Report to:	Audit and Governance Committee	**Date of Meeting:**	Wednesday 5 December 2018
Subject:	Treasury Management Position to October 2018		
Report of:	Head of Corporate Resources	**Wards Affected:**	All Wards
Portfolio:	Cabinet Member - Regulatory, Compliance and Corporate Services		
Is this a Key Decision:	No	**Included in Forward Plan:**	No
Exempt / Confidential Report:	No		

Summary:

This report provides Members with a review of the Treasury Management activities undertaken to 31st October 2018. Monitoring reports will be presented to Audit & Governance Members on a quarterly basis, whose role it is to carry out scrutiny of treasury management policies and practices.

Recommendation(s):

Members are requested to note the Treasury Management update to 31st October 2018, to review the effects of decisions taken in pursuit of the Treasury Management Strategy and to consider the implications of changes resulting from regulatory, economic and market factors affecting the Council's treasury management activities.

Reasons for the Recommendation(s):

To ensure that Members are fully appraised of the treasury activity undertaken to 31st October 2018 and to meet the reporting requirements set out in Sefton's Treasury Management Practices and those recommended by the CIPFA code.

Alternative Options Considered and Rejected: (including any Risk Implications)

N/A

What will it cost and how will it be financed?

(A) Revenue Costs

The financial position on the external investment budget to the end of October indicates a surplus to the end of the period. The forecast to the end of the financial year also shows that investment income will exceed the level set in the budget.

(B) Capital Costs

None.

Implications of the Proposals:

Resource Implications (Financial, IT, Staffing and Assets): External Interest is forecast to achieve the target for the year.
Legal Implications: The Council has a statutory duty to review its Treasury Management activities from time to time during the financial year.
Equality Implications: None.

Contribution to the Council's Core Purpose:

Protect the most vulnerable: n/a
Facilitate confident and resilient communities: n/a
Commission, broker and provide core services: n/a
Place – leadership and influencer: Support strategic planning and promote innovative, affordable and sustainable capital investment projects through application of the CIPFA Prudential Code.
Drivers of change and reform: The Treasury Management function ensures that cash flow is adequately planned and cash is available when needed by the Council for improvements to the borough through its service provision and the Capital Programme.
Facilitate sustainable economic prosperity: Pursuit of optimum performance on investments activities and minimising the cost of borrowing and the effective management of the associated risk continues to contribute to a balanced budget for the Council.
Greater income for social investment: n/a
Cleaner Greener: n/a

What consultations have taken place on the proposals and when?

(A) Internal Consultations

The Head of Corporate Resources (FD.5457/18) and Chief Legal and Democratic Officer (LD.4582/18) have been consulted and any comments have been incorporated into the report.

(B) External Consultations

N/A

Implementation Date for the Decision

With immediate effect.

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Appendices:

There are no appendices to this report

Background Papers:

There are no background papers available for inspection.

1. Background to the Report

1.1. As recommended under CIPFA's revised 2017 Code of Practice on Treasury Management in Public Services, the Council's Treasury Management Policy and Strategy document for 2018/19 (approved by Council on 1st March 2018) included a requirement for regular updates to be provided on the investment activity of the Authority. This report is the second of such reports for the year and presents relevant Treasury Management information for the period ending 31st October 2018.

1.2. The report includes information on the investments held / entered into during the period and the interest rates obtained (with a comparison of performance against a standard benchmark figure). In addition, the report highlights whether there has been any variance from the Treasury Management Policy and Strategy and the Council's approved Prudential Indicators (the operational boundaries within which the Council aims to work).

2. Investments Held

2.1. Investments held at the 31/10/2018 comprise the following:

Institution		Deposit £m	Rate %	Maturity	Rating
Money Market Funds					
Aviva		3.360	0.70	n/a	AAA
BNP Paribas		3.360	0.78	n/a	AAA
Invesco		3.360	0.70	n/a	AAA
Federated Investors		3.050	0.71	n/a	AAA
Insight		1.780	0.69	n/a	AAA
	Total	14.910			

Call Accounts					
Santander		3.000	1.00	95 day notice	A
GSIB		3.000	0.82	185 day notice	A
	Total	6.000			
Fixed Term Deposits					
Lloyds		3.000	0.75	16/11/2018	A+
ANZ		3.000	0.72	30/11/2018	AA-
DBS		3.000	0.90	04/02/2019	AA-
	Total	9.000			
Property Fund					
CCLA		5.000	4.29	n/a	n/a
	Total	5.000			
TOTAL INVESTMENTS		34.910			

2.2. All of the investments made since April 2018 have been with organisations on the current counterparty list. The maximum level of investment permitted in the Treasury Management Strategy in any one institution, or banking group, is currently £25m. Whilst the maximum should be retained, in case economic conditions change, a day to day operational maximum of 10% of the total portfolio is currently being imposed. This will spread the risk of investments for the Council, but will have a small detrimental impact on the returns the Council will receive in the future. The Council has remained within that boundary during the year. At present, it is not expected that there will be any need to review this limit.

