AUDIT COMMITTEE

Date of Meeting	Wednesday 22nd November 2017
Report Subject	Treasury Management Mid-Year Review 2017/18 & Quarter 2 update
Report Author	Corporate Finance Manager

EXECUTIVE SUMMARY

This report presents the draft mid-year Treasury Management report 2017/18 for review and seeks the Committee's recommendation for approval to Cabinet.

The report provides an update on matters relating to the Council's Treasury Management activity during the period 1st July to 31st October 2017.

RECOMMENDATIONS	
1	Members review the draft Treasury Management Mid-Year Report 2017/18 and identify any matters to be drawn to the attention of Cabinet on 19th December 2017.
2	Audit Committee recommends to Cabinet that the Council elects to 'opt up' to professional client status by regulated financial services firms as a result of the second Markets in Financial Instruments Directive (MiFID II) as explained in paragraphs 1.09 - 1.15.

REPORT DETAILS

1.00	**EXPLAINING THE MID YEAR REVIEW**
1.01	The Council has nominated 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 14th February 2017, the Council approved the Treasury Management Strategy 2017/18, following the recommendation of the Cabinet and consideration by the Audit Committee.

	<u>Treasury Management Mid-Year Report 2017/18</u>
1.03	The Treasury Management Mid-Year Report for 2017/18 is attached as Appendix 1 for review. As required by the Council's Financial Procedure Rules, this review will be reported to the Cabinet and Council.
	<u>Summary of Key Points</u>
1.04	2017/18 continues the trend of 2016/17 as an extraordinary year politically. The Prime Minister called an unscheduled General Election in June, to resolve uncertainty but the result has led to a minority Government. Lack of clarity over future trading partnerships, in particular future customs agreements with the rest of the EU block flowing from UKs negotiations to leave the EU, is denting business sentiment and investment.
1.05	The Bank of England made no change to monetary policy at its meetings in the first half of the financial year with the official Bank Rate remaining at 0.25%. The Monetary Policy Committee highlighted concerns about rising inflation over risks to growth and implied a rate rise in the coming months. Section 3 of the mid-year report provides a full economic and interest rate review of the first half of 2017/18.
1.06	The historic low Bank Rate contributed to the low level of interest the Council was able to generate on its investments, with an average return of 0.25%. Section 5 provides further details of the Council's investment activity during the year.
1.07	No new long term borrowing was undertaken to date in 2017/18. Short term borrowing was undertaken as necessary in accordance with the 2017/18 borrowing strategy. The total short term (temporary) borrowing as at 30th September 2017 was £15.1m with an average rate of 0.29%. Section 4 provides more information on borrowing and debt management during the period.
1.08	The treasury function has operated within the limits detailed in the Treasury Management Strategy 2017/18 to date.
1.09	Section 6 provides information on regulatory changes coming into force in the near future.
1.10	The main change is called MiFID II (the second Markets in Financial Instruments Directive) which comes into force on the 3rd of January 2018. MiFID II requires local authorities to be categorised by regulated financial services firms as retail clients by default who can "opt up" to be professional clients, providing that they meet certain criteria.
1.11	The Council is currently classed as a professional client. To opt up and continue its status as professional the Council must hold 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 to ensure that they benefit from the greatest level of investor protection along with other qualitative and quantitative tests. In addition, the financial service firm must assess that the person has the expertise, experience and knowledge to make investment decisions and

	understand the risks involved.
1.12	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. The Council doesn't currently use many of the kinds of products where it would benefit from the additional protection offered from being a retail client for example; shares, bonds and derivatives.
1.13	It is anticipated that retail clients will face increased transaction costs due to the increased level of advice that firms will need to provide, and will potentially face restricted access to certain money market / pooled funds, treasury bills and to financial advice from brokers etc. The costs of being a retail client would potentially outweigh any benefits.
1.14	Officers have considered the differing impacts of remaining a professional client or changing to be a retail client. The assessment considered the security, liquidity and yield of investments and the availability, flexibility and costs of short and long term borrowing. Officers recommend that the Council maintains its current MiFID status of professional in order to continue to manage the Council's daily treasury management activities as at present.
1.15	This will result in a slight change to operating procedures to maintain the daily investment balance required of £10m. The status will be reviewed regularly and can be subsequently changed.
	Treasury Management 2017/18 – Quarter 2 update
1.16	<u>Investments Update</u> A statement setting out the Council's investments as at 31st October 2017 is attached at Appendix 2. The investment balance at this time was £5.2m, spread across 4 counterparties and the average investment rate was 0.22% for the period.
1.17	<u>Borrowing Update</u> Appendix 3 shows the Council's long term borrowing as at 31st October 2017. The total amount of loans outstanding was £253.7m with an average interest rate payable of 4.96%. Appendix 4 shows the Council's short term borrowing as at 31st October 2017. The total amount of loans outstanding was £22.1m with an average interest rate payable of 0.31%.
1.18	Appendix 5 is a graph showing the investment and short term borrowing position for 2017/18 to date.
1.19	The Bank of England's Monetary Policy Committee on the 2nd of November 2017 voted to raise the official Bank Rate to 0.50%. The committee emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent. Arlingclose's future expectations for higher short term rates are subdued and they project 0.5%

