Average balance	Average rate (*)ˆ
Budget 2017/18– full year*	£57.7m	0.50%	£26.1m	0.77%
Actual to end Sept 2017	£106.9m	0.55%	£26.1m	0.50%
Benchmark rate to end Sept 2017**	-	0.36%	-	0.12%

* *This is an average for the full year –profile of balances are higher in the first half of the year and are expected to reduce over the financial year*

** *The in-house benchmark rate is set at the 7 Day LIBID plus 0.25% whilst the Cash Manager’s fund’s benchmark rate is 105% of the 7 day LIBID*

ˆ *The Cash Manager average rates are net of fees (deducted at 0.15%)*

3.14 The return on the cash manager funds had been declining. As a result, officers have commissioned the council's treasury advisors to undertake a fund selection process for similar funds. This will allow the council to ensure it's is receiving value for money from its investment portfolio. Any alternative investments entered into will be in line with the council's Annual Investment Policy (Appendix 3).

3.15 The council is part of a regional benchmark club which shares investment strategies and performance on a confidential basis. The latest benchmarking data demonstrates that the council's investment portfolio is performing in line with expectations given the challenging investment climate.

Changes in Financial Instrument Regulations – MiFID II

3.16 Under current market regulations all Local Authorities in the UK are treated by investment counterparties as "Professional" clients. This allows authorities to access a number of tradeable instruments (such as Certificates of Deposits, Treasury Bills and Money Market Funds) that "retail" clients, or individuals are not able to access.

3.17 The EU has revised the regulations within MiFID II (Markets in Financial Instruments Directive). Within the revised regulations, Local Authorities will automatically be classified as "Retail" clients. There is the opportunity to "opt-up" to professional status so long as the council fulfils a number of quantitative and qualitative criteria. These new regulations come into effect on 3rd January 2018 and the council will be required to opt up to professional status, prior to this date, with all those counterparties where it invests in tradeable instruments in order to continue to access these instruments.

3.18 The council meets the requirements to opt up to professional status and the Treasury Team are currently undertaking the opting up process with the council's investment counterparties. It is not envisaged that the council's access to investments and counterparties will change.

Proposed change to the Annual Investment Strategy 2017/18

3.19 The council's average cash balances in 2017/18 to date have been higher than in previous years. This is principally due to the timing differences between capital receipts, new external borrowing being undertaken in 2015/16 and 2016/17 and capital expenditure. As the cash balances increase, it is vital that the council's investment portfolio is adequately diversified to minimise the risk of loss and strengthen the security of the council's cash.

3.20 An investment opportunity has arisen from one of the council's market lenders (Danske Bank). The proposal is a variable rate 10 year investment which is offset against the council's loan with Danske. This will result in the council being able to undertake a longer term investment with no credit risk as the offset would result in the investment being used to repay the council's loan in the event of a default by Danske.

3.21 An amendment to the council's Annual Investment Strategy (AIS) would be required in order to undertake this opportunity. The revised AIS (Appendix 3) outlines that any investment where there is a direct and legal offset would be outside of the scope of the investment strategy's usual assessment of lending periods and investment values.

Proposed Change to the MRP Policy

3.22 The council makes a Minimum Revenue Provision (MRP) in each year in order to set aside the resources to repay the council's debt. The MRP policy is approved each year as part of the budget process and the 2017/18 MRP was approved by Budget Council on 23 February 2017.

3.23 Paragraph 8.5 of the Living Wage Joint Venture Business Plan report, presented to this committee on 12 October 2017, explained that the MRP Policy would need to be amended to ensure that the MRP relating to the Joint Venture project would be made in such a way that it matched the cash flows of the project. This is to minimise revenue impact in the early years of the project whilst still ensuring a prudent provision is being made. The proposed amendment to the MRP policy specifies that MRP will commence in Year 9 of the project, coinciding with the start of anticipated net surpluses.

3.24 The revised MRP Policy is set out in Appendix 4.

Borrowing Strategy

3.25 The General fund entered into £20.0m of planned new borrowing over the last two years. This borrowing was undertaken to reduce the council's internal borrowing position (i.e. the extent to which the council was borrowing cash from its own reserves) in light of interest rate forecasts and the reduction in certain reserves expected over the medium term.

3.26 The Housing Revenue Account (HRA) has entered into £10m of external borrowing and £3.2m of borrowing from the General Fund to support the 2016/17HRA Capital Programme.

3.27 As a result of the increase in cash balances, it is not expected that the council will enter into any new external borrowing in 2017/18. The Treasury Team, along with the council's treasury advisors, monitor interest rates and will seek to externalise the HRA's borrowing from the General Fund at a time which would be optimal for both the HRA and the General Fund. The Treasury Team are also exploring alternative borrowing sources, such as forward market borrowing for future capital investment plans.

Treasury Advisors

3.28 The council's current contract for treasury advisory services is with Link Asset Services (LAS). The Capita group announced the sale of its Asset Services arm to The Link Group in June 2017. The Link group provides financial administration services across Asia, Africa and Australasia, the Middle East and Europe, and is seeking to increase its UK presence. Formal completion of the sale was on 6 November 2017, and Capita Asset Services has therefore rebranded as Link Asset Services as part of the move to the Link Group.

4. ANALYSIS & CONSIDERATION OF ANY ALTERNATIVE OPTIONS

4.1 This report sets out action taken in the 6 months to September 2017. Treasury management actions have been carried out within the parameters of the AIS, TMPS and Prudential Indicators. Therefore no alternative options have been considered.

5. COMMUNITY ENGAGEMENT & CONSULTATION

5.1 The council's external treasury advisors have been consulted over the content of this report. No other consultation was undertaken.

6. CONCLUSION

6.1 Treasury management is governed by a code that is recognised as "best and proper practice" under the Local Government Act 2003. The Code requires a minimum of two reports per year, one of which is required to review the previous year's performance. This report fulfils that requirement.

7. FINANCIAL & OTHER IMPLICATIONS:

Financial Implications:

7.1 The financial implications of treasury management activity are reflected in the financing costs budget set out in paragraph 3.8.

Finance Officer Consulted: James Hengeveld *Date: 16/11/17*

Legal Implications:

7.2 The TMPS and associated actions are exercised under powers given to the council by Part 1 of the Local Government Act 2003, which include the power for a local authority to invest for the purposes of the prudent management of its financial affairs (section 12).

7.3 The terms of the proposed investment with the Danske Bank referred to in paragraphs 3.20 and 3.21 have been reviewed by the Legal team. In the event of the Bank becoming insolvent, the Council's obligation to repay the loan and any interest on it would be automatically offset by its deposit with no further sums becoming due.

Lawyer Consulted: Victoria Simpson *Date: 14/11/17*

Equalities, Sustainability and other significant implications:

7.4 There are no direct implications arising from this report.

SUPPORTING DOCUMENTATION

Appendices:

1. A summary of the action taken in the period April 2017 to September 2017

2. September 2017 Treasury Management performance data

3. Amended Annual Investment Strategy 2017/18 for approval

4. Amended Minimum Revenue Provision statement 2017/18 for approval

Documents in Members' Rooms

None

Background Documents

1. Part I of the Local Government Act 2003 and associated regulations

2. The Treasury Management Policy Statement and associated schedules 2017/18 approved by Policy, Resources & Growth Committee on 23 March 2017

3. The Annual Investment Strategy 2017/18 approved by full Council on 6 April 2017

4. Papers held within Financial Services, Finance & Resources Directorate

5. The Prudential Code for Capital Finance in Local Authorities published by CIPFA 2011