

Southend-on-Sea Borough Council

**Report of Corporate Director of Corporate Services
to
Cabinet
on
10 November 2015**

**Agenda
Item No.**

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Mid-Year Treasury Management Report – 2015/16

Policy and Resources Scrutiny Committee

Executive Councillor: Councillor Woodley

A Part 1 Public Agenda Item

1. Purpose of Report

- 1.1 The Mid-Year Treasury Management Report covers the treasury management activity and compliance with the treasury management strategy for both quarter two and the period from April to September 2015.

2. Recommendations

That the following is approved:

- 2.1 **The Mid-Year Treasury Management Report for 2015/16.**
- 2.2 **The Revised Minimum Revenue Provision Policy 2015/16 attached at Appendix 3, the changes to which are set out in Section 12.**

That the following is noted:

- 2.3 **Treasury management activities were carried out in accordance with the CIPFA (The Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management in the Public Sector during the period from April to September 2015.**
- 2.4 **The loan and investment portfolios were actively managed to minimise cost and maximise interest earned, whilst maintaining a low level of risk.**
- 2.5 **An average of £66.0m of investments were managed in-house. These earned £0.20m of interest during this six month period at an average rate of 0.62%. This is 0.26% over the average 7 day LIBID (London Interbank Bid Rate) and 0.12% over bank base rate.**

- 2.6 An average of £24.9m of investments was managed by our external fund manager. These earned £0.08m of interest during this six month period at an average rate of 0.66%. This is 0.30% over the average 7 day LIBID and 0.16% over bank base rate.
- 2.7 An average of £5.0m was managed by a property fund manager. This earned £0.185m during this six month period from a combination of an increase in the value of the units and income distribution, giving a combined return of 7.38%. The fund started the six month period at £4.989m and increased in value with the fund at the end of the period at £5.174m.
- 2.8 The level of borrowing from the Public Works Loan Board (PWLB) (excluding debt relating to services transferred from Essex County Council on 1st April 1998) remained at the same level of £237.8m (Housing Revenue Account (HRA): £80.8m, General Fund: £157.0m) during the period from April to September 2015.
- 2.9 The level of financing for 'invest to save' schemes increased from £0.14m to £0.65m during the period from April to September 2015.

3. Background

- 3.1 This Council has adopted the 'CIPFA Code of Practice for Treasury Management in the Public Sector' and operates its treasury management service in compliance with this code. The code recommends that local authorities submit reports regularly as part of its Governance arrangements.
- 3.2 Current guidance is that authorities should report formally at least twice a year and preferably quarterly. The Treasury Management Policy Statement for 2015/16 set out that reports would be submitted to Cabinet quarterly on the activities of the treasury management operation. This is the second quarter report for the financial year 2015/16.
- 3.3 Appendix 1 shows the treasury management position at the end of quarter two of 2015/16.
- 3.4 Appendix 2 shows the treasury management performance specifically for quarter two of 2015/16.

4 National Context

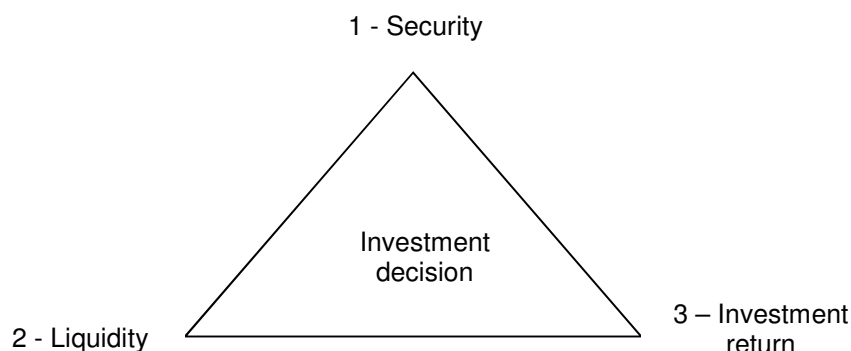
- 4.1 The UK economy has continued to grow and with earnings growth continuing to exceed the rate of inflation and supporting growth in real income, retail sales growth should be supported for the coming months at least. There was a return to deflation of -0.1% in September from 0% in August.
- 4.2 With the governor of the Bank of England and the Monetary Policy Committee not expecting a rise in inflation until the turn of the year, a temporary bout of deflation is seen as beneficial for the UK economy. This has relieved the

pressure on the Bank of England to increase interest rates, which are now likely to remain stable until next year. Throughout the period the Bank of England kept the bank base rate at its historic low of 0.5% and continued with its policy of quantitative easing, keeping the level at £375 billion.

