Chichester District Council

CORPORATE GOVERNANCE AND AUDIT COMMITTEE 26 July 2018

2017-2018 Treasury Management Out-turn

1. Contacts

Report Author:
Mark Catlow - Group Accountant
Telephone: 01243 521076 E-mail: mcatlow@chichester.gov.uk

2. Recommendation

The Corporate Governance and Audit Committee is requested to:

Consider this 2017-2018-out turn position of the treasury management activity and performance and provide 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). This report follows a half yearly report presented to this committee on 23 November 2017.

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 during the 2017-18 financial year. These activities are undertaken within a framework set by Council's treasury management strategy for 2017-18, which was approved by Council on 7 March 2017.

4.2. On 31st March 2018, the Authority had investments of £53.9m with no external borrowing.

Table 1: Treasury Management Summary

Investments £000	**Balance 01/04/2017**	**Movement**	**Balance 31/03/18**
Short term Investments	24,305	(3,305)	21,000
Money Market Funds	11,000	(1,200)	9,800
Corporate Bonds	2,020	193	2,213
Total liquid investments	**37,325**	**(4,312)**	**33,013**
Long term Investments	5,000	(2,000)	3,000
Pooled Funds – External	-	7,950	7,950
Pooled funds – Local Authority Property fund	10,000	-	10,000
TOTAL INVESTMENTS	**52,325**	**1,638**	**53,963**

Note: the figures in the table above exclude any movements in Fair value. The return figure is income only.

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 2017-18, given the increasing risk and low returns from short-term unsecured bank investments, the Authority made greater use of Local Authority counterparties for short term investing and made further investments in long term external pooled funds with the aim of generating a steady income stream from classes of investment assets that are, by design, diversified.

5.3. The overall income return across the entire portfolio is shown below:

Table 2: Treasury Management returns

Measure	Qtr 1 17-18	Qtr2 17-18	Qtr 3 17-18	Qtr4 17-18	Non-met districts Q4 average	Rating
Internal investment return %	0.65	0.52	0.57	0.70	0.71	GREEN
External funds – income return %	4.35	4.38	4.54	4.31	3.39	
External funds – capital gains/losses %	(0.81)	2.19	2.48	1.90	0.07	AMBER
Total treasury Investments – income return %	1.29	1.62	1.71	1.88	1.41	

5.4 The Council's internal investment return has reduced very slightly over the final quarter. Following the Bank of England's Monetary Policy Committee (MPC)

February Inflation report which indicating that the MPC was keen to return inflation to the 2% target over a 18-24 month horizon, the Council has not sought to invest for periods over 6 months duration which has reduced returns slightly. Following the subsequent May MPC meeting this stance is now under review.

5.5 Whilst the capital losses on the Council's external funds are reducing in aggregate, officers reported to Council in earlier this year on the potential implications of IFRS9 in respect of these funds, particularly in respect of the possible impact on the Council's general fund of changes in market values.

5.6 The Corporate Governance and Audit Committee requested more information on how these funds are performing to allow them to fully assess this risk. Table 3 summarises the present performance of the Council's external pooled funds and is supported by a more detailed analysis Appendix A. The data covers to period to end June 2018, slightly beyond the end of the reporting financial year

Table 3: Gains and losses from external pooled funds

Fund	Type of fund	Investment (£)	Capital gain (loss)	Market Value	Current return (Income)
Local Authority Property Fund	Property	10,000,000	(248,015)	9,751,985	4.32%
Investec Diversified Income Fund	Multi Asset	3,650,000	(48,545)	3,601,455	4.12%
Columbia Threadneedle Strategic Bond Fund	Bonds	2,650,000	(66,030)	2,583,970	3.41%
M&G Optimal Income Fund	Bonds	1,650,000	(15,719)	1,634,281	3.21%
Totals		17,950,000	(378,309)	17,571,691	4.04%

5.7 Since the end of 2017 our investments in non-property pooled funds have been affected by weaknesses on the global bond markets, driven by investor reactions to the prospects of higher inflation and interest rates and concerns about global trade and tariffs.

5.8 Officers continue to monitor the market value of the funds, as well as the wider income return. The importance of this has been highlighted by the implementation from 1 April 2018 of IFRS9, which has the potential to increase volatility in revenue budgets if movements in fair values are required to be charged against the Council's General Fund.

5.9 At the date of this report, officers understand that the Ministry of Housing, Communities and Local Government intend to consult this summer on option to mitigate some of the increased volatility to Council reserves arising from this new accounting standard. We are still awaiting this to be published and will provide a verbal update if this position changes.