2.3. The Council will only invest in institutions that hold a minimum Fitch rating of A- for banking institutions, or AAA for money market funds. The ratings applied to investment grade institutions, and the much riskier speculative grade institutions, as defined by Fitch, have been placed into a risk matrix (paragraph 2.7).

2.4. An investment has been made with the Church, Charities and Local Authority Investment Fund (CCLA) in June 2014. CCLA invest in commercial property which is rented out to enterprises as retail units, warehousing, and offices. The majority of properties owned are in the south of the country where the market is currently more buoyant than the north. The Council has in effect bought a share of the property portfolio, and returns paid are in the region of 4%. This is a long-term investment with the potential for capital growth of the investment as property prices potentially increase.

2.5. The Net Asset Value of the Property Fund has increased from 295.27p per unit to 303.67p per unit over a 12-month period to September 2018, an increase of 2.8% in the value of the Council’s investment.

2.6. The matrix below shows how the Council has set its risk appetite by being risk averse and putting security and liquidity before yield:

High

INCREASING YIELD

PROBABLITY of DEFAULT

High

F1 A+ 6	**F2 12**	**F3 18**	**B 24**	**C 30**	**D 36**
F1 A+ 5	**F2 10**	**F3 15**	**F3 20**	**B 25**	**C 30**
F1+/AA- 4	**F1 A 8**	**F2 12**	**F3 16**	**F3 20**	**B 24**
F1+/AA 3	**F1 A+ 6**	**F1 A 9** **£6m**	**F2 12**	**F3 15**	**F3 18**
F1+/AA+ 2	**F1+/AA- 4**	**F1 A+ 6** **£3m**	**F1 A 8**	**F2 10**	**F2 12**
F1+/AAA 1 **£14.91m**	**F1+/AA+ 2**	**F1+/AA 3**	**F1+/AA- 4** **£6m**	**F1 A+ 5**	**F1 A+ 6**

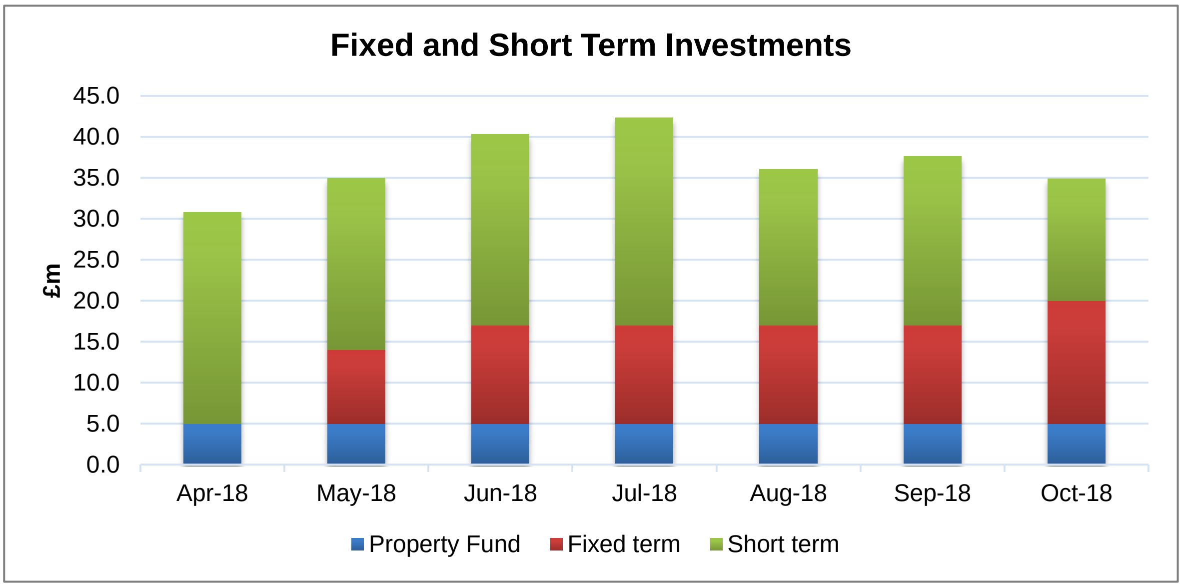
Low

High

SEVERITY of CONSEQUENCE

SEFTON RISK TOLERANCE			**INVESTED**
LOW	**1 - 4**	Investment Grade	**£20.91m**
LOW – MEDIUM	**5 - 9**	Investment Grade	**£9.00m**
MEDIUM	**10 - 20**	Investment Grade	Nil
HIGH	**21 - 36**	Speculative Grade	Nil

