Southend-on-Sea Borough Council

Agenda Item No.

Report of Corporate Director of Corporate Services
to

Cabinet

on

22 September 2015

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Quarter One Treasury Management Report – 2015/16
Policy and Resources Scrutiny Committee
Executive Councillor: Councillor Woodley
A Part 1 Public Agenda Item

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1. Purpose of Report

1.1 The Quarter One Treasury Management Report covers the treasury management activity for the period from April 2015 to June 2015 and compliance with the treasury management strategy for that period.

2. Recommendations

That the following is approved:

2.1 The Quarter One Treasury Management Report for 2015/16.

That the following is noted:

2.2 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 June 2015.

2.3 The loan and investment portfolios were actively managed to minimise cost and maximise interest earned, whilst maintaining a low level of risk.

2.4 An average of £65.4m of investments were managed in-house. These earned £0.099m of interest during this three month period at an average rate of 0.61%. This is 0.25% over the average 7-day LIBID and 0.11% over the bank base rate.

2.5 An average of £24.9m of investments were managed by fund managers. These earned £0.042m of interest during this three month period at an average rate of 0.67%. This is 0.31% over the average 7-day LIBID and 0.17% over bank base rate.

2.6 An average of £5.0m was managed by a property fund manager. This earned £0.100m during this three month period from a combination of an increase in the value of the units and income distribution, giving a combined return of 7.98%. The fund started the quarter at £4.989m and increased in value with the fund at the end of the quarter at £5.081m.

2.7 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 (HRA: £80.8m, GF: £157.0m) during the period from April to June 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 first quarterly report for the financial year 2015/16.

3.3 Appendix 1 shows the treasury management position at the end of quarter one of 2015/16.

3.4 Appendix 2 shows the treasury management performance specifically for quarter one of 2015/16.

4. National Context

4.1 The UK economy has continued to grow and rising household spending together with robust business investment are predicted to drive further growth. The CBI raised its growth forecasts to 2.6% and 2.8% for 2015 and 2016 as low inflation (at 0.1% in July rising from 0% in June) and rising wages stimulate consumer spending. Public finances returned the first July surplus for three years on the strongest monthly tax receipts on record.

4.2 The governor of the Bank of England had said last month the decision on UK interest rates would come into 'sharper focus' before the end of the year, and other Bank officials warned that the time for an in increase was approaching. However falling global stock markets following China's surprise currency devaluation and the falling oil price could again delay interest rate rises. Lower commodity prices could bring back deflation, while falling markets reflect concerns about global growth. 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 EU finance ministers have formally approved the first tranche of a new bailout for Greece after parliaments in member states backed the move. Following this approval, the Prime Minister of Greece resigned and called a snap election which is expected in September. Although concerns about a Greek exit from the Eurozone have subsided, there is still on-going uncertainty over the future economic prospects for Greece.

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.

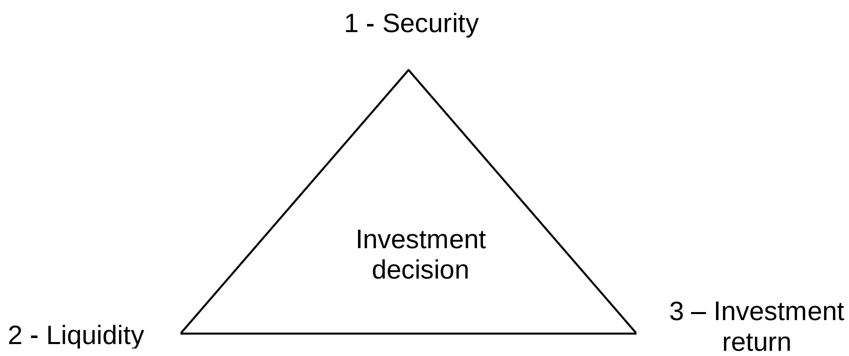
4.5 However, with a restricted list of counterparties and the increased focus on counterparty risk following the Icelandic Banks collapse, monies were mainly placed for short periods of time or in instant access accounts, which increased the liquidity of these funds.

4.6 Low interest rates prevailed throughout the quarter from April to June 2015 and this led to low investment income earnings from most investments.

5. Investments

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 and then other relevant information is considered. During the period from April to June 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 on the next page:



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 all monies is minimised through the Annual Investment Strategy.

