Treasury Management Mid-year Report for 2018/19

Summary

This Report advises members of the Treasury Management Service performance for 2018/19 as at 30th September 2018 and illustrates the compliance to-date with the Treasury Management Indicators for 2018/19.

Portfolio - Finance

Date signed off: - 12th November 2018

Wards Affected – All

Recommendation

The Executive is advised to NOTE and COMMENT on the report.

1. Executive Summary

1.1 This report sets out the performance of the Council's investments and borrowing for the first six months of the year. It is also intended to demonstrate that the Council is complying with the Treasury Management Indicators set by Full Council as part of the Treasury Management Strategy.

1.2 The Council is complying with all the Treasury Management Indicators set for 2018/19 as at the 30th September 2018.

2. Resource Implications

2.1 None directly as a result of this paper, but the investment income and borrowing costs do impact the revenue budget.

3. Key Issues

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 Council's Treasury Management Strategy for 2018/19 was approved by Executive on 21st February 2018.

3.3 Following consultation in 2017, CIPFA 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. In England MHCLG published its revised Investment Guidance which came into effect from April 2018.

3.4 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.

3.5 Through investment, the Council is potentially exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The Council seeks to moderate this impact by following the advice of its treasury advisers. This report covers treasury activity and the associated monitoring and control of risk.

Local Context

3.6 At 31 March 2018, the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £142.2m (an increase of £1.97m from 2016/17).

3.7 The Council's CFR is predicted to increase over the next 3 years due to the capital programme as currently known. Any further capital investment, for example in investment in property, would increase the CFR further still.

4. Treasury Performance

Borrowing Activity to 30th September 2018

4.1 At 30 September 2018 the Council held £125.0m of borrowing, (a decrease of £5.7m on 31/3/2018), which was used to fund the previous years' capital programmes – principally property investment.

4.2 At 30th September 2018, the Council had an upper authorised operational limit of borrowing £185m.

4.3 The Council's chief objective when borrowing continues to be striking an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective. On the advice of its treasury advisers, the Council has continued to borrow on a short term basis in order to take advantage of low interest rates and hence borrowing costs.

4.4 Borrowing has increased in the 6 month period due to investment property purchases.

Borrowing Position - 30.09.2018

	31.3.18 Balance £m	Movement £m	30.09.18 Balance £m	30.09.18 Weighted average rate %	30.09.18 Weighted average maturity years
Public Works Loan Board	16.10	12.94	29.04	2.76%	30.7
Local authorities (long-term)	0.77	(0.27)	0.50	0.00%	5.0
Local authorities (short-term)	102.50	(7.00)	95.50	0.56%	0.3
Total Borrowing	**119.37**	**5.67**	**125.04**	**1.11%**	**0.9**

Investment Activity to 30th September 2018

4.5 The Councils investment position at the half year is shown in the table below.

Investment Counterparty	Balance on 01/04/18	Investments Made	Maturities/ Investments Sold	Balance on 30/09/18	Average Income Rate at 30th September
	£000s	£000s	£000s	£000s	%
UK Central Government					
- Short Term	**0**	62,400	-61,500	**900**	0.30
UK Local Authorities					
- Long Term	**2,000**	0	0	**2,000**	1.30%
Banks, Building Societies & Other Organisations					
- Short Term	**572**	32,148	-32,620	**100**	0.14%
AAA-rated Money Market Funds					
- Short Term Cash Equivalents	**9,752**	30,180	-31,232	**8,699**	0.22%
- Long Term	**2,151**	46	0	**2,197**	4.52%
Total Investments	**14,475**	**124,774**	**-125,353**	**13,897**	**1.33%**

4.6 The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

4.7 The Council maintained its investment in the CCLA Longer Term Property Fund whilst the remainder of investments were placed invested in short-term unsecured deposits and money market funds. The £2m longer term investment generated an average total return of £92k (4.52%), comprising £46k income return which is used to support services in year, and £46k of capital growth. As this fund has no defined maturity date, but is available for withdrawal after a notice period, its performance and continued stability in meeting the Council's investment objectives are regularly reviewed. In light of its recent performance the investment in this fund has been maintained.

