Chichester District Council

THE CABINET **5 February 2019**

2018-19 Treasury Management Half-Year Report

1. Contacts

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2. Recommendation

2.1. **That the Cabinet considers the Treasury Management activity and performance for 2018-2019 to date and the comments made by Corporate Governance and Audit Committee set out in the agenda report.**

3. Background

The Treasury Management performance outlined in this report was considered by Corporate Governance and Audit Committee on 10 January 2019 and a section of the outcomes following this meeting is included in this report.

3.1. The Authority has continued to invest substantial sums of money and presently has a Treasury portfolio in excess of £60m, as shown in table 1.

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.

4. Recommendation from the Corporate Governance and Audit Committee

4.1. Following its consideration of the investment performance outlined above, the Corporate Governance and Audit Committee recommended that a review of Chichester District Council's (CDC) portfolio of external fund investments is performed during 2019-20.

4.2. Officers support this recommendation and will work to finalise a methodology and terms for this review, which is expected to include:

- Restate/review the objectives for investing in the external pooled funds.
- Evaluate whether existing investments have met those objectives to date.
- Investigate whether other investment options might better meet the objectives in the future.

4.3. The Cabinet is invited to comment whether they are willing to support this proposal.

5. Investment Activity

5.1. The Authority's objective when investing money is to comply with CDC's Treasury Strategy and Policy statement, including CDC's appetite for risk.

5.2. During the first half of 2018-2019 uncertainty surrounding the accounting framework for fair value gains and losses following the application of IFRS9 to local authority accounts meant that CDC 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 Cabinet is due to consider the 2019-2020 Treasury Strategy at its February 2019 meeting and possibility of increasing CDC's longer term investments, as well as options for 12 to 18 month term deposits will be built into this strategy.

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:

<u>Table 2: Treasury Management returns</u>

Measure	Qtr 3 17-18	Qtr4 17-18	Qtr 1 18-19	Qtr 2 18-19	Non-met districts Q2 average	Rating

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 CDC'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 CDC'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 the appendix. Following Corporate and Governance Committee, the percent capital return to date for each fund has been added to this table.

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

Fund	Type of fund	Investment (£)	Market Value	Capital gain (loss) £	Cumulative Revenue income	Current return (capital)	Current return (Income)
Local Authority Property Fund	Property	10,000,000	9,770,900	(229,100)	995,598	(2.29)	4.3%
Investec Diversified Income Fund	Multi Asset	3,650,000	3,562,800	(87,200)	185,251	(2.39)	4.0%
Columbia Threadneedle Strategic Bond Fund	Bonds	2,650,000	2,569,000	(81,000)	113,682	(3.06)	2.9%
M&G Optimal Income Fund	Bonds	1,650,000	1,646,500	(3,500)	45,894	(0.21)	2.5%
Totals		17,950,000	17,549,200	(400,800)	1,340,425		

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 CDC'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 31 March 2023. The capital losses shown above, therefore, are not crystalised in CDC's accounts until the instrument is sold. It is not anticipated that these will be sold for the foreseeable future.

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 2018-2019 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 2018-2019 for the period covered by this report.

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 17-18	Qtr4 17-18	Qtr 1 18-19	Qtr 2 18-19	Non-met District average	Rating
Average Credit Score (time-weighted)	3.95	3.88	4.04	3.64	4.00	GREEN
Average Credit Rating	AA-	AA-	AA-	AA-	AA-	AMBER

(time weighted)						
Proportion Exposed to Bail-in (%)	41	41	46	32	56	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 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 long 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 2018-2019

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 the 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 the Cabinet in February 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 (November 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 CDC given its pooled investment portfolio.

