Chichester District Council

THE CABINET 5 December 2017

Treasury Management – 2017-2018 Half-yearly Update

1. Contacts

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2. Recommendation

2.1. That the Cabinet considers the Treasury Management activity and performance for 2017-2018 to date together with any comments made by Corporate Governance and Audit Committee.

3. Background

3.1. The Treasury Management performance outlined in this report was considered by Corporate Governance and Audit Committee on 23 November 2017. A verbal update on this, and any comments or amendments requested, will be provided to the Cabinet before they consider this report.

3.2. The Authority has continued to invest substantial sums of money and presently has a Treasury portfolio in excess of £60m. The graph below shows the movement in various asset classes over the past year. The main changes being investments in the Local Authority Property Fund and other external funds starting February 2016 with a corresponding reduction in funds deposited with other Local Authorities over that same period.

3.3. The Council's Treasury team are presently responding to three important regulatory changes:

- The second Markets in Financial Instruments Directive (MiFID II)
- CIPFA's proposals to update the Prudential and Treasury Management Codes
- European Money Market Reform

3.4. These developments are summarised in Appendix 2 and any changes required to the draft 2018-19 Treasury Strategy are due to be considered by the Cabinet on 6 February 2018.

4. Borrowing

4.1. The Authority does not presently expect to undertake any borrowing in 2017/18.

5. Benchmarking

Security

Measure	Qtr3 16-17	Qtr4 16-17	Qtr 1 17-18	Qtr 2 17-18	Non-met District average	Rating
Average Credit Score (time-weighted)	4.01	4.07	4.18	4.27	4.28	AMBER
Average Credit Rating (time weighted)	AA-	AA-	AA-	AA-	AA-	GREEN
Proportion Exposed to Bail-in (%)	40	48	54	60	65	GREEN

5.1. The increase in average time weighted credit score over the period (4.18 to 4.27) since 31 June 2017 is driven by three investments in Corporate Bonds during Q2. Risk associated with these investments is managed by restricting the maximum amount and duration that investments can be made for.

Liquidity

Measure	Qtr3 16-17	Qtr4 16-17	Qtr 1 17-18	Qtr 2 17-18	Non-met districts (average)	Rating
Proportion available within 7 days (%)	21	24	17	18	38	GREEN
Proportion available within 100 days (%)	52	47	48	38	61	GREEN
Average days to maturity	176	174	177	161	108	GREEN

5.2. The relatively low proportion of funds available within 7 days reflects the Council's active management of its investments and the longer term investments made recently in pooled funds.

Return

Measure	Qtr3 16-17	Qtr4 16-17	Qtr 1 17-18	Qtr2 17-18	Non-met districts (average)	Rating
Internal investment return %	0.73	0.68	0.65	0.52	0.51	GREEN
External funds –	4.31	4.50	4.35	4.38	3.56	GREEN

income return %						
External funds – capital gains/losses %	(8.00)	(3.77)	(0.81)	2.19	0.99	GREEN
Total treasury Investments – income return %	1.29	1.37	1.93	1.62	1.12	GREEN
Property – income return % (1)			7.82			

[1] Note: This figure has been calculated from the Council's audited statement of accounts, adjusting for changes in fair value.

5.3. The overall internal investment return on internal treasury investments continues to exceed the benchmark measure. This quarter showed the first overall capital growth in the Council's pooled and property funds and as a result the indicator has been re-categorised as Green (from Red).

5.4. The return for the previous four quarters on our £10m investment in the Local Authority Property Fund is shown below

	Dividend £	Dividend % (p.a.)
October – December 2016	105,239	4.2
January 2017 – March 2017	105,216	4.2
April - June 2017	109,243	4.4
July - September 2017	123,123	4.8
Total for 12 months to September	442,821	4.5

5.5. The return on our investments with external pooled funds is as follows

	Balance £	Income return % (p.a.)
Investec	3,650,000	4.55
Columbia Threadneedle	2,650,000	3.55
M&G	1,650,000	No data yet[1]

6. Treasury management activity

6.1. The following exceptions have been recorded between April and September. Each was reported as soon as identified to the Council's Section 151 officer.

July 2017

- £2m was invested with National Counties Building Society. This amount exceeded the limit for unsecured building society deposits (£1m). The Council's Treasury system alerted officers to this exception but unfortunately

[1] M&G dividends are paid half yearly

the deal had already been confirmed with the broker and the Council was committed to honour it. The deposit was repaid in full on 13 October 2017.

- The Council's bank account was overdrawn by £54,000 overnight as a redemption requested from Standard Life did not arrive until the following day.

September 2017

- The limit on unsecured investments (£20m) was exceeded by £1m for 7 days. It is not possible to monitor this via the Council's Treasury management system and a reminder has been given to officers to conduct a manual check on this limit going forward. The investment made was above our minimum lending criteria (AA-) and for a very short period of 7 days.

7. Consultation

7.1. A workshop to help Members exercise proper oversight of Treasury Management activities is offered each year to all members. Members of the Corporate Governance and Audit Committee and the Cabinet in particular are encouraged to attend the next training session which is scheduled for 8 December.

8. Resource and Legal Implications

8.1. The Council has complied with all the relevant statutory and regulatory requirements that 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 demonstrates a low risk approach.