4.8 In order to bring Local Government accounting in line with commercial accounting IFRS 9 – Accounting for Financial Instruments – was adopted for the year 2018/19. One implication of this adoption was that certain investments, such as pooled funds, would need to be accounted for at fair value with unrealised losses impacting the General Fund rather than going to reserves as is currently the case. Following representations from Local Government MHCLG consulted on a time limited statutory override to mitigate the impact on the General fund of IFRS9 by allowing Council's to reverse the impact out. The Authority responded to the consultation which closed on 28th September and a final decision is awaited.

4.9 Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2018/19.

4.10 Counterparty credit quality was assessed and monitored with reference to credit ratings (the Council's minimum long-term counterparty rating for institutions defined as having "high credit quality" is A+ across rating agencies Fitch, S&P and Moody's); credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

4.11 Annex A lists the Council's investments as at the 30th September 2018.

Credit Risk

4.12 The table below shows counterparty credit quality as measured by credit Ratings.

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating	Time Weighted Average – Credit Risk Score	Time Weighted Average – Credit Rating
31.03.2018	4.42	AA-	3.65	AA-
30.09.2018	4.38	AA-	4.10	AA-

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 26
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

Budgeted Income and Outturn

4.13 The average cash balances were £10m during the half year. The Council's best performing investment was its £2m of externally managed pooled (property fund) which generated an average return of 4.52%.

4.14 The majority of the Council's investments were kept in short-term money market rates and have remained at relatively low levels although these have increased slightly following the Bank of England base rate increase from to 0.75% in August 2018.

4.15 The Council's investment income for the first six months was £82k compared to an annual budgeted figure of £160k.

Counterparty Update provided in association with Arlingclose Treasury Advisers

4.16 Credit background: Reflecting its perceived higher risk, the Credit Default Swap (CDS) spread for non-ringfenced bank NatWest Markets plc rose relatively sharply over the period to around 96bps. The CDS for the ringfenced entity, National Westminster Bank plc, has held steady below 40bps. Although the CDS of other UK banks rose marginally over the period, they continue to remain low compared to historic averages.

4.17 The ringfencing of the big four UK banks - Barclays, Bank of Scotland/Lloyds, HSBC and RBS/Natwest Bank plc – is complete, the transfer of their business lines into retail (ringfenced) and investment banking (non-ringfenced) is progressing and will need to be completed by the end of 2018.

4.18 There were a few credit rating changes during the period. Moody's downgraded Barclays Bank plc's long-term rating to A2 from A1 and NatWest Markets plc to Baa2 from A3 on its view of the credit metrics of the entities post ringfencing. Upgrades to long-term ratings included those for Royal Bank of Scotland plc, NatWest Bank and Ulster Bank to A2 from A3 by Moody's and to A- from BBB+ by both Fitch and Standard & Poor's (S&P). Lloyds Bank plc and Bank of Scotland plc were upgraded to A+ from A by S&P and to Aa3 from A1 by Moody's.

4.19 Our treasury advisor, Arlingclose will henceforth provide ratings which are specific to wholesale deposits including certificates of deposit, rather than provide general issuer credit ratings. Non-preferred senior unsecured debt and senior bonds are at higher risk of bail-in than deposit products, either through contractual terms, national law, or resolution authorities' flexibility during bail-in. Arlingclose's creditworthiness advice will continue to include unsecured bank deposits and CDs but not senior unsecured bonds issued by commercial banks.

Compliance with Treasury Management Indicators

4.20 The Council confirms compliance with its Treasury Management Indicators in the period to 30th September 2018. These were set in February 2018. Details of these indicators are shown in Annexes B and C.

Economic Review and Outlook for the remainder of the year

4.21 The Council's advisers Arlingclose have provided an Economic Review of the year so far and an outlook for Quarters 3 and 4. This is included in Annex D.

5. Options

5.1 The Executive is asked to note and comment on the report as appropriate.

6. Proposals

6.1 It is proposed that the Executive NOTE and COMMENT on the report;

7. Corporate Objectives and Key Priorities

7.1 The Treasury Management processes support the Council's objective of 'Delivering services efficiently, effectively and economically'.

8. Policy Framework

8.1 The Council fully complies with the requirements of the CIPFA Code of Practice on Treasury Management. The current relevant criteria and constraints incorporated into the Treasury Management Policy Statement are:

- New borrowing is to be contained within the limits approved by the Council, in accordance with the CIPFA Prudential Code for Capital Finance in Local Authorities, and the Council's prudential indicators.