11. Resource and Legal Implications

11.1. CDC 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

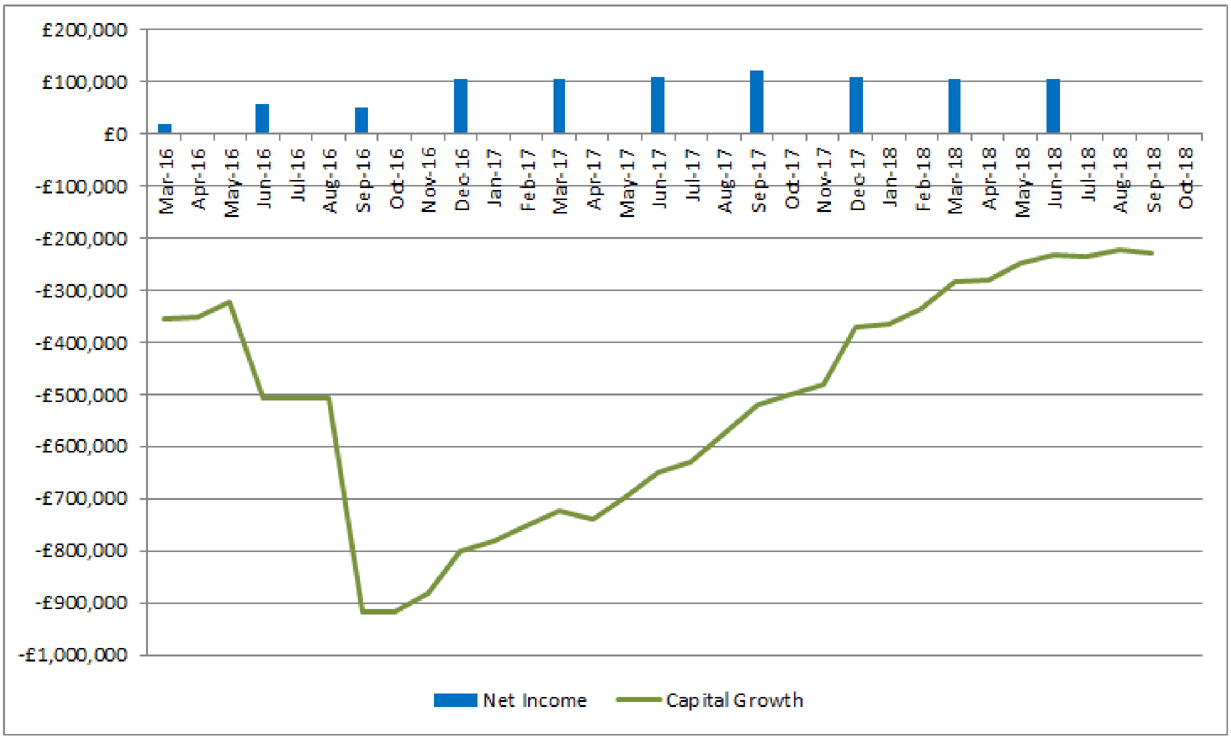
12.1. Appendix – Movements in Fund fair values and income – Pooled Funds

