Southend-on-Sea Borough Council

Agenda
Item No.
6

Report of Chief Executive
to
Cabinet
on
14 March 2017

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Quarter Three Treasury Management Report – 2016/17
Policy and Resources Scrutiny Committee
Executive Councillor: Councillor Moring
A Part 1 Public Agenda Item

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1. Purpose of Report

1.1 The Quarter Three Treasury Management Report covers the treasury management activity and compliance with the treasury management strategy for both quarter three and the period from April to December 2016.

2. Recommendations

That the following is approved:

2.1 The Quarter Three Treasury Management Report for 2016/17.

2.2 The Revised Minimum Revenue Provision Policy 2016/17 attached at Appendix 3, the changes to which are set out in Section 14.

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 December 2016.

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 £49.2m of investments were managed in-house. These earned £0.21m of interest during this nine month period at an average rate of 0.57%. This is 0.34% over the average 7 day LIBID and 0.21% over the average bank base rate.

2.6 An average of £13.1m of investments were managed by our former external fund manager. These earned £0.14m of interest during this nine month period at an average rate of 1.37%. This is 1.14% over the average 7 day LIBID and 1.01% over the average bank base rate.

2.7 During September 2016 £22.7m was recalled from our former external fund manager and £15m was invested equally across two short dated bond funds and £5m was invested into an enhanced cash fund.

2.8 An average of £6.1m was managed by two short dated bond fund managers. This earned £0.22m since it was invested from a combination of an increase in the value of the units and income distribution, giving a combined return of 1.32%.

2.9 An average of £1.7m was managed by an enhanced cash fund manager. This earned £0.007m since it was invested at an average rate of 1.60%.

2.10 An average of £14.7m was managed by two property fund managers. This earned £0.278m during this nine month period from a combination of an increase in the value of the units and income distribution, giving a combined return of 2.50%.

2.11 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 £227.8m (Housing Revenue Account (HRA): £77.0m, GF: £150.8m) during the period from April to December 2016.

2.12 The level of financing for 'invest to save' capital schemes increased from £3.21m to £6.78m during the period from April to December 2016.

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 2016/17 set out that reports would be submitted to Cabinet quarterly on the activities of the treasury management operation. This is the third quarter report for the financial year 2016/17.

3.3 Appendix 1 shows the treasury management position at the end of quarter three of 2016/17.

3.4 Appendix 2 shows the treasury management performance specifically for quarter three of 2016/17.

4 National/Global Context

4.1 The Bank of England has amended its growth forecast for the UK to reach 2% in 2017. Inflation forecasts are now expected to remain above the 2% target until 2020. The headline inflation figure, CPI, rose to 1.8% in January on an annual basis. The fall in sterling and higher global oil prices were the main contributors to this increase.

4.2 The preliminary estimate for Q4 GDP showed a rise of 0.6%, unchanged from the previous quarter. On the year, growth was 2.2% higher than a year ago. The UK unemployment rate remained at 4.8% in Q4. British wage growth, including bonuses, roses by 2.6% in December on an annual basis.

4.3 The Bank of England cut the bank rate for the first time since 2009 to 0.25% in August 2016, as the Monetary Policy Committee (MPC) voted unanimously in favour of a cut. It also expanded its Quantitative Easing (QE) programme by £60bn to £435bn. Both the Bank Rate and QE program were left unchanged in the February MPC meeting.

4.4 The first estimate for Q4 GDP in the US was recorded at an annual growth rate of 1.9%, a fall from the 3.5% recorded in Q3. A fall in shipments on food products pushed exports down but rising business investment suggests the economy will continue to expand. In December 2016, the Fed raised interest rates to a range between 0.50% - 0.75% after initially increasing them in December 2015 for the first time since 2006. This increase comes after positive rises in employment and labour market conditions.

4.5 The estimate for Eurozone Q4 GDP showed quarterly growth remained unchanged at 0.4%. Q4 annual growth fell to 1.7% from 1.8% recorded in Q3. In its January meeting, the European Central Bank (ECB) kept the main refinancing rate and deposit rate steady at 0% and -0.40% respectively.

4.6 China's annual GDP grew faster than expected by an annual rate of 6.8% in Q4, as increased Government spending and record level bank lending contributed to the rise as well as continued strong investment in the property sector. As a result, the economy expanded by 6.7% for 2016.