	for the medium term. On-going decisions remain dependent on economic data and the Brexit negotiations to leave the EU.
1.20	As has been reported previously, the borrowing strategy in 2017/18 continues to be 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 and is currently being utilised as far as possible without taking on excessive refinancing risk. Arlingclose are supportive of this approach.
1.21	Member Training – Treasury Management Member training has been arranged for 4th December 2017 11am – 1pm which will be a Treasury Management Workshop presented by Arlingclose Ltd. The session will be hosted by the Audit Committee but will be open to all Members.
1.22	At its meeting on July 19th Audit Committee highlighted the need for assurance on the ability of the revenue account to support the increasing debt levels along with a comparison with other Council's. Information in the paragraphs below has been extracted from the Prudential Indicator report that all Local Authorities are required to produce under the Prudential Code for Capital Finance in Local Authorities. These prudential indicators are the mechanism whereby a Local Authority demonstrates that decisions relating to capital investment are affordable, sustainable and prudent.
1.23	The key indicator which assess ability to support debt is the ratio of financing costs to net revenue stream. The indicator is a measure of affordability, addressing the revenue implications of capital expenditure funded by borrowing. The table below as requested shows Flintshire's estimated 2017/18 ratio compared with figures for all North Wales Council's.

RATIO OF FINANCING COSTS TO NET REVENUE STREAM

	FCC	DCC	CCBC	WCBC	GCC	YMCC
Council Fund	5.1%	6.8%	6.73%	4.11%	5.78%	6.5%
HRA	25.2%	44.42%	N/A	26.8%	N/A	19.38%

The Council Fund net revenue stream is the amount to be met from Welsh Government (WG) grants and local taxpayers, and the HRA equivalent is the amount to be met from WG grants and from rent payers. The estimate of financing costs includes the current commitments and the proposals included in capital programmes.
The HRA ratio, calculated in accordance with the Prudential Code, reflects

	the increase in financing costs attributable to the settlement payment required to exit the HRA negative subsidy system.
1.24	<u>Limitations of prudential indicators:</u> It should be noted that the prudential indicators are not designed for comparison between authorities, but are a means 'to support and record local decision-making'.

2.00	RESOURCE IMPLICATIONS
2.01	Financial implications are addressed in the 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 and appendices including identification of risks and measures to mitigate likelihood and impact of risks identified.

5.00	APPENDICES
5.01	1. Draft Treasury Management Mid-Year Report 2017/18 2. Investment Portfolio as at 31st October 2017 3. Long term borrowing as at 31st October 2017 4. Short term borrowing as at 31st October 2017 5. Graph showing investments and short term borrowing in 2017/18 to date

6.00	LIST OF ACCESSIBLE BACKGROUND DOCUMENTS
6.01	**Contact Officer:** Liz Thomas – Technical Finance Manager **Telephone:** 01352 702289 **E-mail:** liz.thomas@flintshire.gov.uk

7.00	GLOSSARY OF TERMS
7.01	**Authorised Limit:** A statutory limit that sets the maximum level of external debt for the Council.

Balances and Reserves: Accumulated sums that are held, either for specific future costs or commitments (known as earmarked) or generally held to meet unforeseen or emergency expenditure.

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.

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. **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.

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): In relation to the UK, it is the process used by the Bank of England to directly increase the quantity of money in the economy. It does not involve printing more banknotes. Instead, the Bank buys assets from private sector institutions – that could be insurance companies, pension funds, banks or non-financial firms – and credits the seller's bank account. So the seller has more money in their bank account, while their bank holds a corresponding claim against the Bank of England (known as reserves). The end result is more money out in the wider economy.

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.