9. Other Implications

Are there any implications for the following?		
	Yes	No
Crime and Disorder		X
Climate Change Solar powered parking payment machines will reduce the electrical demands across our 29 car parks and thus have a positive impact on our environmental footprint.		X
Human Rights and Equality Impact		X
Safeguarding and Early Help		X
Other (please specify) e.g. biodiversity		X

10. Appendices

10.1. Appendix 1 – Economic and credit commentary
10.2. Appendix 2 – Regulatory update
10.3. Appendix 2 – Other Treasury Indicators

Appendix 1

Economic and credit commentary

Summarised from information provided by Arlingclose

Economic background: The major external influence on the Authority's treasury management going forward will be the UK's progress in negotiating its exit from the European Union and agreeing future trading arrangements. The domestic economy has remains relatively robust since the surprise outcome of the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff-edge, but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018/19.

Consumer price inflation reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports. However, this effect is expected to fall out of year-on-year inflation measures during 2018, removing pressure on the Bank of England to raise interest rates.

In contrast, the US economy is performing well and the Federal Reserve is raising interest rates in regular steps to remove some of the emergency monetary stimulus it has provided for the past decade. The European Central Bank is yet to raise rates, but has started to taper its quantitative easing programme, signalling some confidence in the Eurozone economy.

Credit outlook: High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Sluggish economies and fines for pre-crisis behaviour continue to weigh on bank profits, and any future economic slowdown will exacerbate concerns in this regard.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. In addition, the largest UK banks will ringfence their retail banking functions into separate legal entities during 2018. There remains some uncertainty over how these changes will impact upon the credit strength of the residual legal entities.
The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however remain very low.

Interest rate forecast: Following the Bank of England's decision on 2 November 2017 to increase Bank Rate by 0.25 percentage points, to 0.5% Arlingclose's updated central forecast is for the base rate to remain at 0.5% until December 2020, with equal upside and downside risk.

Appendix 2

Regulatory update

The second Markets in Financial Instruments Directive (MiFID II)

Local authorities are currently treated by regulated financial services firms as professional clients who can “opt down” to be treated as retail clients instead. But from 3rd January 2018, as a result of the second Markets in Financial Instruments Directive (MiFID II), local authorities will be treated as retail clients who can “opt up” to be professional clients, providing that they meet certain criteria. Regulated financial services firms include banks, brokers, advisers, fund managers and custodians, but only where they are selling, arranging, advising or managing designated investments.

To opt up to professional status, the authority must have an investment balance of at least £10 million, and the person authorised to make investment decisions on behalf of the authority must have at least one year’s relevant professional experience. In addition, the firm must assess that that person has the expertise, experience and knowledge to make investment decisions and understand the risks involved.

The main additional protection for retail clients is a duty on the firm to ensure that the investment is “suitable” for the client. However, local authorities are not protected by the Financial Services Compensation Scheme nor are they eligible to complain to the Financial Ombudsman Service whether they are retail or professional clients. It is also likely that retail clients will face an increased cost and potentially restricted access to certain products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice. The Council has declined to opt down to retail client status in the past as the costs were thought to outweigh the benefits.

The authority meets the conditions to opt up to professional status and intends to do so in order to maintain their current MiFID status.

CIPFA Prudential and Treasury Management Codes

The proposed changes to the Prudential Code include the production of a new high-level Capital Strategy report to full council which will cover the basics of the capital programme and treasury management.

Proposed changes to the Treasury Management Code include the potential for non-treasury investments such as commercial investments in properties, to come into the definition of “investments” as well as loans made or shares brought for service purposes.

Another proposed change is the inclusion of financial guarantees as instruments requiring risk management and addressed within the Treasury Management Strategy. Approval of the technical detail of the Treasury Management Strategy may be delegated to a committee rather than needing approval of full Council.

There are also plans to drop or alter some of the current treasury management indicators.

European Money Market Reform

The EU has been concerned about aspects of the present money market for some time and has recently issued regulations that will be implemented over the next 18 months until January 2019.
In short, the regulations mean that the majority of available Money Market Funds (MMF) will elect to become Low Volatility NAV during 2018. In ‘normal’ market circumstances, LVNAV should operate in the same way as our present funds, but under very stressed market conditions, it is possible that the value of funds invested in MMF will change.

At present the Council uses MMF for liquidity management. There are limited (and narrowing) options for other liquidity deposits other than the DMO or overnight deposits with banks and LVNAV funds will still offer benefits of diversification, security and liquidity.

Appendix 3

Other Treasury Management Indicators

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

Interest Rate Exposure: 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, expressed as the amount and proportion of net principal invested during the year were:

	2017-18	2018-19	2019-20
Upper limit on fixed interest rate exposure	£28m/40%	£24m/40%	£22m/40%
CDC Actual (30 September 2017)	£5m/8%		
Upper limit on variable interest rate exposure	£70m/100%	£60m/100%	£55m/100%
CDC Actual	£38.7m/63%[2]		

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. Instruments that mature during the financial year are classed as variable rate.

Principal Sums Invested for Periods Longer than 364 days: 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 actual principal sum invested to final maturities beyond 31 March 2018 is forecast to be:

	2017-18	2018-19	2019-20
Limit on principal invested beyond year end	£35m	£30m	£25m
CDC Actual (30 September 2017)	£23.9m	£20.9m	£23m

[2] The residual 29% is invested in asset classes where returns are based on dividend distributions rather than interest rates