- Investments to be made in accordance with the MHCLG guidance on Local Authority Investments, on the basis of Fitch, Moody's and Standard & Poors credit ratings and as detailed in the Treasury Management Policy statement and approved schedules and practices.

- Sufficient funds to be available to meet the Council's estimated outgoings for any day.

- Investment objectives are to maximise the return to the Council balanced against the risks to protect reserves.

9. Legal Issues

9.1 The report demonstrates that the Council is complying with the Prudential Framework.

10. Risk Management

10.1 Weak returns on investments could lead to a reduction in income generated to support the revenue budget.

10.2 The limits in this report in respect to counterparties and investments are the overall limits for agreement by Council. However from time to time these may be tightened temporarily by the Executive Head of Finance in consultation with the Portfolio Holder for Finance to reflect increased uncertainty and increase in perceived risk in financial institutions and the economy. This will usually be at the cost of lower returns.

10.3 The Council has taken and acted on advice from its advisers in relation to increasing returns albeit at increased risk and its borrowing strategy. There are risks that interest rates can change and that any investment is not guaranteed

10.4 The investments ratings provided by credit ratings agencies are only a guide and do not give 100% security. There is always a risk that an institution may be unable to repay its loans whatever the credit rating. However this can be mitigated by spreading investments amongst a number of institutions.

11. Officer Comments

11.1 None other than within the report.

Annexes	**Annex A – Investments as at 30th September 2018** **Annex B – Treasury Management Performance Indicators** **Annex C - Additional Compliance Information** **Annex D - Economic Review provided by the Council's Treasury Advisors**
Background papers	**CIPFA code on Treasury Management**
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Annex A

INVESTMENTS as at 30th September 2018

	£	Maturity Date	
Debt Management Office	900,000	12-Oct-18	AA
Total Central Government	**900,000**		
Glasgow City Council	2,000,000	30-Oct-18	Unrated
Total Local Authorities	**2,000,000**		
AAA Rated MM Fund - Blackrock	3,000,000	N/A	AAA
AAA Rated MM Fund - CCLA	1,000,000	N/A	AAA
AAA Rated MM Fund - Legal and General	3,000,000	N/A	AAA
AAA Rated MM Fund - Standard Life (Ignis)	1,700,000	N/A	AAA
Total Money Market Funds	**8,700,000**		
CCLA Property Fund	2,197,004	N/A	None
Total Longer Term Investments	**2,197,004**		
NatWest Bank Accounts	99,584	Instant Access	BBB+
Total Invested	**13,896,588**		

Annex B

Treasury Management Indicators as at the 30th September 2018

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

Interest Rate Exposures: 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 an amount of net principal borrowed will be:

	30.09.18 Actual	2018/19 Limit	Complied
Upper limit on fixed interest rate exposure	£0.2m	£190m	Yes
Upper limit on variable interest rate exposure	£0.3m	£190m	Yes

Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	Lower	Actual
Not over 1 year	100%	0%	77%
Over 1 but not over 2 years	100%	0%	0%
Over 2 but not over 5 years	100%	0%	2%
Over 5 but not over 10 years	100%	0%	2%
Over 10 but not over 15 years	100%	0%	1%
Over 15 but not over 20 years	100%	0%	1%
Over 20 but not over 30 years	100%	0%	1%
Over 25 but not over 30	100%	0%	3%
Over 30 but not over 40 years	100%	0%	6%
Over 40 years	100%	0%	7%
Total			**100%**

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal Sums Invested for Periods Longer than 365 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 limits on the total principal sum invested to final maturities beyond the period end will be:

	2018/19	**2019/20**	**2020/21**
Limit on principal invested beyond year end	£17m	£17m	£17m
Actual	£4m		

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average [credit rating] or [credit score] of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

	Target	**Actual 30/09/2018**
Portfolio average credit rating	A+	AA-

Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

	Target	**Actual 30/09/2018**
Total cash available within 3 months	£5m	£7m

Annex C

Additional Compliance Information

The Authority reports that all treasury management activities undertaken during complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in the table below:

Investment Limits

	2018/19 Limit	30.9.18 Actual	Complied
Any single organisation, except the UK Government	£3m each	£2.0m	Yes
UK Central Government	Unlimited	0	Yes
Any group of organisations under the same ownership	£3m per group	£0.1m	Yes
Any group of pooled funds under the same management	£5m per manager	£2.1m	Yes
Negotiable instruments held in a broker's nominee account	£10m per broker	0	Yes
Limit per non-UK country	£2m per country	0	Yes
Registered providers	£5m in total	0	Yes
Unsecured investments with building societies	£5m in total	0	Yes
Loans to unrated corporates	£2m in total	0	Yes
Money Market Funds	£10m in total	£8.7m	Yes

Compliance with the authorised limit and operational boundary for external debt is demonstrated in the table below.

	30.09.18 Actual	2018/19 Operational Boundary	2018/19 Authorised Limit	Complied
Borrowing	£125m	£185m	£190m	Yes

Annex D

Economic Review provided by the Council's Treasury Advisors, Arlingclose

Economic background: Oil prices rose by 23% over the six months to around $82/barrel. UK Consumer Price Inflation (CPI) for August rose to 2.7% year/year, above the consensus forecast and that of the Bank of England's in its August Inflation Report, as the effects of sterling's large depreciation in 2016 began to fade. The most recent labour market data for July 2018 showed the unemployment rate at 4%, its lowest since 1975. The 3-month average annual growth rate for regular pay, i.e. excluding bonuses, was 2.9% providing some evidence that a shortage of workers is providing support to wages. However real wages (i.e. adjusted for inflation) grew only by 0.2%, a marginal increase unlikely to have had much effect on households.

The rebound in quarterly GDP growth in Q2 to 0.4% appeared to overturn the weakness in Q1 which was largely due to weather-related factors. However, the detail showed much of Q2 GDP growth was attributed to an increase in inventories. Year/year GDP growth at 1.2% also remains below trend. The Bank of England made no change to monetary policy at its meetings in May and June, however hawkish minutes and a 6-3 vote to maintain rates was followed by a unanimous decision for a rate rise of 0.25% in August, taking Bank Rate to 0.75%.

Having raised rates in March, the US Federal Reserve again increased its target range of official interest rates in each of June and September by 0.25% to the current 2%-2.25%. Markets now expect one further rise in 2018.

The escalating trade war between the US and China as tariffs announced by the Trump administration appeared to become an entrenched dispute, damaging not just to China but also other Asian economies in the supply chain. The fallout, combined with tighter monetary policy, risks contributing to a slowdown in global economic activity and growth in 2019.

The EU Withdrawal Bill, which repeals the European Communities Act 1972 that took the UK into the EU and enables EU law to be transferred into UK law, narrowly made it through Parliament. With just six months to go when Article 50 expires on 29th March 2019, neither the Withdrawal Agreement between the UK and the EU which will be legally binding on separation issues and the financial settlement, nor its annex which will outline the shape of their future relationship, have been finalised, extending the period of economic uncertainty.

Financial markets: Gilt yields displayed marked volatility during the period, particularly following Italy's political crisis in late May when government bond yields saw sharp moves akin to those at the height of the European financial crisis with falls in yield in safe-haven UK, German and US government bonds. Over the period, despite the volatility, the bet change in gilt yields was small. The 5-year benchmark gilt only rose marginally from 1.13% to 1.16%. There was a larger increase in 10-year gilt yields from 1.37% to 1.57% and in the 20-year gilt yield from 1.74% to 1.89%. The increase in Bank Rate resulted in higher in money markets rates. 1-month, 3-month and 12-month LIBID rates averaged 0.56%, 0.70% and 0.95% respectively over the period.

Outlook for the remainder of 2018/19

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.

The MPC has a definite bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. While policymakers are wary of domestic inflationary pressures over the next two years, it is believed that the MPC members consider both that (a) ultra-low interest rates result in other economic problems, and that (b) higher Bank Rate will be a more effective weapon should downside Brexit risks crystallise and cuts are required.

Arlingclose's central case is for Bank Rate to rise twice in 2019. The risks are weighted to the downside. The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in Q2 2018, but the annual growth rate of 1.2% remains well below the long term average

	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Ca	0.75	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
Downside risk	0.00	0.00	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75

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.