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All Wards

WELWYN HATFIELD BOROUGH COUNCIL
CABINET – 7 NOVEMBER 2017
REPORT OF THE EXECUTIVE DIRECTOR (RESOURCES, ENVIRONMENT AND CULTURAL SERVICES)

TREASURY MANAGEMENT MID-YEAR REPORT 2017/18

1 Executive Summary

1.1 In accordance with the Treasury Management Strategy (TMS), this report provides a mid-year update on the Council's treasury activities from 1 April to 30 September 2017, including details of the investment and loans portfolios and an economic review from treasury advisors.

1.2 Details are also provided of imminent regulatory changes affecting treasury activity, namely the implementation of the European Union's second *Markets in Financial Instruments Directive* (MiFID II) in January 2018 and CIPFAs proposed changes to the Prudential and Treasury Management Codes

2 Recommendation

2.1 It is recommended that Members

i) note the current treasury position and Treasury Management Indicators;

ii) note the intention to 'opt-up' to professional status under MiFID II regulations and the need to obtain a 'Legal Entity Identifier';

iii) note that the Treasury Management Strategy 2018/19 will aim to include proposed changes to CIPFAs Prudential and Treasury Management Codes, as appropriate.

3 Investment Activity

3.1 Investment balances in the first half of the financial year ranged from £50m to £65m, with a daily average of £59m. The investment portfolio continued to contain short term deposits with banks, building societies and money market funds; and tradeable instruments such as bonds, certificates of deposit and floating rate notes, which allowed diversification across a wider spectrum of institutions.

3.2 As interest rates continued to decline, more deposits were also made with other local authorities, who offered competitive returns coupled with greater security than traditional bank deposits. The short term nature of the majority of investments also reflected the change in the credit risk/reward ratio for longer term deposits, due to the low rate environment. Appendix A details investments at 30 September 2017.

3.3 The table below show investment activity in the period 1 April to 30 September 2017:-

Investment Counterparty	Opening balance 01/04/2017 £'000	Investments Made £'000	Maturities/ Investments Sold £'000	Closing balance 30/09/2017 £'000
UK Local Authorities - Short term - Long term	6,000 4,000	9,000 0	11,000 0	4,000 4,000
UK Banks - Short term	9,000	18,867	16,020	11,847
UK Building Societies - Short term	4,000	8,000	5,000	7,000
Foreign Banks - Short term	5,000	3,000	5,000	3,000
AAA rated Money Market Funds	10,738	71,073	69,540	12,271
Property Fund*****	4,000	4,000	4,000	4,000
Registered Providers of Social Housing – Long term	2,185	2,185	2,185	2,185
Covered Bonds – Long term Corporate Bonds – Short term	3,000 3,770	0 1,744	0 2,765	3,000 2,749
TOTAL INVESTMENTS	**51,693**	**117,869**	**115,510**	**54,052**

* £4m invested – share value subject to market changes

3.4 The weighted average return for investments in this period was 0.915% and total interest earned £270k, assuming a 4.29% dividend is received on the CCLA Property Fund for Q2, which is still to be confirmed. All investments were made in accordance with the treasury management strategy applicable at the time of the deposits.

3.5 The average interest rate for investments, as detailed in the covering report to the 2017/18 TMS, was forecast to be 0.9%, based on an average balance for the year of £50m, giving a return of £450k.

3.6 In general, balances decrease rapidly in the last two months of the financial year as Council tax and NNDR are not collected but continue to be paid over. As a result of this and the capital programme, it is anticipated that the average daily balance for the second half of the year will fall to approximately £40m. A return of 0.9% will result in an additional £180k interest, meeting the forecast for the year.

3.7 For Member's information, the maturity structure of investments is detailed in the table below.

Matures in:	£'000
Instant access	19,118
3 Months	12,734
3-6 Months	9,015
1-2 Years	6,185
Over 2 Years*	7,000
Total	54,052

*****Includes £4m in CCLA Property Fund

4 Borrowing Activity

4.1 In March 2012 the Council borrowed £304,799k from Public Works Loans Board (PWLB) to meet its obligations under the new Housing Self-Financing regime. The loans were structured so that, following the first year, debt was repaid every quarter. The table below shows the movement in the first half of this financial year.

Opening balance 01/04/17 £000	Loans matured	Closing balance 30/09/17 £000	Average rate of remaining loans on 30/09/17	Interest payable 1/4/17 – 30/9/17 (accruals basis) £000
251,899	7,600	244,299	2.55%	3,156

4.2 No new external borrowing was undertaken during the period.

5 Treasury Management Indicators

5.1 The Council measure its exposure to treasury management risks using the following indicators:

5.2 Interest rate exposures

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short term rates on investments.

	2017/18	Maximum during period	Complied
Upper limit on fixed interest rate exposures	£300m	£230.4m	✓
Upper limit on variable interest rate exposures	£0m	-£26.6m	✓

For definition purposes, fixed rate investments and borrowings are those where the interest rate is fixed for the next 365 days or more. Instruments that mature during the period are classed as variable rate. Investments are treated as having negative value in this instance and are netted off against borrowing. By setting a £0 value on variable exposures, the Council seeks to always hold more variable rate investment than borrowing.

5.3 Maturity structure of borrowing

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

	Upper Limit	Lower Limit	Actual fixed borrowing at 30/9/17	% fixed borrowing at 30/9/17	Complied
Under 12 months	20%	0%	£16.2m	6.6%	✓
12 months and within 24 months	30%	0%	£18.0m	7.4%	✓
24 months and within 5 years	50%	0%	£62.1m	25.4%	✓
5 years and within 10 years	80%	0%	£133.7m	54.7%	✓
10 years and within 20 years	100%	0%	£14.3m	5.9%	✓
20 years and within 30 years	100%	0%	£0	0%	✓

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 payment.

