AUDIT COMMITTEE

Date of Meeting	Wednesday 27th March 2019
Report Subject	Treasury Management Quarterly Update 2018/19
Cabinet Member	Leader and Cabinet Member for Finance
Report Author	Corporate Finance Manager
Type of Report	Operational

EXECUTIVE SUMMARY

The report provides an update on matters relating to the Council's Treasury Management Policy, Strategy and Practices 2018/19 to the end of February 2019.

RECOMMENDATIONS	
1	Members note the Treasury Management 2018/19 quarterly update.

REPORT DETAILS

1.00	**EXPLAINING THE QUARTERLY UPDATE**
1.01	The Council has nominated the Audit Committee to be responsible for ensuring effective scrutiny of Treasury Management Strategy and Policies. The Audit Committee has previously agreed to include Treasury Management as a standing item on each quarterly agenda to receive an update.
1.02	On 16th February 2016 the Council approved the Treasury Management Policy Statement 2016-2019 and Treasury Management Practices 2016-2019, following the recommendation of the Cabinet and consideration by the Audit Committee.

1.03	On 20th February 2018, the Council approved the Treasury Management Strategy 2018/19, following the recommendation of the Cabinet and consideration by the Audit Committee.
1.04	A statement setting out the Council's investments as at 28th February 2019 is attached at Appendix 1 and shows that the investment balance at this time was £17.7m, spread across 6 counterparties with an average investment rate of 0.75%.
1.05	A schedule of outstanding loans as at 28th February 2019 is attached as Appendix 2, with total long-term borrowing of £271.3m with a weighted average interest rate of 4.79%.
1.06	Appendix 3 shows the Council's short term borrowing as at 28th February 2019. The total amount of loans outstanding was £27.0m with an average interest rate payable of 0.94%.
1.07	The borrowing strategy throughout 2018/19 has been to monitor capital expenditure plans to confirm the Council's long term borrowing need. This is to ensure that the Council does not commit to long term borrowing too early and borrow unnecessarily which will be costly. Short term borrowing continues to be available at much lower rates than long term borrowing and is currently being utilised as far as possible without exposure to excessive refinancing risk. The structure of the Council's borrowing portfolio is constantly being reviewed as interest rates are forecast to rise, using current forecasts short term borrowing will be more cost effective over the medium term compared with long term borrowing. In the near future it is likely that borrowing long term could represent a better deal over the long term but this would be more expensive in the short to medium term and will reduce the flexibility of our debt portfolio. The position is finely balanced and is being monitored closely.
1.08	**<u>Economic update – Provided by Arlingclose</u>** The uncertain political situation surrounding Brexit has produced the prospect of divergent paths for UK monetary policy. Recent political manoeuvrings appear aimed at avoiding the worst-case Brexit scenarios, which may suggest reduced downside risks to the economic outlook and the interest rate forecast, although it is too soon to reflect this in the Arlingclose forecast. The Bank of England Monetary Policy Committee (MPC) bias towards tighter monetary policy remains, but appears to have eased a little on the back of slower global and UK growth/inflation expectations. Policymakers are unlikely to raise Bank Rate unless there is a withdrawal arrangement and the prospect of a transitionary period. Both our projected outlook and the increase in the magnitude of political and economic risks facing the UK economy means we maintain the significant downside risks to our forecasts, despite the potential for stronger growth following an extension to Article 50 or a withdrawal agreement as business investment/general confidence recovers. The potential for severe economic outcomes in the short term is uncomfortably higher than it should be. We