- 4.3 US data supports this stance on rates in terms of the Federal Reserve whose market participants also do not expect to increase rates until next year. Across the globe there are increased concerns surrounding the economic health of China, who witnessed its CPI inflation fall further from target, while the Eurozone recovery remains sluggish.
- 4.4 The economic situation together with the financial market conditions prevailing throughout the quarter continued to provide challenges for treasury management activities. There have not been substantial changes in the credit ratings of financial institutions so we continue to have a restricted list of counterparties (i.e. people we can invest with) that still meet our prudent investment criteria.
- 4.5 However, with a restricted list of counterparties and the increased focus on counterparty risk following the Icelandic Banks collapse, monies were mainly placed for short periods of time or in instant access accounts, which increased the liquidity of these funds.
- 4.6 Low interest rates prevailed throughout the period from April to September 2015 and this led to low investment income earnings from all our investments.

5 Investments – quarter two (July to September)

- 5.1 A prime objective of our investment activities is the security of the principal sums invested. To ensure this security before a deposit is made an organisation is tested against a matrix of credit criteria. During the period from July to September 2015 investment deposits were limited to those who met the criteria in the Annual Investment Strategy when the deposit was placed.
- 5.2 Other investment objectives are to maintain liquidity (i.e. adequate cash resources to allow the council to operate) and to optimise the investment income generated by surplus cash in a way that is consistent with a prudent level of risk. Investment decisions are made with reference to these objectives, with security and liquidity being placed ahead of the investment return. This is shown in the diagram below:



Security:

- 5.3 To maintain the security of sums invested, we seek to lower counterparty risk by investing in financial institutions with good credit ratings, across a range of sectors and countries. The risk of loss of principal of monies is minimised through the Annual Investment Strategy.
- 5.4 Pie chart 1 of Appendix 1 shows that at the end of quarter two; 61% of our in-house investments were placed with financial institutions with a long term rating of AAA, 9% with a long term rating of A and 30% with a long term rating of A-.
- 5.5 As shown in pie chart 2 of Appendix 1, these monies were with various counterparties, 39% being placed directly with banks and 61% placed with a range of counterparties via money market funds.
- 5.6 Pie chart 3 of Appendix 1 shows the range of countries where the parent company of the financial institution with which we have monies invested is registered. For money market funds there are various counterparties spread across many countries. The cumulative balance of funds held with any one institution was kept within agreed limits.

Liquidity:

- 5.7 Our in-house monies were mostly available on an instant access basis at the end of quarter two, except for £10m which has been placed in a 100 day notice account and £5m which has been placed in a 9 month fixed term deposit. The maturity profile of our investments is shown in pie chart 4 of Appendix 1.

Investment return:

- 5.8 During the quarter the Council continued to use the fund manager Aberdeen Asset Management to manage monies on our behalf. An average of £24.9m was invested in this fund throughout the quarter earning an average rate of 0.66%.
- 5.9 The Council had an average of £66.6m of investments managed in-house over the period from July to September, and these earned an average interest rate of 0.62%. Of the in-house managed funds:
- an average of £10.0m was held in notice accounts that earned an average interest rate of 0.68%;
 - an average of £1.6m was held in fixed term deposits that earned an average interest rate of 0.88%;
 - use was also made of call accounts during the year, because they provide instant access to funds. An average of £8.3m was held in these accounts and earned an average return of 0.64% over the quarter;
 - an average of £46.7m was held in money market funds earning an average of 0.60% over the quarter. These work in the same way as a deposit account but the money in the overall fund is invested in a number of counterparties, therefore spreading the counterparty risk.