2.7. The ratio of overnight deposits (short term) to fixed term investments is shown below:



2.8. One new fixed term investment of £3m has been made with DBS Bank during October 2018. A deposit of £3m in a 95-day call account with Santander matured during October and following a review of the current cash position it was decided to place this deposit again with Santander on the same terms but at an improved rate of return.

3. Interest Earned

3.1. The actual performance of investments against the profiled budget to the end of October 2018 and the forecast performance of investments against total budget at year end is shown below:

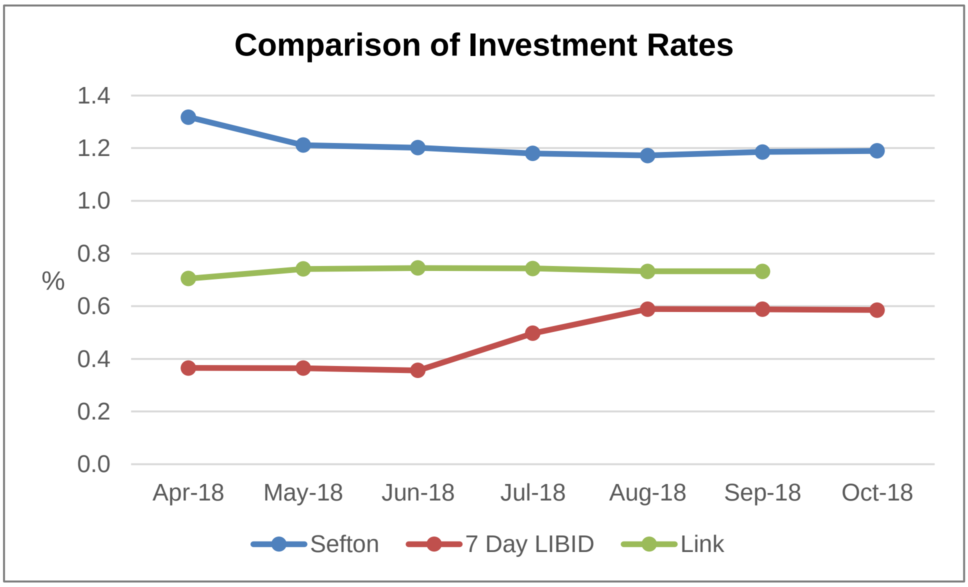
	Profiled Budget £m	Actual £m	Variance £m
Oct-18	0.198	0.235	0.037

	Total Budget £m	Forecast Out-turn £m	Variance £m
2018/19	0.375	0.403	0.028

3.2. The budgeted investment return for the financial year 2018/19 was set at £0.375m on 1st April 2018. The actual investment return to the end October has exceeded the profiled budget and the forecast to year end is also showing a surplus compared to budget. The additional income is due to a rise in Money Market investment rates in response to the Bank of England base rate rise on 2nd August. Fixed term deposit rates have also improved more recently and the

Council has opted to place additional deposits (see 2.9 above) to take advantage of the rise and fix these rates for as long as possible.

3.3. The Council has achieved an average rate of return on its investments that has out-performed the 7 day LIBID and the model portfolio provided by Link:



NB: Link's October position not available at the time of writing.

4. Interest Rate Forecast

4.1. Link Asset Services, our Treasury Advisors, have supplied the interest rate forecast below:

Link Asset Services Interest Rate View	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%
3 Month LIBID	0.75%	0.80%	0.80%	0.90%	1.10%	1.10%	1.20%	1.40%	1.50%	1.60%	1.60%
6 Month LIBID	0.85%	0.90%	0.90%	1.00%	1.20%	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%
12 Month LIBID	1.00%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%	1.60%	1.70%	1.80%	1.80%
5yr PWLB Rate	2.00%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
10yr PWLB Rate	2.40%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%

The flow of generally positive economic statistics after the end of the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, to 0.75%. However, the MPC emphasised again, that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years' time but they declined to give a medium term *forecast. We do not think that the MPC will increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. We also feel that the MPC is more likely to wait until August 2019, than May 2019, before the next increase, to be followed by further increases of 0.25% in May and November 2020 to reach 1.5%. However, the cautious pace of even these limited increases is dependent on a reasonably orderly Brexit.*

