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A meeting of the **Corporate Governance & Audit Committee** will be held in Committee Room 2 - East Pallant House on **Thursday 10 January 2019 at 9.30 am**

MEMBERS: Mrs P Tull (Chairman), Mrs P Plant (Vice-Chairman), Mr J Brown, Mrs N Graves, Mrs P Hardwick, Mr F Hobbs, Mr S Lloyd-Williams, Mr K Martin, Mr S Morley and Mr P Wilding

SUPPLEMENT TO AGENDA

- 6 **2018-19 Treasury Management half-year report** (Pages 1 - 9)
The committee is requested to consider the 2018-19 mid-year review of treasury management activity and performance and provide comments to the Cabinet as necessary.

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Chichester District Council

Corporate Governance and Audit Committee

10 January 2019

2018-19 Treasury Management half-year report

1. Contacts

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2. Recommendation

The committee is requested to:

- (a) That the committee considers this 2018-19 mid-year review of treasury management activity and performance and provides comments to the Cabinet as necessary.**

3. Background

- 3.1. The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that Authorities report on the performance of the treasury management function at least twice yearly (mid-year and at year end).
- 3.2. The Authority has continued to invest substantial sums of money and manage financial risks including the loss of invested funds and the revenue effect of changing interest rates. This report covers treasury activity and the associated monitoring and control of risk. It also highlights to Members relevant regulatory changes that will impact on the Council's next Treasury Management Strategy.

4. Treasury position at year end

- 4.1. This report this report describes the main outcomes from treasury activities undertaken to date in the 2018-19 financial year. These activities are undertaken within a framework set by Council's treasury management strategy for 2018-19, which was approved by Council on 6 March 2018.
- 4.2. On 28 September 2018, the Authority had investments of £69.2m with no external borrowing.

Table 1: Treasury Management Summary

Investments £000	Balance 01/04/2018	Movement	Balance 30/09/18
Short term Investments	21,000	16,000	37,000
Money Market Funds	9,800	(2,450)	7,350
Corporate Bonds	2,213	1,713	3,926
Total liquid investments	33,013	15,263	48,276
Long term Investments	3,000	-	3,000
Pooled Funds – External	7,950	--	7,950
Pooled funds – Local Authority Property fund	10,000	-	10,000
TOTAL INVESTMENTS	53,963	15,263	69,226

Note: the figures in the table above exclude any movements in Fair value..

5. Investment Activity

- 5.1. The Authority's objective when investing money is to comply with the Council's Treasury Strategy and Policy statement, including the Council's appetite for risk.
- 5.2. During the first half of 2018-19 uncertainty surrounding the accounting framework for fair value gains and losses following the application of IFRS9 to local authority accounts meant that the Council did not make further longer term investments in external pooled funds. This, together with this natural cycle for cash collection, which sees balances rise steadily until December and then fall back again in the final quarter of the financial year, has led to a significant jump in short term investments.
- 5.3. The Committee is due to consider the 2019-20 Treasury Strategy at its January meeting and the options to increase the Council's longer term investment, as well as options for 12 to 18 month term deposits will be built into this strategy following the clarification of the accounting framework at the end of 2018.
- 5.4. The other significant trend during the first half of the financial year has been a gradual move towards lending with Local Authorities as opposed to financial institutions as the uncertainty surrounding BREXIT continues. At 31 March 2018, lending to other local authorities comprised 22% of the portfolio, six months later this had increased to 39%.
- 5.5. The overall income return across the entire portfolio is shown below:

Table 2: Treasury Management returns

Measure	Qtr 3	Qtr4	Qtr 1	Qtr 2	Non-met districts Q2 average	Rating
	17-18	17-18	18-19	18-19		
Internal investment return %	0.57	0.70	0.77	0.83	0.78	GREEN
External funds – income return %	4.54	4.31	4.18	4.06	3.18	GREEN
External funds – capital gains/losses %	2.48	1.90	1.38	0.68	(0.28)	AMBER
Total treasury Investments – income return %	1.71	1.88	1.80	1.65	1.37	GREEN

5.4 The Council’s internal investment return has steadily increased following the Bank of England’s Monetary Policy Committee’s decision to raise interest rates in August.