- 5.10 In accordance with the Treasury Management Strategy the performance during the quarter is compared to the average 7 day LIBID(London Interbank Bid Rate). Overall, investment performance was higher than the average 7 day LIBID and higher than the average base rate for the quarter. The bank base rate remained at 0.50% throughout the period from July to September 2015, and the 7 day LIBID rate fluctuated between 0.36% and 0.38%. Performance is shown in Graph 1 of Appendix 2.

6 Investments – quarter two cumulative position

- 6.1 During the period from April to September 2015 the Council complied with all of the relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of the Code of Practice for Treasury Management means its treasury practices demonstrate a low risk approach.
- 6.2 The Council is aware of the risks of passive management of the treasury portfolio and has proactively managed levels of debt and investments over the six month period with the support of its treasury management advisers.
- 6.3 The table below summarises the Council's investment position for the period from April to September 2015:

Table 1: Investment position

	At 31 March 2015	At 30 September 2015	April to September 2015	
	Actual Balance (£000s)	Actual Balance (£000s)	Average Balance (£000s)	Average Rate (%)
Notice accounts	10,000	10,000	10,000	0.68
Fixed term deposits	0	5,000	806	0.88
Call accounts	8,037	7,074	7,975	0.64
Money market funds	33,000	34,000	47,239	0.59
Total investments managed in-house	51,037	56,074	66,020	0.62
Investments managed by external fund managers	24,858	24,941	24,907	0.66
Property fund	0	5,174	5,036	7.38
Total investments	75,895	86,189	95,963	0.99

- 6.4 The majority of the cash balances held by the Council are required to meet short term cash flow requirements and therefore throughout the six month period monies were placed 30 times for periods of one year or less. The table on the next page shows the most used counterparties overall and the countries in which they are based. All deals are in sterling despite the country the counterparties are based in.
- Table 2: Counterparties used

Counterparty	Country	No. of Deals	Value of Deals (£m)
Goldman Sachs	Money Market Fund (Various Counterparties)	12	62
BlackRock	Money Market Fund (Various Counterparties)	13	59
Insight Investment Management Ltd	Money Market Fund (Various Counterparties)	1	6
Standard Life Investment	Money Market Fund (Various Counterparties)	3	12
Goldman Sachs International Bank (Fixed Term Deposit)*	UK Bank	1	5

*This fixed term deposit is shown in Table 1 of Appendix 2.

- 6.5 In addition to the above, use was also made of call accounts during the year, because they provide instant access or 7-day notice to funds. This meant that funds were available for unexpected cash flow events to avoid having to pay higher rates to borrow from the market. During the period from April to September 2015 an average of £8.0m was held in such accounts.

7. Property Funds – quarter two (July to September)

- 7.1 Following a tender exercise, two property funds were chosen for the investment of long term funds: Rockspring Property Investment Management Limited and Lothbury Investment Management Limited. At the beginning of quarter one £5.0m was invested in the Rockspring property fund with £5m expected to be invested in the Lothbury fund in quarter three.
- 7.2 The monies are invested in units in the fund, the fund is then invested as a whole by the fund managers into properties. An income distribution will be generated from the rental income streams from the properties in the fund. Income distributions will be reinvested back into the fund. There are high entrance and exit fees and the price of the units can rise and fall, depending on the value of the properties in the fund, so these funds are invested over the long term with the aim of realising higher yields than other investments.
- 7.3 The interest equalisation reserve will be used to capture some of the income in the years when the property values are rising, and will then be available to offset any losses should property values fall. Members should be aware that this means that the investment returns in some quarters will look very good and in other quarters there may be losses reported, but these will not impact the revenue account as the interest equalisation reserve would be used to meet any temporary losses.

- 7.4 An average of £5.1m was managed by Rockspring Property Investment Management Limited. During quarter two, the value of the fund increased by £0.029m due to the increase in the unit value. There was also an income distribution relating to that period of £0.064m and this distribution will be confirmed and distributed in quarter three.
- 7.5 The fund earned £0.093m during this three month period from a combination of the increase in the value of the units and the income distribution, giving a combined return of 7.18%. The fund started the quarter at £5.081m and increased in value with the fund at the end of the quarter at £5.174m. This is set out in Table 2 of Appendix 2.