4.7 The economic situation together with the financial market conditions prevailing throughout the quarter continued to provide challenges for treasury management activities. There have been gradual changes in the credit ratings of financial institutions but we continue to have a restricted list of counterparties (i.e. people we can invest with) that still meet our prudent investment criteria.

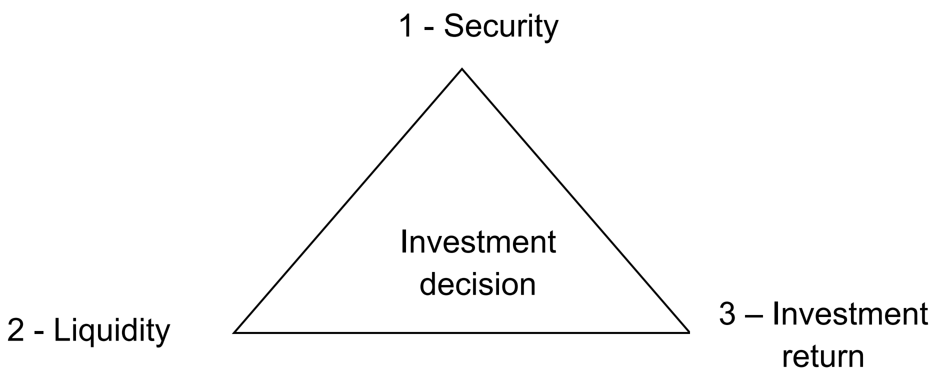
4.8 However, with a restricted list of counterparties, the increased focus on counterparty risk following the Icelandic Banks collapse and the interest rate outlook, monies were mainly placed for short periods of time or in instant access accounts, which increased the liquidity of these funds.

4.9 Low interest rates prevailed throughout the period from April to December 2016 and this led to low investment income earnings from all our investments.

5 Investments – quarter three (October to December)

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 October to December 2016 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 monies invested is minimised through the Annual Investment Strategy.

5.4 Pie chart 1 of Appendix 1 shows that at the end of quarter two; 42% of our in-house investments were placed with financial institutions with a long term rating of AAA and 58% with a long term rating of A-.

5.5 As shown in pie chart 2 of Appendix 1, these monies were with various counterparties, 58% being placed directly with banks and 42% 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 available on an instant access basis at the end of quarter three, except for £10m which had been placed in a 95 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 used the enhanced cash fund manager Payden & Rygel to manage monies on our behalf. An average balance of £5.0m was invested in these funds during the quarter earning an average rate of 0.70%. More details are set out in Table 2 of Appendix 2.

5.9 The Council had an average of £47.6m of investments managed in-house over the period from October to December, and these earned an average interest rate of 0.48%. Of the in-house managed funds:

- an average of £10.0m was held in notice accounts that earned an average interest rate of 0.44%.

- use was also made of call accounts during the quarter because they provide instant access to funds. An average of £8.6m was held in these accounts and earned an average return of 0.65% over the quarter.

- an average of £29.0m was held in money market funds earning an average of 0.44% 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, performance on our investments was higher than the average 7 day LIBID and higher than the average base rate for the quarter. The bank base rate remained at 0.25% throughout the period from October to December 2016, and the 7 day LIBID rate fluctuated between 0.11% and 0.13%. Performance is shown in Graph 1 of Appendix 2.

6 Investments – quarter three cumulative position

6.1 During the period from April to December 2016 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 nine 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 December 2016:

Table 1: Investment position

	At 31 March 2016	At 31 December 2016	April to December 2016	
	Actual Balance (£000s)	Actual Balance (£000s)	Average Balance (£000s)	Average Rate (%)
Notice accounts	10,000	10,000	10,000	0.55
Fixed term deposits	5,000	0	1,148	0.88
Call accounts	7,315	13,411	8,422	0.65
Money market funds	24,000	17,000	29,593	0.54
Total investments managed in-house	**46,315**	**40,411**	**49,163**	**0.57**
Enhanced Cash Funds	22,541	5,007	14,854	1.40
Short Dated Bond Funds	0	15,008	6,128	1.32
Property Funds	12,712	15,491	14,721	2.50
Total investments managed externally	**35,253**	**35,506**	**35,703**	**1.84**
Total investments	**81,568**	**75,917**	**84,866**	**1.10**

6.4 The majority of the cash balances managed in-house are required to meet short term cash flow requirements and therefore throughout the nine month period monies were placed 36 times for periods of one year or less. The table below 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)	14	72
BlackRock	Money Market Fund (Various Counterparties)	9	54
Standard Life Investment	Money Market Fund (Various Counterparties)	6	40
Insight Investment Management Ltd	Money Market Fund (Various Counterparties)	7	29

6.5 In addition to the above, use was also made of call accounts during the year because they provide instant access to funds. This meant that funds were available for cash flow movements to avoid having to pay higher rates to borrow from the market. During the period from April to December 2016 an average of £8.4m was held in such accounts.

