Subject:	**TREASURY MANAGEMENT QUARTER THREE REPORT 2017/18**
Meeting and Date:	**Governance – 8th March 2018**
Report of:	**Mike Davis – Director of Finance, Housing & Community**
Portfolio Holder:	**Councillor Mike Connolly – Portfolio Holder for Corporate Resources and Performance**
Decision Type:	**Non-Key Decision**
Classification:	**Unrestricted**
Purpose of the report:	To provide details of the Council's treasury management for the quarter ended 31st December 2017 (Q3) and an update of activity to date.
Recommendation:	That the report is received

1. **Summary**

1.1 The Council's investment return for the year-to-date was 0.65%, which outperformed the benchmark[1] by 0.25%. Actual interest and dividends income to the end of December was £316k, which is a favourable variance compared with the year-to-date (YTD) budget of £229k. The Council's projected investment return for 2017/18 is £552k, which is £247k better than the original budget estimate of £305k. This improvement is due to the estimated dividend from investments in pooled investment funds.

1.2 As of 1st April 2017, the Council appointed Arlingclose Limited as its treasury advisors, and they have proposed various investment options that would help to improve returns and spread risk. At the Investment Advisory Group on 4th October 2017 the group considered the pooled investment funds suggested by Arlingclose. It was proposed to deposit up to £28m into a number of these funds to improve income. £6m had already been placed in the CCLA property fund, with a forecast return of 4.57%.

1.3 During December, £12 million was deposited into pooled investment funds: £6 million was invested with Colombia Threadneedle in their strategic bond fund and £6 million was invested with Investec in their diversified income fund. Both funds are forecast to generate an annual return exceeding 4%. This will significantly improve the overall return on the Council's investments.

1.4 It is currently proposed to invest a further £8 million in Payden and Rygel's sterling reserve fund once the account opening process has been completed. This generates a return closer to 1.0%, which is better than standard money market and bank deposit rates, but lower than the other pooled investment fund returns as it is a more liquid investment.

[1] The "benchmark" is the interest rate against which performance is assessed. DDC use the London Inter-Bank Bid Rate or LIBID, as its benchmark.

1.5 A new International Financial Reporting Standard (IFRS9) is due to be implemented from 2018/19, which could force us to charge unrealised gains or losses on the capital value of such funds to the General Fund revenue budget each year, even if we propose to hold the funds for a longer period of time and avoid selling if the capital value is lower than the price paid. It is often normal to pay a premium on purchasing such funds, as with the CCLA Property Fund, to take account of stamp duty and other costs but, over time, the capital value is expected to rise, based on past trends, so that capital losses are unlikely in the longer term. However, we currently recognise the dividend returns, paid each year, and credit these returns to our budget. We are awaiting further guidance from CIPFA as to whether there will be any statutory override for local authorities. In the meantime, to reduce the potential impact of this on the General Fund, the 2018/19 budget proposes setting aside £2m in the Dover Regeneration and Economic Development Reserve as a prudent provision for any unexpected potential fluctuations in the capital value of investments.

1.6 The forecast return of £552k for the full financial year includes estimates for additional income from investments made in pooled funds in December, in addition to the return on the £6m invested in the CCLA property fund earlier in the financial year.

1.7 The Council remained within its Treasury Management and Prudential Code guidelines during the period.

2. Introduction and Background

2.1 CIPFA (the Chartered Institute of Public Finance and Accountancy) issued the revised Code of Practice for Treasury Management in November 2011; it recommends that members should be updated on treasury management activities at least twice a year, but preferably quarterly. This report therefore ensures this council is implementing best practice in accordance with the Code.

2.2 Council adopted the 2017/18 Treasury Management Strategy (TMS) on 1st March 2017 as part of the 2017/18 Budget and Medium Term Financial Plan.

2.3 In order to comply with the CIPFA code referred to above, a brief summary is provided below, and Appendix 1 contains a full report from the Council's Treasury Management Advisors, Arlingclose.

2.4 Members are asked to note that, in order to minimise the resource requirements in producing this report, Arlingclose's report has been taken verbatim. Treasury advisors generally use a more journalistic style than is used by our officers, but in order to avoid changing the meaning or sense of Arlingclose's work, this has not been edited out.

2.5 As at 31st December 2017, the Council's investment portfolio totalled £55.9m (see Appendix 2). However, some of this is shorter term, as significant funds sitting in the Dover Regeneration and Economic Development Reserve are earmarked for spending during 2017/18 and 2018/19 on the new Dover District leisure centre and other approved capital projects. After these approved commitments, there should be £20m - £25m underlying core funds available for longer term investment, while the remainder of funds will need to be kept in shorter term instruments and bank accounts for cash-flow requirements and future capital projects (subject to project appraisals).

2.6 In December £6 million was deposited into Columbia Threadneedle's strategic bond fund and £6 million was deposited into Investec's diversified income fund.

2.7 From 3 January 2018 the MIFID II regulations came in to force, which has meant that the authority has had to apply to its investment advisors and investment providers to be recognised as a professional client in order to continue to be able to use their services.

3. Annual investment strategy

3.1 The investment portfolio, as at the end of December 2017, is attached at Appendix 2. Total balances held for investment and cash-flow purposes were £55.8m, rising to £58.9m at the end of January (see Appendix 4). The increase reflects normal cash-flow fluctuations arising from the timing of 'major preceptor' payments, which are made over twelve months, while the Council Tax receipts that fund them typically come in over the ten months to January and then decline.