5.10 Despite these risks, in light of their strong income generation performance and the Authority's latest cash flow forecasts, investment in these funds has presently been maintained for the 2018/19 financial year in accordance with the approved Treasury Strategy.

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 £11.8m of investments in directly owned property. This represents an increase of £3.55m on the previous year due to the purchase of 2-3 East Street, Chichester.

6.2. These non-treasury investments generated £901k of investment income for the Authority after taking account of direct costs (but excluding fair value movements), representing a rate of return of 7.7%. 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 2017-18 Treasury limits is shown in table 4 below

Table 4: Investment Limits

	2017/18 Limit	**Complied/ Exception Ref**
Banks unsecured, total	£20m	3
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	2, 4
Money market Funds, total	£20m	✓
Counterparty ratings	various	1

7.2. The four reportable exceptions in the financial year were as follows;

Table 5: Exceptions

Reference	Exception	Action taken
1.	£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 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	This issue was reported to Corporate Governance Committee in November and following this meeting, procedures now require discussion with senior officer prior to verbal agreement of deals.

Reference	Exception	Action taken
2	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.	This issue was reported to Corporate Governance Committee in November. Interest paid was recovered from the third party.
3	The limit on unsecured investments (£20m) was exceeded twice during the year. Once by £1m for 7 days and by £0.5m for just under a month in October and November 2017.	This issue was reported to Corporate Governance Committee in November and following this meeting, the Council's daily investment was amended to include a specific check is carried out against this limit going forward
4	The Council's bank account was left overdrawn by £585,000 as funds were not brought back from Money market funds to cover expenditure.	The Council's daily processing checklist was not fully complied with. Further training and guidance has been provided to the member of staff.

8. Other Treasury Management indicators

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

Table 6: Treasury Management Security indicators

Measure	Qtr1 17-18	Qtr2 17-18	Qtr 3 17-18	Qtr 4 17-18	Non-met District average	Rating
Average Credit Score (time-weighted)	4.18	4.27	3.95	3.88	4.08	GREEN
Average Credit Rating (time weighted)	AA-	AA-	AA-	AA-	AA-	AMBER
Proportion Exposed to Bail-in (%)	54	60	41	41	53	GREEN

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 reduction in average duration of investments outlined in 7.4, below.

8.3. As ever, the Council's counterparty list was subject to a number of credit rating changes during the year, the most significant of which being;

(a) The downgrade by Moody's to the UK sovereign rating in September from Aa1 to Aa2.
(b) Moody's placed a number of UK banks' long-term ratings on review to reflect the impending ring-fencing of retail activity from investment banking
(c) Standard & Poor's (S&P) revising upwards the outlook of various UK banks and building societies to positive or stable and simultaneously affirmed their

long and short-term ratings, reflecting the institutions' resilience, progress in meeting regulatory capital requirements and being better positioned to deal with uncertainties and potential turbulence in the run-up to the UK's exit from the EU in March 2019

Liquidity

Table 7: Treasury Management Liquidity Indicators

Measure	Qtr1 17-18	Qtr2 17-18	Qtr 3 17-18	Qtr 4 17-18	Non-met districts (average)	Rating
Proportion available within 7 days (%)	17	18	14	18	32	GREEN
Proportion available within 100 days (%)	48	38	46	50	59	GREEN
Average days to maturity	177	161	137	116	109	GREEN

8.4. There are two main drivers for the reduction in average days to maturity seen above.

(a) The Council has actively maintained a short term position following the Bank of England's Monetary Policy Committee (MPC) February Inflation report indicating that the MPC was keen to return inflation to the 2% target over a 18-24 month horizon.

(b) In advance of bank ring-fence restructuring, Arlingclose advised in May 2017 adjusting downwards the maturity limit for unsecured investments to a maximum of 6 months for many counterparties.

Interest rate exposure

8.5. 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 8: Treasury Management Interest rate exposure

	31.3.18 Actual	**2017/18 Limit**	**Complied**
Upper limit on fixed interest rate exposure*	£3m	£28m	✓
Upper limit on variable interest rate exposure	£33m	£70m	✓

8.6. 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

8.7. 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 9: Treasury Management long term investment indicators

	2017/18	2018/19	2019/20
Actual principal invested beyond year end	£20.95m	£20.95	£17.95m
Limit on principal invested beyond year end	£35m	£30m	£25m
Complied	✓	✓	✓

9. Other Developments during 2017-2018

9.1. This section updates the Committee on relevant developments since the last report in November 2017.

Revised CIPFA codes

9.2. CIPFA published revised editions of the Treasury Management and Prudential Codes in December 2017. The required changes from the 2011 Code are being incorporated into Treasury Management Strategies and monitoring reports.