	expect the Bank of England to hold at or reduce interest rates from current levels if Brexit risks materialise. The UK economic environment appears relatively soft, despite seemingly strong labour market data. Uncertainty surrounding Brexit and global growth is damaging consumer and business sentiment. GDP growth slowed markedly in Q4 2018 and has not recovered in Q1 2019. Our view is that the UK economy faces a challenging outlook as the country exits the European Union and Eurozone/global economic growth softens, notwithstanding a possible short term bounce in activity should a Brexit deal be agreed. Cost pressures have eased due to a fall in oil prices. The apparent tight labour market risks longer term domestically-driven inflationary pressure whatever the external inflation effects. Wage growth has picked up in recent months. Global economic growth has eased and the economic/political outlook has prompted central banks to reduce expectations for on-going monetary tightening. Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets. The optimism about global growth evident in the second half of 2017 continued into 2018, with repercussions for central bank decision-making and interest rate expectations. Expectations for the US economy in particular were riding high, after strong Q3 GDP growth and the Donald Trump-driven tax reforms eventually passed late in 2017, while Eurozone activity continued to strengthen.
1.09	**<u>Interest Rate Forecast</u>** Arlingclose Ltd, the Council Treasury Management Advisors have provided an interest rate projection, which is for a Bank Rate rise of 0.25% in December 2019 and June 2020. Any borrowing that the Council undertakes is linked to Gilt yields, which have remained at low levels. The Arlingclose projection is for some upward movement from current levels based on a Brexit transitionary period. However, the projected weak economic outlook and volatility arising from both economic and political events will continue to offer borrowing opportunities.
1.10	**<u>Credit Rating Update</u>** Arlingclose have informed the Council that the credit ratings agency Fitch has placed the long-term ratings of UK banks on Rating Watch Negative (RWN). This means that the credit ratings agency is considering lowering the company's credit rating. Arlingclose has advised the RWN reflects the heightened uncertainty over the ultimate outcome of the Brexit process and the increased risk of a disruptive 'no-deal' Brexit, where the UK leaves the EU without a withdrawal agreement in place. Arlingclose have advised the Council that they are comfortable with the Council continuing making deposits with a majority of UK banks, in compliance with our Treasury Strategy. However where a credit rating agency announces that the rating for a company is under review for possible downgrade leading to a possibility that the rating could fall below the Council's investment criteria, then the Council will make no further investments in that company until the outcome of the review is announced.

1.11	**No-Deal Brexit Preparations** To ensure the Council is prepared to manage the risks associated with a no deal Brexit the Council has sought advice from Arlingclose and devised an action plan to address the following risks to mitigate risks arising from a no-deal scenario; • Security and liquidity of the Council's investments, • Legislative changes that would impact immediate Treasury operations, and; • The availability of cash to borrow post Brexit. **Security and Liquidity of Portfolio:** In advance of the Brexit leaving date of the 29th of March, all investments which are held by the Council will be invested in the Debt Management Office (DMO)'s deposit account. Holding the Council's cash with a Central Government deposit is considered the most secure location. After the leaving date the Council and Arlingclose will be better placed to assess the risk of continuing to invest in Money Market Funds (MMFs) and Banks. **Impact of Legislative changes:** The main consideration in the short term for the Council will be the 'passporting' for organisations we borrow and invest with. This means that if an organisation is registered with their local regulator (FCA in the UK), then no further registration will be required to for the organisation to operate. The local registration will 'passport' into all EU countries and vice versa. The UK is proposing to put in place a temporary permissions regime to allow EU entities and funds currently passported into the UK under the EU financial service legislation to continue to operate in the UK for a limited period after 29 March 2019. The temporary permission regime will be available for up to three years after this period while an alternative regime is being agreed. This should allow a smooth continuation of investment in MMFs domiciled outside the UK post Brexit. **Availability of Cash post-Brexit:** The Council manages its daily cash requirement on the basis of estimated cash flows and has put in place the necessary arrangements to ensure that it has sufficient cash in place to cover the Brexit and year end period. If there is a no deal Brexit this will probably support the local authority borrowing market. Other Local Authorities will be taking a risk averse approach to Treasury Management around the Brexit date and will be making short term investments with other Local Authorities. Overall the Council is comfortable that it will be able to secure cash to cover our short term day-to-day cash requirements.

2.00	**RESOURCE IMPLICATIONS**
2.01	The financial implications of changes to investing and borrowing rates as set out in the report will be factored into the next revenue budget report; no other resource implications directly as a result of this report.

3.00	**CONSULTATIONS REQUIRED / CARRIED OUT**
3.01	Arlingclose Ltd, being the Council's treasury management advisors.

4.00	**RISK MANAGEMENT**
4.01	Risk Management directly addressed within the report.