8 Property Funds – quarter two cumulative position

- 8.1 An average of £5.0m was managed by Rockspring Property Investment Management Limited. During the period from April to September 2015, the value of the fund increased by £0.062m due to the increase in the unit value. There was also an income distribution relating to that period of £0.123m and the quarter two part of this distribution will be confirmed and distributed in quarter three.
- 8.2 The fund earned £0.185m during this six month period from a combination of the increase in the value of the units and the income distribution, giving a combined return of 7.38%. The fund started the six month period at £4.989m and increased in value with the fund at the end of the period at £5.174m.

9. Borrowing – quarter two

- 9.1 The Capital Financing Requirement (CFR) is the Council's theoretical need to borrow but the Section 151 Officer can manage the Council's actual borrowing position by either:
- 1 - borrowing to the CFR;
 - 2 - choosing to use temporary cash flow funds instead of borrowing (internal borrowing) or;
 - 3 - borrowing for future increases in the CFR (borrowing in advance of need)
- 9.2 The Council began quarter two in the second of the above scenarios, with actual borrowing below CFR.
- 9.3 This, together with the Council's cash flow, the prevailing Public Works Loans Board (PWLB) interest rates and the future requirements of the capital programme, were taken into account when deciding the amount and timing of any loans. No new PWLB loans were taken out during the quarter and none were repaid on maturity.
- 9.4 The level of borrowing from the Public Works Loan Board (PWLB) (excluding debt relating to services transferred from Essex County Council on 1st April 1998) remained at £237.8m during the quarter. A profile of the repayment dates is shown in Graph 2 of Appendix 2.

- 9.5 The level of PWLB borrowing at £237.8m is in line with the financing requirements of the capital programme and the revenue costs of this borrowing are fully accounted for in the revenue budget. The current level of borrowing is also in line with the Council's prudential indicators and is prudent, affordable and sustainable.
- 9.6 Interest rates from the PWLB fluctuated throughout the quarter in response to economic events: 10 year PWLB rates between 2.61% and 3.10%; 25 year PWLB rates between 3.21% and 3.67% and 50 year PWLB rates between 3.07% and 3.58%. These rates are after the PWLB 'certainty rate' discount of 0.20%.
- 9.7 During quarter two, there was no short term borrowing activity undertaken for cash flow purposes. This is shown in Table 3 of Appendix 2.

10. Borrowing – quarter two cumulative position

- 10.1 The Council's borrowing limits for 2015/16 are shown in the table below:

	2015/16 (£m)
Authorised Limit	280
Operational Boundary	270

The Authorised Limit is the "Affordable Borrowing Limit" required by the Local Government Act 2003. This is the outer boundary of the Council's borrowing based on a realistic assessment of the risks and allows sufficient headroom to take account of unusual cash movements.

The Operational Boundary is the expected total borrowing position of the Council during the year and reflects decisions on the amount of debt needed for the Capital Programme. Periods where the actual position is either below or over the Boundary are acceptable subject to the Authorised Limit not being breached.

- 10.2 The Council's outstanding borrowing as at 30th September 2015 was:

- Southend-on-Sea Borough Council £237.8m
- ECC transferred debt £13.8m

Repayments in the first 6 months of 2015/2016 were:

- Southend-on-Sea Borough Council £0m
- ECC transferred debt £0m

- 10.3 Outstanding debt relating to services transferred from Essex County Council (ECC) on 1st April 1998, remains under the management of ECC. Southend Borough Council reimburses the debt costs incurred by the County. The debt is recognised as a deferred liability on our balance sheet.

- 10.4 The interest payments for PWLB and excluding transferred debt, during the period from April to September 2015 were £5.373m, compared to the original budget of £5.373m for the same period. These interest payments are the same as budgeted as, due to the reasons set out in paragraph 9.3, no new loans were taken out in 2014/15 and no new loans were taken during the first two quarters of 2015/16.
- 10.5 The table below summarises the PWLB borrowing activities over the period from April to September 2015:

Quarter	Borrowing at beginning of quarter (£m)	New borrowing (£m)	Re-financing (£m)	Borrowing repaid (£m)	Borrowing at end of quarter (£m)
April to June 2015	237.8	0	0	(0)	237.8
July to September 2015	237.8	0	0	(0)	237.8
<i>Of which:</i>					
General Fund	157.0	0	0	(0)	157.0
HRA	80.8	0	0	(0)	80.8

All PWLB debt held is repayable on maturity.