The balance of risks to the UK:

- *The overall balance of risks to economic growth in the UK is probably neutral.*
- *The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.*

(Link Asset Services, 03.10.2018)

5. Markets in Financial Instruments Directive (MiFID II)

5.1. From 3rd January 2018, the Financial Conduct Authority is obligated to treat all Local Authorities as “retail clients” under European Union legislation (MiFID II). The client status of the Local Authority relates to its knowledge and experience with regards to the use of regulated investment products and the decision-making processes it has in place for making such investments. The directive is focused on products such as Certificates of Deposit, Gilts, Corporate Bonds and investment funds, including Money Market Funds.

5.2. As at 31st October 2018 the Council has opted up to “professional status” with the following institutions to continue to have access to these funds as an investment option as they are not available to retail clients:

<u>Money Market Funds</u>

- Aberdeen
- Amundi
- Aviva
- BNP Paribas
- Goldman Sachs
- Invesco
- Morgan Stanley
- Federated Investors
- Insight
- Standard Life

<u>Banks</u>

- Australia and New Zealand Banking Group
- Commonwealth Bank of Australia
- Goldman Sachs International Bank
- Toronto Dominion Bank

Building Societies

- Coventry
- Leeds

Property Funds

- CCLA

6. Money Market Regulatory Changes

6.1. Effective from 21st January 2019 the European Securities and Markets Authorities has introduced structural changes with regards to the compliance of existing Money Market Funds (MMFs). This will mean that the structure of short-term MMFs currently utilised by the Council for investments will be changing.

6.2. Under the outgoing structure all funds in use by Sefton for deposits are classed as Constant Net Asset Value (CNAV). The fund is subscribed to in units of £1 in principal and the value of this asset does not materially fluctuate over time. Upon maturity, the total value of principal invested in the fund is returned.

6.3. The structural changes imposed under the new regulations will convert the funds used by Sefton to Low Volatility NAV (LVNAV) MMFs. LVNAV funds are permitted to maintain a constant dealing NAV provided that certain criteria are met, including that the market NAV of the Fund does not deviate from the dealing NAV by more than 20 basis points (0.20%). This means that they can value such investments at par, thus these investments should not affect the underlying Fund's NAV.

6.4. The Council's Treasury Management strategy permits the use of both constant and variable net asset value funds, and given that the underlying credit quality of these funds will not be adversely affected by these changes, it is envisaged that we will continue to use MMFs for short term liquidity needs after they have converted to LVNAV

6.5. Members should note that although these MMFs will maintain a constant net asset value for dealing purposes, there will be the potential for the value of the Council's investment to fluctuate in the unlikely event that the 20 basis point collar is exceeded due to movements in the market value of the underlying fund. Our investment portal provider (Institutional Cash Distributers) will provide daily updates on the market value of individual funds and these rates will be monitored closely by the Treasury Management Team.

7. Capital Financing Strategy

7.1. The Council is currently internally borrowed. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as an alternative measure. This strategy is prudent as investment returns remain low whilst reducing the Council's cost of borrowing. This position also reduces counterparty risk.

7.2. Due to the timing of grant income and revenues received during the financial year the profile of the Council's cash balances is front loaded. External borrowing in the short term may be required to maintain the Councils cash flow during March 2019 when it is forecast that up to £10m of borrowing may be required. Short term borrowing from another Local Authority with current offer rates at 0.85% over a 3-month period would incur an estimated £21k in additional loan charges.

7.3. Officers will continue to monitor the cash flow and report to members by the end of next quarter regarding any requirement for additional borrowing in March 2019.

8. Compliance with Treasury and Prudential Limits

8.1. During the quarter ended 30th September 2018, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

8.2. The key treasury indicators compared to the actuals as at 30th September 2018 are shown below:

External Debt:	2018/19 £m
Authorised limit for external debt	177.000
Operational boundary for external debt	167.000
Actual external debt 30.09.18	164.276

Maturity structure of fixed rate borrowing:	Upper Limit %	Lower Limit %	Actual %
Under 12 months	35	0	4
12 months to 24 months	40	0	4
24 months to 5 years	40	0	22
5 years to 10 years	40	0	16
10 years to 15 years	40	0	17
15 years +	90	25	37

Upper limit for principal sums invested for longer than 365 days:	Limit %	Actual %
Principal sums invested	40	19