5.00	**APPENDICES**
5.01	1. Investment Portfolio as at 28th February 2019 2. Long Term Borrowing Portfolio as at 28th February 2019 3. Short Term Borrowing Portfolio as at 28th February 2019

6.00	**LIST OF ACCESSIBLE BACKGROUND DOCUMENTS**
6.01	**Contact Officer:** Paul Vaughan – Technical Finance Manager **Telephone:** 01352 702289 **E-mail:** paul.vaughan@flintshire.gov.uk

7.00	**GLOSSARY OF TERMS**
7.01	**Bank Rate:** The official interest rate set by the Bank of England's Monetary Policy Committee and what is generally termed at the "base rate". **Basis Point:** A unit of measure used in finance to describe the percentage change in the value or rate of a financial instrument. One basis point is equivalent to 0.01% (1/100th of a percent). In most cases, it refers to changes in interest rates and bond yields. For example, if interest rates rise by 25 basis points, it means that rates have risen by 0.25% percentage points. **Bond:** A certificate of debt issued by a company, government, or other institution. The bond holder receives interest at a rate stated at the time of issue of the bond. The price of a bond may vary during its life. **Capital Expenditure:** Expenditure on the acquisition, creation or enhancement of capital assets. **Capital Financing Requirement (CFR):** The Council's underlying need to borrow for capital purposes representing the cumulative capital expenditure of the local authority that has not been financed.

Credit Default Swaps: Similar to an insurance policy against a credit default.

Certificates of Deposits (CD's): A savings certificate entitling the bearer to receive interest. A CD bears a maturity date, a specified fixed interest rate and can be issued in any denomination. CDs are generally issued by commercial banks. The term of a CD generally ranges from one month to five years.

Cost of Carry: The "cost of carry" is the difference between what is paid to borrow compared to the interest which could be earned. For example, if one takes out borrowing at 5% and invests the money at 1.5%, there is a cost of carry of 3.5%.

Consumer Price Index (CPI): The UK's main measure of inflation (along with Retail Price Index or 'RPI') The Monetary Policy Committee of the Bank of England set the Bank Rate in order to try and keep CPI at or close to the target set by the Government. The calculation of CPI includes many items of normal household expenditure but excludes some items such as mortgage interest payments and Council Tax.

Credit Rating: Formal opinion by a registered rating agency of a counterparty's future ability to meet its financial liabilities; these are opinions only and not guarantees.

Corporate Bonds: Corporate bonds are bonds issued by companies. The term is often used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies.

Counterparty List: List of approved financial institutions with which the Council can place investments.

Custodian: A custodian is a financial institution that holds customers' securities for safekeeping to minimise the risk of their theft or loss. Most custodians also offer other services, such as account administration, transaction settlements, collection of dividends and interest payments and foreign exchange.

Debt Management Office (DMO): The DMO is an Executive Agency of Her Majesty's Treasury and provides direct access for local authorities into a government deposit facility known as the Debt Management Account Deposit Facility (DMADF). All deposits are guaranteed by HM Government and therefore have the equivalent of a sovereign credit rating.

Federal Reserve: The US central bank, the equivalent of the Bank of England. (Often referred to as "the Fed").

Financial Instruments: Financial instruments are tradable assets of any kind. They can be cash, evidence of an ownership interest in an entity, or a contractual right to receive or deliver cash or another financial instrument.

Gilts: Gilts are bonds issued by the UK Government. They take their name from 'gilt-edged'. They are deemed to be very secure as the investor expects to receive the full face value of the bond to be repaid on maturity.

LIBID: The London Interbank Bid Rate (LIBID) is the rate bid by banks on Eurocurrency deposits (i.e. the rate at which a bank is willing to borrow from other banks).

LIBOR: The London Interbank Offered Rate (LIBOR) is the rate of interest that banks charge to lend money to each other. The British Bankers' Association (BBA) work with a small group of large banks to set the LIBOR rate each day. The wholesale markets allow banks who need money to borrow from those with surplus amounts. The banks with surplus amounts of money are keen to lend so that they can generate interest which it would not otherwise receive.