11 Funding for Invest to Save Schemes

- 11.1 During 2014/15 a capital project was completed on draught proofing and insulation in the Civic Centre which will generate on-going energy savings. This is an invest-to-save project and the predicted revenue streams cover the financing costs of the project.
- 11.2 To finance this project the Council took out an interest free loan of £0.14m with Salix Finance Ltd which is an independent, not for profit company, funded by the Department for Energy and Climate Change that delivers interest-free capital to the public sector to improve their energy efficiency and reduce their carbon emissions. The loan is for a period of four years with equal instalments to be repaid every six months. There are no revenue budget implications of this funding as there are no interest payments to be made and the revenue savings generated are expected to exceed the amount needed for the repayments. There were no repayments of this loan during the period from April to September 2015.
- 11.3 At the meeting of Cabinet on 23rd June 2015 the LED Street Lighting and Illuminated Street Furniture Replacement Project was approved which was to be partly funded by 25 year reducing balance 'invest to save' finance from the Green Investment Bank (GIB). The balance outstanding at the end of quarter two was £0.65m. There were no repayments during the period from April to September 2015.
- 11.4 Funding of these invest to save schemes is shown in Appendix 2.

12 Revised Minimum Revenue Provision Policy

- 12.1 As a result of the funding for Invest to Save Schemes it has been necessary to amend the Minimum Revenue Provision Policy for 2015/16 to clarify the charges that will be applicable.
- 12.2 A Revised Minimum Revenue Provision Policy for 2015/16 is attached as Appendix 3. A new paragraph (4.5) has been added at the end.

13 Compliance with Treasury Management Strategy – quarter two

- 13.1 The Council's investment policy is governed by the CIPFA Code of Practice for Treasury Management in the Public Sector (revised in November 2009), which has been implemented in the Annual Investment Strategy approved by the Council on 26th February 2015. The investment activity during the quarter conformed to the approved strategy and the cash flow was successfully managed to maintain liquidity. This is shown in Table 4 of Appendix 2.

14 Other Options

- 14.1 There are many options available for the operation of the Treasury Management function, with varying degrees of risk associated with them. The Treasury Management Policy aims to effectively control risk to within a prudent level, whilst providing optimum performance consistent with that level of risk.

15 Reasons for Recommendations

- 15.1 The CIPFA Code of Practice on Treasury Management recommends that Local Authorities should submit reports regularly. The Treasury Management Policy Statement for 2015/16 set out that reports would be submitted to Cabinet quarterly on the activities of the treasury management operation.

16 Corporate Implications

- 16.1 Contribution to Council's Vision & Critical Priorities

Treasury Management practices in accordance with statutory requirements, together with compliance with the prudential indicators acknowledge how effective treasury management provides support towards the achievement of the Council's Vision and Critical Priorities.

- 16.2 Financial Implications

The financial implications of Treasury Management are dealt with throughout this report.

16.3 Legal Implications

This Council has adopted the 'CIPFA Code of Practice for Treasury Management in the Public Sector' and operates its treasury management service in compliance with this code.

16.4 People Implications

None.

16.5 Property Implications

None.

16.6 Consultation

The key Treasury Management decisions are taken in consultation with our Treasury Management advisers.

16.7 Equalities and Diversity Implications

None.

16.8 Risk Assessment

The Treasury Management Policy acknowledges that the successful identification, monitoring and management of risk are fundamental to the effectiveness of its activities.

16.9 Value for Money

Treasury Management activities include the pursuit of optimum performance consistent with effective control of the risks associated with those activities.

16.10 Community Safety Implications

None.

16.11 Environmental Impact

None.

17 Background Papers

None.

18 Appendices

Appendix 1 – Treasury Management Position as at 30th September 2015

Appendix 2 – Treasury Management Performance for Quarter Two – 2015/16

Appendix 3 – Revised Minimum Revenue Provision Policy 2015/16