5.5 Whilst the capital losses on the Council’s external funds are reducing in aggregate, overall capital returns for three of the funds have been weak and continue to be driven by investor reactions to the prospects of higher inflation and interest rates and concerns about global trade and tariffs. The benchmark score in the table above has been maintained at amber and more detail of the fair value movements is provided below in Table 3 and in Appendix A.

Table 3: Gains and losses from external pooled funds- 28 September 2018

Fund	Type of fund	Investment (£)	Capital gain (loss)	Market Value	Current return (Income)
Local Authority Property Fund	Property	10,000,000	(229,100)	9,770,900	4.3%
Investec Diversified Income Fund	Multi Asset	3,650,000	(87,200)	3,562,800	4.0%
Columbia Threadneedle Strategic Bond Fund	Bonds	2,650,000	(81,000)	2,569,000	2.9%
M&G Optimal Income Fund	Bonds	1,650,000	(3,500)	1,646,500	2.5%
Totals		17,950,000	(400,800)	17,549,200	

5.6 Officers have continued to monitor the impact of the implementation of IFRS9, which had the potential to increase volatility in revenue budgets if movements in fair values were required to be charged against the Council’s General Fund. Following consultation, the Government announced in November 2018 that it has decided to introduce a statutory override for fair value movements in pooled funds for at least five years until 31st March 2023.

6. Other non-Treasury holdings and activity

- 6.1. Although not classed as treasury management activities, the 2017 CIPFA Code now requires the Authority to report on investments for policy reasons outside of normal treasury management. This includes service investments for operational and/or regeneration as well as commercial investments which are made mainly for financial reasons. The Authority also holds £7.5m of investments in directly owned property.
- 6.2. These non-treasury investments generated a return of 6.7% against initial purchase cost. This is higher than the return earned on treasury investments but reflects the additional risks to the Authority of holding such investments.

7. Compliance report

- 7.1. Compliance with the main 2018-19 Treasury limits is shown in table 4 below

Table 4: Investment Limits

	2018/19 Limit	Complied/ Exception Ref
Banks unsecured, total	£20m	✓
Corporates, total	£10m	✓
Local Authority property fund, total	£10m	✓
Other pooled investment funds, total	£10m	✓
Council's own bank, total max 7 days	£2.5m	✓
Money market Funds, total	£20m	✓
Counterparty ratings	various	✓

- 7.2. There are no reportable exceptions for 2018=19 to date.

8. Other Treasury Management indicators

- 8.1. The Authority measures and manages its exposures to treasury management risks using the following indicators

Table 5: Treasury Management Security indicators

Measure	Qtr3	Qtr4	Qtr 1	Qtr 2	Non-met District average	Rating
	17-18	17-18	18-19	18-19		
Average Credit Score (time-weighted)	3.95	3.88	4.04	3.64	4.00	GREEN
Average Credit Rating (time weighted)	AA-	AA-	AA-	AA-	AA-	AMBER
Proportion Exposed to	41	41	46	32	56	GREEN

Bail-in (%)		
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- 8.2. The amber rating is not considered significant, but is reported here as, strictly, the formal target is to maintain the average credit rating below the time weighted average of other District Councils. The reduction in time weighted credit score is principally caused by the increase in holdings with UK local authorities.

Liquidity

Table 6: Treasury Management Liquidity Indicators

Measure	Qtr3 17-18	Qtr4 17-18	Qtr 1 18-19	Qtr 2 18-19	Non-met districts (average)	Rating
Proportion available within 7 days (%)	14	18	15	17	35	GREEN
Proportion available within 100 days (%)	46	50	45	47	58	GREEN
Average days to maturity	137	116	124	119	88	GREEN

Interest rate exposure

- 8.3. This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures are as follows, expressed as amounts of principal.