3.2 Since the end of the December quarter, the HSBC notice account funds have been repaid (£7.5m). This will be used to manage cash flow over the financial year end. Additionally, notice has been given on the Santander 95 day account and the funds will be repaid in March 2018 and considered for investment in the Payden & Rygel sterling reserve fund to generate better returns while maintaining good liquidity.

3.3 All other funds are currently being held in call accounts, and the process of opening new investment fund accounts is progressing, but without an absolute commitment to making further deposits.

3.4 The Bank of England raised the base rate from 0.25% to 0.5% on 2nd November and this has resulted in a slight improvement in the returns on the money market funds and NatWest SIBA account.

3.5 Cash-flow funds decreased from £16.9m at 30th September 2017 to £13.0m at 31st December 2017 (see Appendix 2), and then increased to £23.6m by the end of January 2018 (see Appendix 4); although this is expected to reduce in the coming weeks due to approved capital spend. The movement in cash-flow funds in the quarter reflects in-flow from Local Authority deposits maturing (£10m) and further increases from the pattern of Council Tax receipts, etc., less £4.2m for the purchase of an investment property in November and £12m investments made in pooled investment funds in December. The increase in January is due to the HSBC deposit maturing (£7.5m).

3.6 The Gilt holding of £1.9 million transferred to King and Shaxson following Investec's withdrawal from the segregated funds market will be held until its maturity date of July 2018

4. Economic background

4.1 The report attached (Appendix 1) contains information up to the end of December 2017; since then we have received an update from Arlingclose, included below. Please note that any of their references to quarters are based on calendar years:

Introduction

4.2 The economic outlook remains uncertain as negations for the UK to leave the EU continue.

4.3 The Bank of England has raised expectations that further rate rises will be sooner and higher than previously anticipated.

UK Data

4.4 In February, the Bank of England's Monetary Policy Committee (MPC) voted unanimously to keep Bank Rate at 0.5% and published its quarterly Inflation Report. The Report and accompanying monetary policy press conference raised expectations for further rises in Bank Rate, both sooner and to a higher level than previously anticipated by markets. Reiterating the view of the UK economy's impaired supply capacity and survey data of higher private sector earnings growth, meaning inflationary outcomes are more likely, the MPC also revised the UK's economic growth prospects slightly higher due to the pull of global economic momentum. Significantly, the MPC also decided to shorten the forecast horizon over which inflation will be brought back to the CPI target.

4.5 Uncertainty remains regarding the UK's exit from the European Union and therefore the UK economy still faces a challenging outlook. The MPC's projections assume that households and companies base their decisions on a smooth adjustment to the new trading relationship with the EU.

4.6 The second estimate of UK Q4 2017 GDP was published and showed growth of 0.4% on the quarter and 1.4% year-on-year, both of which were revised down by one percentage point from the first estimate. Inflation data for January 2018 showed CPI remaining slightly higher than expected at 3%, but expectations are for this to gradually ease in the medium term as the effects of the previous depreciation in sterling start to wane. Labour market data for the period to December 2017 showed employment increasing and pay growth edging up to 2.5%, although real wage growth (adjusting for inflation) remains negative.

4.7 The second estimate of UK Q4 2017 GDP was published and showed growth of 0.4% on the quarter and 1.4% year-on-year, both of which were revised down by one percentage point from the first estimate.

Global

4.8 Near-term global growth prospects continued to improve and broaden. Expectations of inflation, while relatively subdued, started to increase, particularly on the back of US economic momentum, increasing oil prices and improving emerging markets growth. Data in the US continued to suggest an increasingly buoyant economy receiving a further boost from President Trump's tax reforms and expectations remained for the Federal Reserve to hike rates several times during 2018. The prospect of central bank stimulus being removed more rapidly than expected, amongst other things, led to relatively sharp corrections in stock market values in early February. The Eurozone economy continued to perform well, raising expectations that the ECB could possibly look to bring an end to its asset purchase programme over the next year.

Interest Rates & Financial Indicators

4.9 Following these signals from the MPC, Arlingclose's central case is for Bank Rate to rise twice in 2018 and once more in the first half of 2019, with the risks weighted to the downside.

Regulatory

4.10 Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. In addition, the largest UK banks will ringfence their retail banking functions into separate legal entities during 2018. There remains some uncertainty over how these changes will impact upon the credit strength of the residual legal entities.

4.11 The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however remain very low.

5. Net Borrowing

5.1 The Council's borrowing portfolio is attached at Appendix 3. No new borrowing was undertaken during the quarter.

6. Debt Rescheduling

6.1 At this time it is not of benefit to the Council to consider rescheduling of its long-term debt, as advised by Arlingclose.

7. Compliance with Treasury and Prudential Limits

7.1 The Council has operated within the treasury limits and Prudential Indicators, and in compliance with the Council's Treasury Management Practices.

Appendices

Appendix 1 – Arlingclose Treasury Management Report for Quarter Three

Appendix 2 – Investment portfolio as at 31 December 2017

Appendix 3 – Borrowing portfolio as at 31 December 2017

Appendix 4 – Investment portfolio as at 31 January 2018

Background Papers

Medium Term Financial Plan 2017/18 – 2020/21

Revised 2017/18 Treasury Management Strategy (Council 19th July 2017)

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Date: 27th February 2018