9.3. The 2017 Prudential Code introduces the requirement for a Capital Strategy which provides a high-level overview of the long-term context of capital expenditure and investment decisions and their associated risks and rewards along with an overview of how risk is managed for future financial sustainability. The Council expects to prepare a draft strategy in time for approval alongside the 2019-20 Treasury Management Strategy early in 2019.

MHCLG Investment Guidance and Minimum Revenue Provision (MRP)

9.4. In February 2018 the MHCLG (Ministry of Housing, Communities and Local Government) published revised Guidance on Local Government and Investments and Statutory Guidance on Minimum Revenue Provision (MRP).

9.5. Changes to the Investment Guidance include a wider definition of investments to include non-financial assets held primarily for generating income return and a new category called "loans" (e.g. temporary transfer of cash to a third party, joint venture, subsidiary or associate). The Guidance introduces the concept of proportionality, proposes additional disclosure for borrowing solely to invest and also specifies additional indicators. Investment strategies must detail the extent to which service delivery objectives are reliant on investment income and a contingency plan should yields on investments fall.

9.6. The Authority is aware of the MHCLG's changes to the Investment Guidance and will comply with any necessary changes as appropriate.

MiFID II

9.7. As a result of the second Markets in Financial Instruments Directive (MiFID II), from 3rd January 2018 local authorities were automatically treated as retail clients but could "opt up" to professional client status, providing certain criteria was met. The Council has met the conditions to opt up to professional status and has now done so where required.

10. Resource and Legal Implications

10.1. 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.

11. Appendices

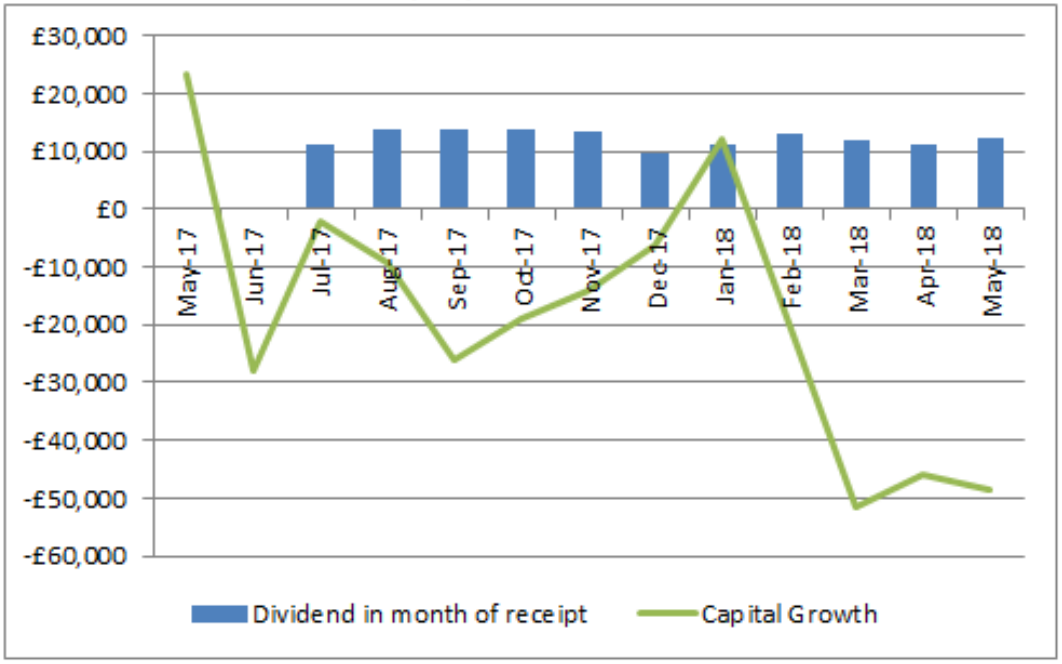
11.1. Movements in Fund fair values and income – Pooled Funds