Table 7: Treasury Management Interest rate exposure

	28.9.18 Actual	2018/19 Limit	Complied
Upper limit on fixed interest rate exposure*	£3m	£28m	✓
Upper limit on variable interest rate exposure	£33m	£70m	✓

- 8.4. Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate

Principal Sums Invested for Periods Longer than 364 days

- 8.5. The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

Table 8: Treasury Management lon term investment indicators

	2018/19	2019/20	2020/21
Actual principal invested beyond year end	£20.95m	£20.95	£17.95m
Limit on principal invested beyond year end	£40m	£35m	£30m
Complied	✓	✓	✓

9. Other developments during 2018-19

- 9.1. CIPFA has now published new versions of the Prudential Code for Capital Finance in Local Authorities (Prudential Code) and the Treasury Management Code of Practice but has yet to publish the local authority specific Guidance Notes to the latter. The MHCLG published its revised Investment Guidance which came into effect from April 2018.
- 9.2. The updated Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, which is to be a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority has prepared a draft Capital Strategy which will be presented to this Committee in January 2019.

10. Outlook

- 10.1. Having raised policy rates in August 2018 to 0.75%, the Bank of England's Monetary Policy Committee (MPC) has maintained expectations of a slow rise in interest rates over the forecast horizon.
- 10.2. The MPC has a definite bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. Arlingclose's central case (Nov 2018) is for Bank Rate to rise twice in 2019, however these are based on there being a transition period following the UK's official exit from the EU. There remains significant downside risks to their forecasts.
- 10.3. The view is that the UK economy still faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. Central bank actions and geopolitical risks, such as prospective trade wars, have and will continue to produce significant volatility in financial markets, including bond markets. The last point is particularly relevant to the Council given its pooled investment portfolio.

11. Resource and legal implications

- 11.1. The Council is required by the Accounts and Audit Regulations to comply with CIPFA's Code of Practice for Treasury Management and the Prudential Code for Capital Finance.

12. Appendices

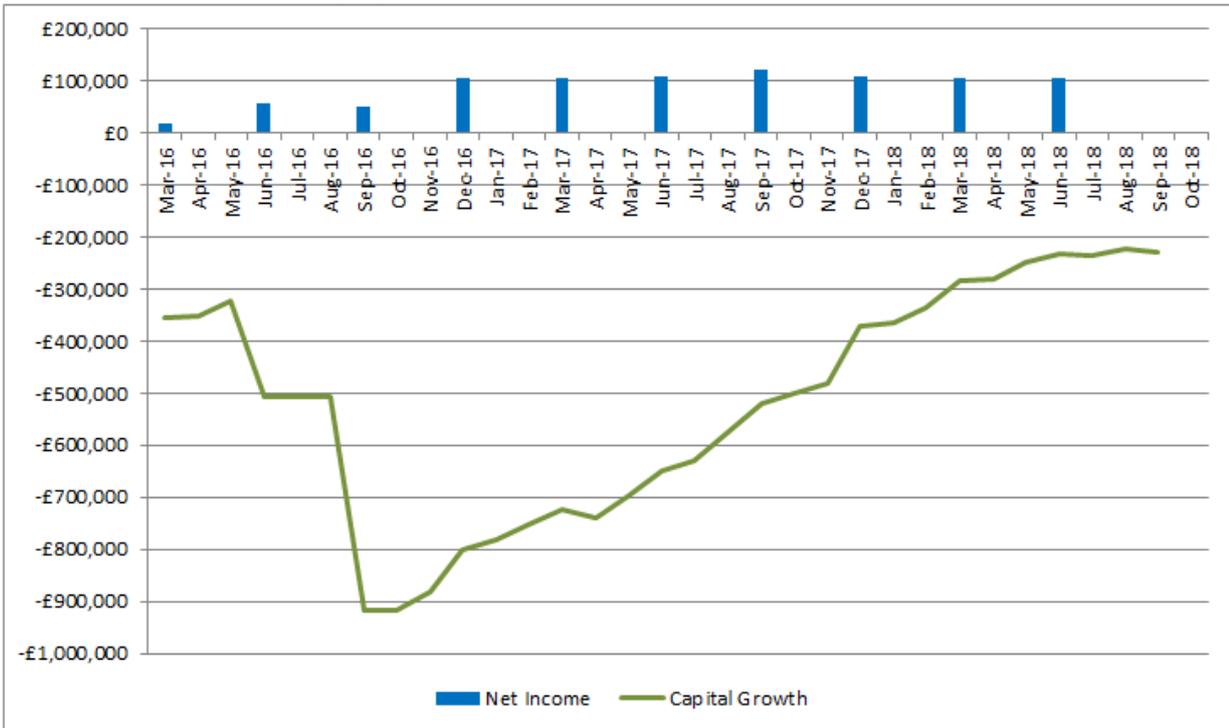
- 12.1. Appendix A – Movements in Fund fair values and income – Pooled Funds