5.4 Principal sums invested for periods longer than 364 days

The purpose of this indicator is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested.

	2017/18 £'000	2018/19 £'000	2019/20 £'000
Limit on principal invested beyond year end	30,000	28,000	25,000
Actual principal invested beyond year end	12,185	9,185	6,185
Complied	✓	✓	✓

6 Economic review

6.1 Attached at Appendix B is comment on the UK economy, market activity and credit risk from the Council's treasury advisors, Arlingclose Ltd.

7 Regulatory updates

MiFID II

7.1 Local authorities are currently treated by regulated financial services firms as professional clients who can 'opt down' to be treated as retail clients instead. From 3 January 2018, however, as a result of the second Markets in Financial Instruments Directive (MiFID II), local authorities will be treated as retail clients who can 'opt up' to be professional clients, providing they meet certain criteria.

7.2 Regulated financial services firms include banks, brokers, advisers, fund managers and custodians, but only where they are selling, arranging, advising or managing designated investments. In order to opt up to professional, the authority must have 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. In addition, the firm must assess that that person has the expertise, experience and knowledge to make investment decisions and understand the risks involved.

7.3 The main additional protection for retail clients is a duty on the firm to ensure that the investment is 'suitable' for the client. Local authorities, however, 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. It is also likely that retail clients will face an increased cost and potentially restricted access to certain products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice.

7.4 As the Council meets the conditions to opt up to professional status, it is the intention to do so in order to maintain the Council's current MiFID status.

7.5 MiFID II also requires regulated firms to report trades in exchanged traded financial instruments, conducted on behalf of institutional clients, to a central trade repository. The reporting format though requires their clients to have a Legal Entity Identifier (LEI). To enable the Council then to continue to invest in gilts, treasury bills and supranational, covered or corporate bonds it will be necessary to obtain an LEI before 3 January 2018. This can be acquired online via a platform provided by the London Stock Exchange at a cost of £115 initially and an annual maintenance fee of £70.

CIPFA Prudential and Treasury Management Codes

7.6 In February 2017 CIPFA canvassed views on the relevance, adoption and practical application of the Treasury Management and Prudential Codes. A further consultation was then launched proposing changes to the codes, with a deadline for responses of 30 September 2017.

7.7 The suggested changes to the Prudential Code include the production of a new high-level Capital Strategy report to full council which will cover the basics of the capital programme and treasury management. The prudential indicators (PIs) for capital expenditure and the authorised borrowing limit would be included in this report but others may be delegated to another committee. There are plans to drop some PIs, however local indicators are recommended for ring fenced funds (including the HRA) and for group accounts. Another proposed change is for principles of the Code to be applied to subsidiaries.

7.8 One of the more significant changes put forward for the Treasury Management Code is that non-treasury investments, such as commercial investments in properties, be included in the definition of ‘investments’, as well as loans made or shares bought for service purposes. Another proposal is that financial guarantees as instruments should be subject to risk management and included within the Treasury Management Strategy (TMS). Approval of the technical detail of the TMS may also be delegated to a committee rather than needing approval of full Council and there are also plans to drop or alter some of the current treasury management indicators.

7.9 CIPFA intends to publish the two revised Codes towards the end of 2017 for implementation in 2018/19. Transitional arrangements though are likely to be put in place for reports that are required to be approved before the start of the 2018/19 financial year, as is the case for this Council.

7.10 The Department of Communities and Local Government (DCLG) and CIPFA, however, wish to have a more rigorous framework in place for the treatment of commercial investments as soon as is practical. It is understood that similarly the DCLG will be revising its Investment Guidance (and its MRP guidance) for local authorities in England; however there have been no discussions with the devolved administrations yet.

Implications

8 Legal Implications

8.1 There are no legal implications contained in this report.

9 Financial Implications

9.1 Obtaining a Legal Entity Identifier, as described in paragraph 7.5 above, will incur expenditure of £115 in 2017/18 and £70 annually thereafter.

9.2 There are no other direct financial implications in the report, however levels of investment income are reviewed and adjusted accordingly through budget monitoring processes

10 Risk Management Implications

10.1 The Council's TMS adheres to the CIPFA Code of Practice on Treasury Management, which promotes the assessment and control of risk related to treasury activities. It is believed the Strategy represents an appropriate balance between risk management and cost effectiveness. Utilising the Treasury Management Practices and information provided by advisors Arlingclose, the Council continues to review the national outlook for interest rates and changing factors affecting the Council's position in order to minimise risk.

10.2 Investment budgets are significant in terms of their financial value and the level of risk that may occur due to interest rate variations. Budgets relating to investments are monitored monthly and any major variances affecting the Council's financial standing would be escalated through appropriate methods and reported to members if significant.

10.3 Opting up to professional status under MiFID II regulations will enable continued access to more diverse investment opportunities, allowing a greater scope to balance risk against reward.

11 Security & Terrorism Implications

11.1 There are no security or terrorism implications contained in this report

12 Procurement Implications

12.1 There are no procurement implications contained in this report

13 Climate Change Implications

13.1 There are no climate change implications contained in this report

14 Link to Corporate Priorities

14.1 The subject of this report is linked to the Council's Corporate Priority 'Engage with our communities and provide value for money'.

15 Equality and Diversity

15.1 An Equality Impact Assessment (EIA) is not required in connection with the proposals that are set out in this report.

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Date	5 October 2017

Background papers:
WHBC Treasury Management Strategy 2017/18
Appendices:
Appendix A - Investments and Loans at 30/09/2017
Appendix B – Economic Commentary and Outlook – Arlingclose Ltd