7 Property Funds – quarter three (October to December)

7.1 Rockspring Property Investment Management Limited and Lothbury Investment Management Limited were appointed for investment of long term funds in April and October 2015 respectively.

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 is 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 Council's 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 £7.8m was managed by Rockspring Property Investment Management Limited. During quarter three, the value of the fund increased by £0.049m due to the increase in the unit value. There was also an income distribution relating to that period of £0.106m and this distribution will be confirmed and distributed in quarter four.

7.5 The Rockspring fund earned £0.155m 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 7.85%. The fund started the quarter at £7.817m and increased in value with the fund at the end of the quarter at £7.972m. This is set out in Table 1 of Appendix 2.

7.6 An average of £7.4m was managed by Lothbury Property Investment Management Limited. During quarter three, the value of the fund increased by £0.141m due to the increase in the unit value. There was also an income distribution relating to that period of £0.061 and this distribution will be confirmed and distributed in quarter four.

7.7 The Lothbury fund earned £0.202m 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 10.86%. The fund started the quarter at £7.317 and increased in value with the fund at the end of the quarter at £7.519m. This is set out in Table 1 of Appendix 2.

8 Property Funds – quarter three cumulative position

8.1 An average of £7.8m was managed by Rockspring Property Investment Management Limited. During the period from April to December 2016, the value of the fund decreased by £0.160m due to the decrease in the unit value. There was also an income distribution relating to that period of £0.317m and the quarter three part of this distribution will be confirmed and distributed in quarter four.

8.2 The Rockspring fund earned £0.157m during this nine month period from a combination of the increase in the value of the units and the income distribution, giving a combined return of 2.65%. The fund started the nine month period at £7.815m and increased in value with the fund at the end of the period at £7.972m.

8.3 An average of £6.9m was managed by Lothbury Property Investment Management Limited. During the period from April to December 2016, the value of the fund decreased by £0.050m due to the decrease in the unit value. There was also an income distribution relating to that period of £0.171m and the quarter three part of this distribution will be confirmed and distributed in quarter four.

8.4 The Lothbury fund earned £0.121m during this nine month period from a combination of the increase in the value of the units and the income distribution, giving a combined return of 2.34%. The value of the fund also increased by £2.502m due to the value of new units purchased after fees. The fund started the nine month period at £4.896m and increased in value with the fund at the end of the period at £7.519m.

9 Short Dated Bond Funds – quarter three (October to December)

9.1 Following a tender exercise, two short dated bond funds were chosen for the investment of medium term funds: Royal London Investment Grade Short Dated Credit Fund and the AXA Sterling Credit Short Duration Bond Fund.

9.2 The monies are invested in units in the fund, the fund is then invested as a whole by the fund managers into corporate bonds in the one to five year range. An income distribution will be generated from the coupon on the bond and income distributions will be reinvested back into the fund. The price of units can rise and fall, depending on the price of units in the fund so these funds are invested over the medium term with the aim of realising higher yields than short term investments.

9.3 The Council's interest equalisation reserve will be used to capture some of the income in the years when the corporate bond values are rising, and will then be available to offset any losses should bond 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.

9.4 An average of £7.6m was managed by AXA Investment Managers UK Limited. During quarter three, the value of the fund decreased by £0.017m due to the decrease in the unit value. There was also an income distribution relating to that period of £0.023m.

9.5 The AXA fund earned £0.006 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 0.34%. The fund started the quarter at £7.492m and increased in value with the fund at the end of the quarter at £7.498m. This is set out in Table 2 of Appendix 2.

9.6 An average of £7.5m was managed by Royal London Asset Management. During quarter three, the value of the fund decreased by £0.066m due to the decrease in the unit value. There was also an income distribution relating to that period of £0.046m.

9.7 The Royal London fund reduced by £0.020m 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 -1.06%. The fund started the quarter at £7.529m and increased in value with the fund at the end of the quarter at £7.509m. This is set out in Table 2 of Appendix 2.