13. Background Papers

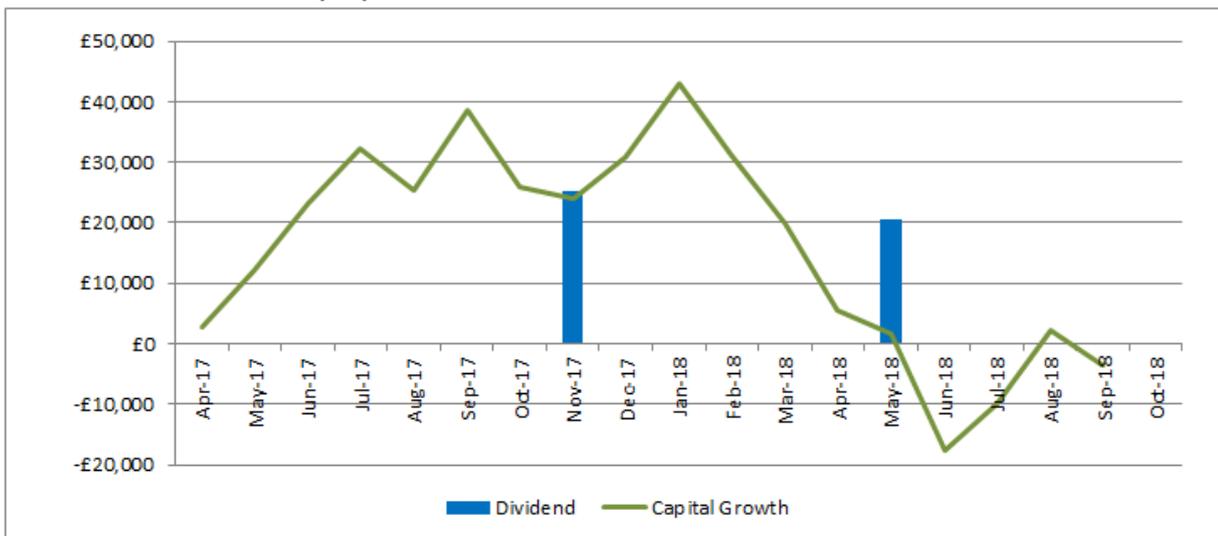
13.1. None.