5.4 Pie chart 1 of Appendix 1 shows that at the end of quarter one; 70% of our in-house investments were placed with financial institutions with a long term credit rating of AAA 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, 30% being placed directly with banks and 70% 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.

Liquidity:

5.7 Our in-house monies were available on an instant access basis at the end of quarter one, except for £10m which has been placed in a 100 day notice account. 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 Plc to manage monies on our behalf. An average of £24.9m was invested in these funds during the quarter earning an average rate of 0.67%.

5.9 The Council had an average of £65.4m of investments managed in-house over the period from April to June 2015, and these earned an average interest rate of 0.61%. Of the in-house managed funds:

- an average of £10.0m was held in notice accounts that earned an average interest rate of 0.67%;
- use was also made of call accounts during the quarter, because they provide instant access to funds while paying base rate or better. An average of £7.6m was held in these accounts and earned an average return of 0.65% over the quarter;
- an average of £47.8m was held in money market funds earning an average of 0.59% 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. Overall for both in-house and externally managed investments, performance on all types of investment was higher than the average 7 day LIBID (London Interbank Bid Rate). The bank base rate remained at 0.50% throughout the period from April to June 2015, and the 7 day LIBID rate fluctuated between 0.36% and 0.37%. Performance is shown in Graph 1 of Appendix 2.

6. Property Funds

6.1 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 the quarter £5.0m was invested in the Rockspring property fund with £5m expected to be invested in the Lothbury fund in quarter three.

6.2 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.

6.3 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.

6.4 An average of £5.0m was managed by Rockspring Property Investment Management Limited. During the three month period, the value of the fund increased by £0.039m due to the increase in the unit value, with £0.007m of this being offset by management fees. There was also an income distribution relating to that period of £0.061m and this distribution will be confirmed and distributed in quarter two.

6.5 The fund earned £0.100m (£0.093m net of fees) 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 7.98%. The fund started the quarter at £4.989m and increased in value with the fund at the end of the quarter at £5.081m.

7. Borrowing

PWLB and short term borrowing

7.1 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).

7.2 The Council began 2014/15 in the second of the above scenarios, with actual borrowing below CFR.

7.3 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 no loans were repaid on maturity. No debt restructuring was carried out during the quarter.

7.4 The level of PWLB borrowing (excluding debt relating to services transferred from Essex County Council on 1st April 1998) remained at £237.8m during quarter one. The average rate of borrowing at the end of the quarter was 4.56%. A profile of the repayment dates is shown in Graph 2 of Appendix 2. All PWLB debt held is repayable on maturity.

7.5 The table below summarises the PWLB activities during the quarter:

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
Of which:					
General Fund	157.0	0	0	(0)	157.0
HRA	80.8	0	0	(0)	80.8

7.6 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.

These figures exclude debt held by Essex County Council of £13.8m relating to assets transferred on 1st April 1998, which this Council is responsible for servicing. The debt is recognised as a deferred liability on our balance sheet.

7.7 Interest rates from the PWLB fluctuated throughout the quarter in response to economic events: 10 year PWLB rates between 2.44% and 3.09%; 25 year

PWLB rates between 3.07% and 3.65% and 50 year PWLB rates between 3.01% and 3.55%. These rates are after the PWLB ‘certainty rate’ discount of 0.20%.

7.8 No short term borrowing was taken out for cash flow purposes during the quarter. See Table 2 of Appendix 2.

Funding for Invest to Save Schemes

7.9 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.

7.10 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 June 2015.

8. Compliance with Treasury Management Strategy

8.1 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. See Table 3 of Appendix 2.

9 Other Options

9.1 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.

10. Reasons for Recommendations

10.1 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.

11. Corporate Implications

11.1 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.

11.2 Financial Implications

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

11.3 Legal Implications

The 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.

11.4 People Implications

None.

11.5 Property Implications

None.

11.6 Consultation

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

11.7 Equalities Impact Assessment

None.

11.8 Risk Assessment

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

11.9 Value for Money

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

11.10 Community Safety Implications

None.

11.11 Environmental Impact

None.

12. Background Papers

None.

13. Appendices

Appendix 1 – Treasury Management Position as at the end of Quarter One - 2015/16

Appendix 2 – Treasury Management Performance for Quarter One - 2015/16