12. Background Papers

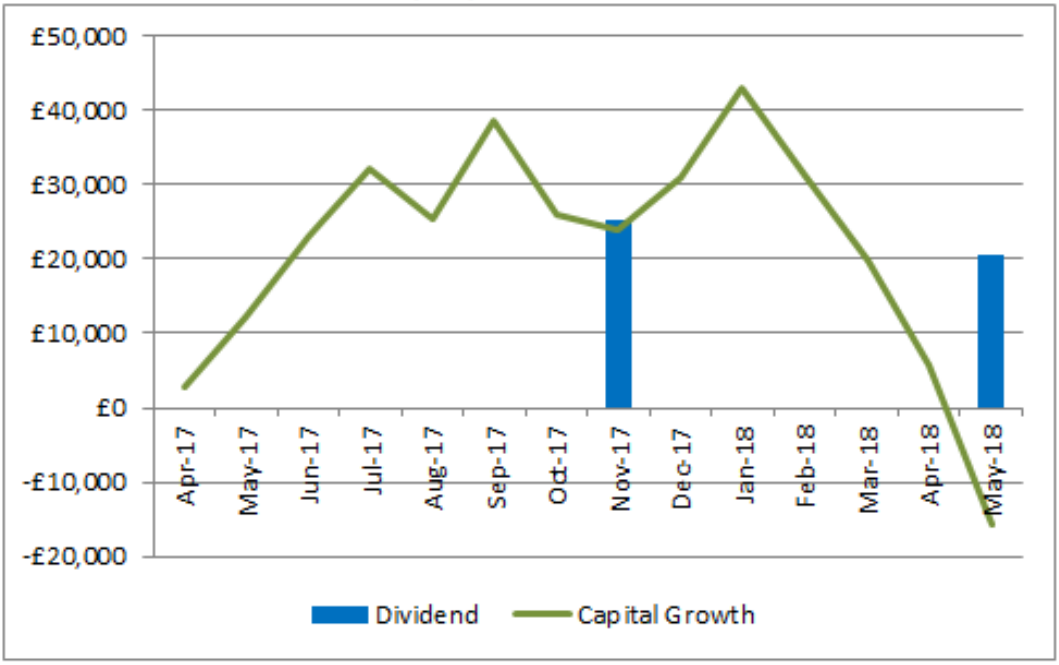
12.1. None.

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

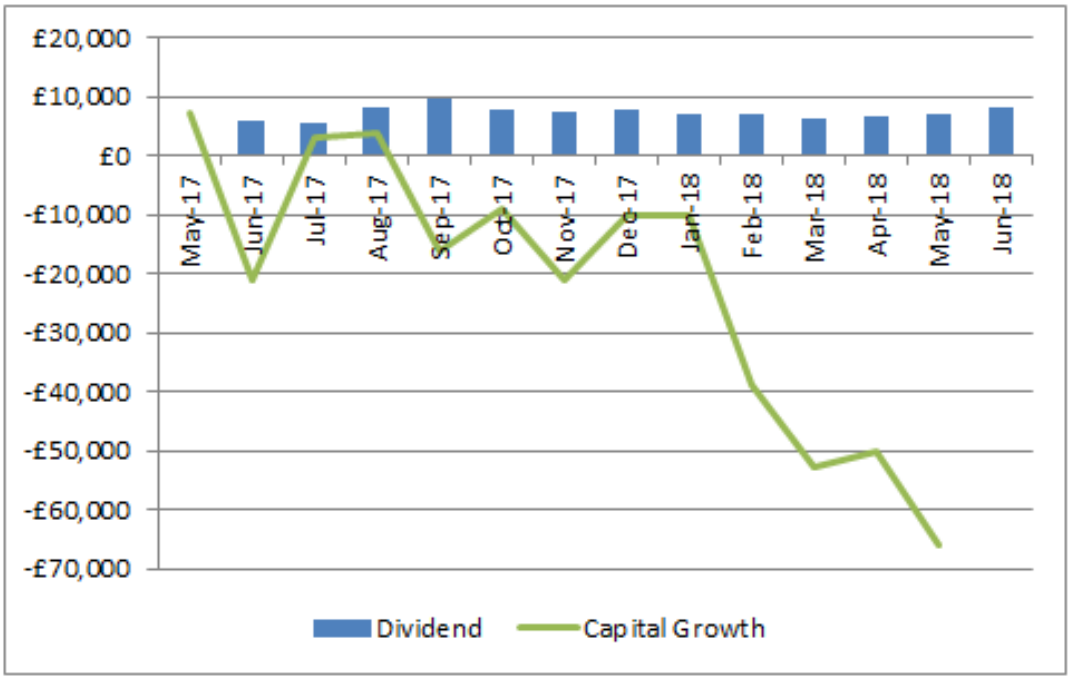
Investec: Total investment £3,650,000



M&G: Total Investment £1,650,000



Columbia Threadneedle: Total investment £2,650,000



LAPF: Total Investment £10,000,000