Appendix A: Movements in Fund fair values and income – Pooled Funds

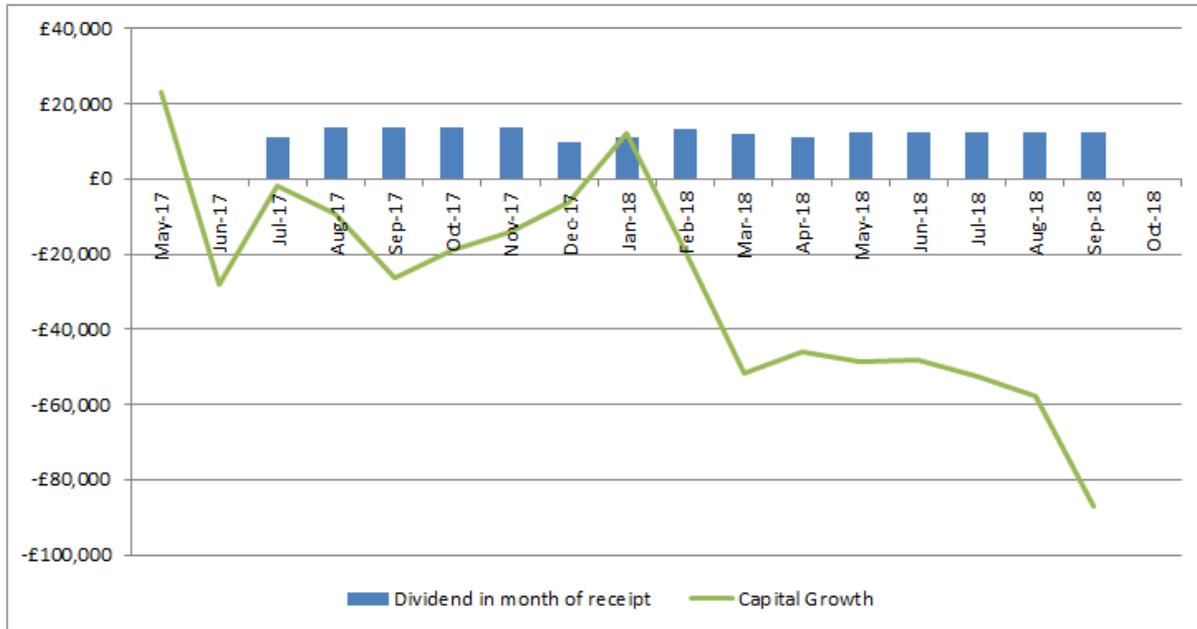
LAPF: Total Investment £10,000,000



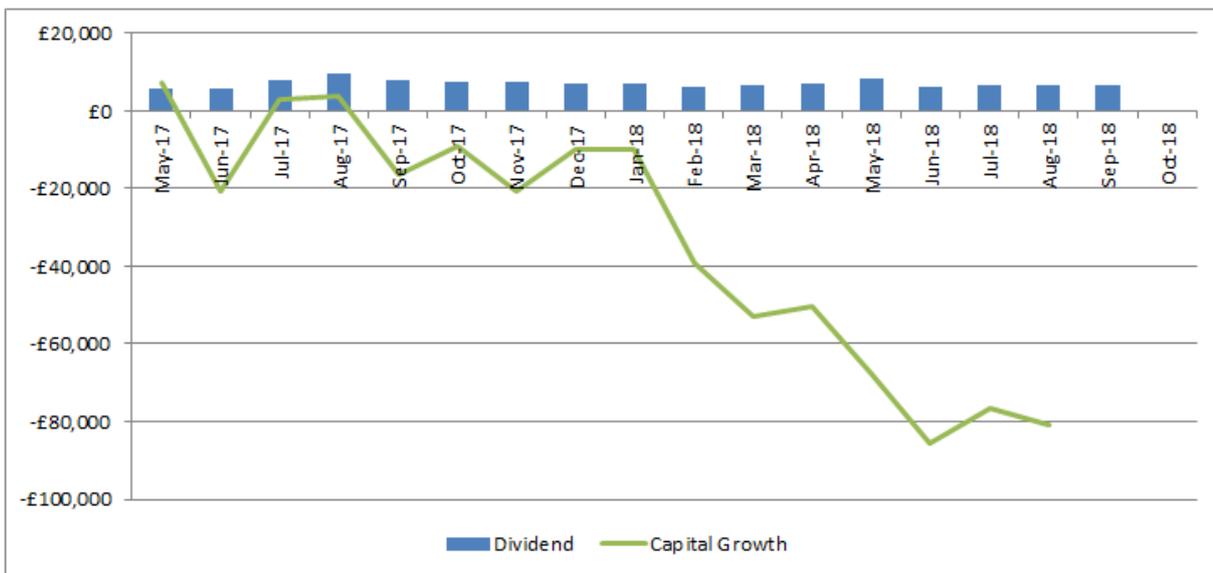
M&G: Total Investment £1,650,000



Investec: Total investment £3,650,000



Columbia Threadneedle: Total investment £2,650,000



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