13. Background Papers

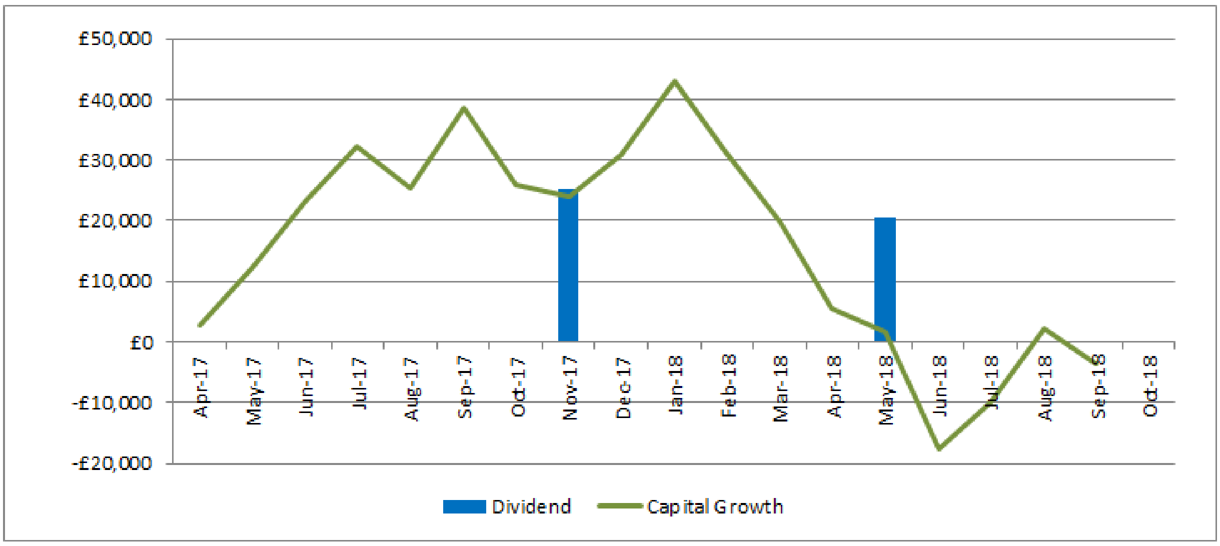
13.1. None.

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

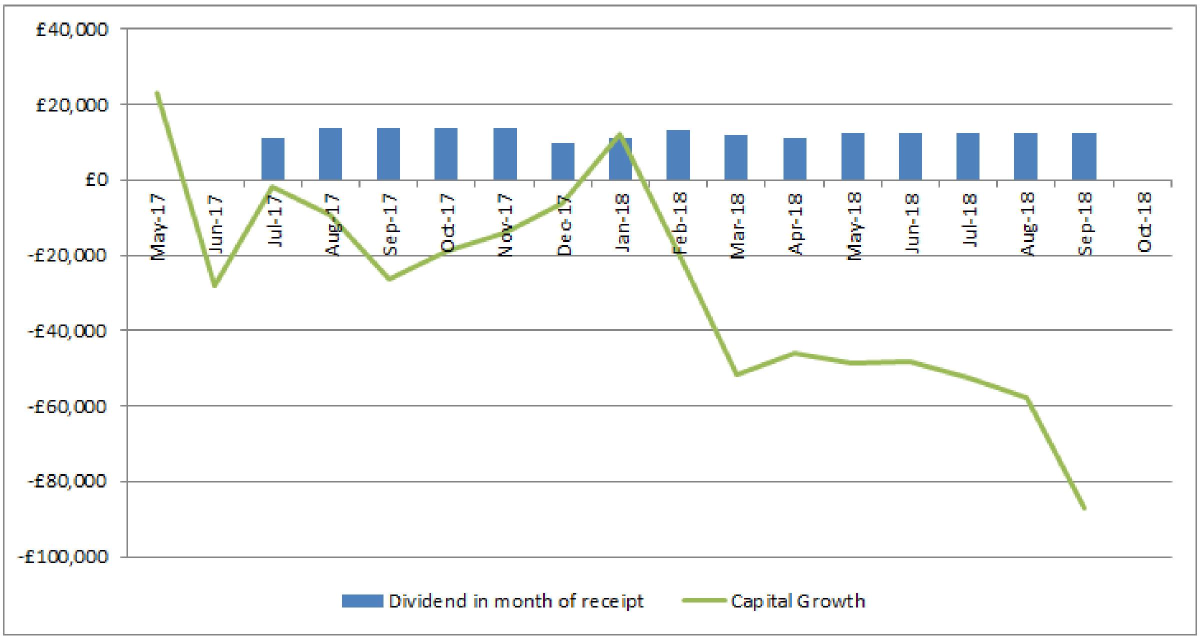
LAPF: Total Investment £10,000,000



M&G: Total Investment £1,650,000



Investec: Total investment £3,650,000



Columbia Threadneedle: Total investment £2,650,000