LOBO: Stands for Lender Option Borrower Option. The underlying loan facility is typically very long-term - for example 40 to 60 years - and the interest rate is fixed. However, in the LOBO facility the lender has the option to call on the facilities at pre-determined future dates. On these call dates, the lender can propose or impose a new fixed rate for the remaining term of the facility and the borrower has the 'option' to either accept the new imposed fixed rate or repay the loan facility.

IFRS: International Financial Reporting Standards.

Maturity: The date when an investment or borrowing is repaid.

Maturity Structure / Profile: A table or graph showing the amount (or percentage) of debt or investments maturing over a time period.

Monetary Policy Committee (MPC): Government Body that sets the Bank Rate. Its primary target is to keep inflation within 1% of a central target of 2%. Its secondary target is to support the Government in maintaining high and stable levels of growth and employment.

Money Market Funds (MMF): Pooled funds which invest in a range of short term assets providing high credit quality and high liquidity.

MiFID II (Markets in Financial Instruments Directive): EU legislation that regulates firms who provide services to clients linked to 'financial instruments'. As a result of MiFID II, from 3rd January 2018 local authorities will be treated as retail clients but can "opt up" to professional client status, providing that they meet certain qualitative and quantitative criteria.

Minimum Revenue Provision (MRP): An annual provision that the Council is statutorily required to set aside and charge to the Revenue Account for the repayment of debt associated with expenditure incurred on capital assets.

Non Specified Investment: Investments which fall outside the WG Guidance for Specified investments (below).

Operational Boundary: This linked directly to the Council's estimates of the CFR and estimates of other day to day cash flow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

Premiums and Discounts: In the context of local authority borrowing,
(a) the premium is the penalty arising when a loan is redeemed prior to its maturity date and
(b) the discount is the gain arising when a loan is redeemed prior to its maturity date.

Prudential Code: Developed by CIPFA and introduced in April 2004 as a professional code of practice to support local authority capital investment planning within a clear, affordable, prudent and sustainable framework and in accordance with good professional practice.

Prudential Indicators: Indicators determined by the local authority to define its capital expenditure and asset management framework. They are designed to support and record local decision making in a manner that is publicly accountable; they are not intended to be comparative performance indicators

Public Works Loans Board (PWLB): The PWLB is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. The PWLB's function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments.

Quantitative Easing (QE): QE is a form of monetary policy where a Central Bank creates new money electronically to buy financial assets, like government bonds. This cash injection lowers the cost of borrowing and boosts asset prices to support spending.

Revenue Expenditure: Expenditure to meet the continuing cost of delivery of services including salaries and wages, the purchase of materials and capital financing charges.

Retail Price Index (RPI): A monthly index demonstrating the movement in the cost of living as it tracks the prices of goods and services including mortgage interest and rent.

Term Deposits: Deposits of cash with terms attached relating to maturity and rate of return (Interest).

Specified Investments: Term used in the Welsh Assembly Guidance for Local Authority Investments. Investments that offer high security and high liquidity, in sterling and for no more than one year. UK government, local authorities and bodies that have a high credit rating.

Supported Borrowing: Borrowing for which the costs are supported by the government or third party.

	Supranational Bonds: Instruments issued by supranational organisations created by governments through international treaties (often called multilateral development banks). The bonds carry an AAA rating in their own right. Examples of supranational organisations are the European Investment Bank, the International Bank for Reconstruction and Development. **Treasury Bills (T-Bills):** Treasury Bills are short term Government debt instruments and, just like temporary loans used by local authorities, are a means to manage cash flow. They are issued by the Debt Management Office and are an eligible sovereign instrument, meaning that they have an AAA-rating. **Treasury Management Code**: CIPFA's Code of Practice for Treasury Management in the Public Services, initially brought in 2003, subsequently updated in 2009 and 2011. **Treasury Management Practices (TMP):** Treasury Management Practices set out the manner in which the Council will seek to achieve its policies and objectives and prescribe how it will manage and control these activities. **Temporary Borrowing:** Borrowing to cover peaks and troughs of cash flow, not to fund capital spending. **Unsupported Borrowing**: Borrowing which is self-financed by the local authority. This is also sometimes referred to as Prudential Borrowing. **Yield:** The measure of the return on an investment instrument.