10 Short Dated Bond Funds – quarter three cumulative position

10.1 An average of £3.0m was managed by AXA Investment Managers UK Limited. During the period from April to December 2016, the value of the fund decreased by £0.010m due to the decrease in the unit value. There was also an income distribution relating to that period of £0.023.

10.2 The AXA fund earned £0.013m during this nine month period from a combination of the decrease in the value of the units and the income distribution, giving a combined return of 1.53%. The fund started the nine month period at nil and increased in value with the fund at the end of the period at £7.499m.

10.3 An average of £3.1m was managed by Royal London Asset Management. During the period from April to December 2016, the value of the fund decreased by £0.037m due to the decrease in the unit value. There was also an income distribution relating to that period of £0.046.

10.4 The Royal London fund earned £0.009m during this nine month period from a combination of the increase in the value of the units and the income distribution, giving a combined return of 1.11%. The fund started the nine month period at nil and increased in value with the fund at the end of the period at £7.509m.

11 Borrowing – quarter three

11.1 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).

11.2 The Council began quarter two in the second of the above scenarios, with actual borrowing below CFR.

11.3 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 debt restructuring was carried out during the quarter.

11.4 During quarter three, no new PWLB loans were taken out. No loans matured during the quarter.

11.5 The level of PWLB borrowing (excluding debt relating to services transferred from Essex County Council on 1st April 1998) remained at £227.8m during quarter three. The average rate of borrowing at the end of the quarter was 4.62%. A profile of the repayment dates is shown in Graph 2 of Appendix 2.

11.6 The level of PWLB borrowing at £227.8m 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.

11.7 Interest rates from the PWLB fluctuated throughout the quarter in response to economic events: 10 year PWLB rates between 1.59% and 2.41%; 25 year PWLB rates between 2.30% and 2.98% and 50 year PWLB rates between 2.12% and 2.73%. These rates are after the PWLB 'certainty rate' discount of 0.20%.

11.8 During quarter three £5m of short term borrowing activity was taken out for cash flow purposes. See Table 3 of Appendix 2.

12 Borrowing – quarter three cumulative position

12.1 The Council's borrowing limits for 2016/17 are shown in the table below:

	2016/17 Original (£m)	**2016/17 Revised (£m)**
Operational Boundary	280	265
Authorised Limit	290	275

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.

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.

12.2 The Council's outstanding borrowing as at 31st December 2016 was:

- Southend-on-Sea Borough Council £234.6m
  - PWLB: £227.8m
  - Invest to save: £6.8m
- ECC transferred debt £12.5m

Repayments in the first 9 months of 2016/2017 were:

- Southend-on-Sea Borough Council £0m
- ECC transferred debt £0.66m

12.3 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.

12.4 The interest payments for PWLB and excluding transferred debt, during the period from April to December 2016 were £6.951m which was unchanged from the original budget for the same period.

12.5 The table below summarises the PWLB borrowing activities over the period from April to December 2016:

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 2016	227.8	0	0	(0)	227.8
July to September 2016	227.8	0	0	(0)	227.8
October to December 2016	227.8	0	0	(0)	227.8
Of which:					
General Fund	150.8	0	0	(0)	150.8
HRA	77.0	0	0	(0)	77.0

All PWLB debt held is repayable on maturity.

13 Funding for Invest to Save Schemes (included in Section 12)

13.1 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.

13.2 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. £0.035 of this loan was repaid during the period from April to December 2016.

13.3 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 three was £6.69m. There were no repayments during the period from April to December 2016.

13.4 Funding of these invest to save schemes is shown in Appendix 2, with Table 4 showing the Salix Finance repayment.

14 Revised Minimum Revenue Provision Policy

14.1 The Minimum Revenue Provision (MRP) Policy is currently under review and various options for the 2017/18 policy are being considered in consultation with our Treasury Management advisers.

14.2 The current policy for capital expenditure financed by supported borrowing is for MRP to be applied at 4% on a reducing balance basis. It is possible to amend the calculation under the current regulations and guidance, as long as the revised approach is considered prudent. There is currently no amendment being proposed for unsupported borrowing and this will be considered as part of the above review.

14.3 The 2016/17 policy has been revised for capital expenditure financed by supported borrowing so that MRP is applied at 2% on a straight line basis. This approach will have the effect of reducing the debt liability to a fixed life of 50 years compared to the current provision which will take in excess of 150 years. A charge based on a fixed straight-line basis is more prudent as it introduces a more certain period for spreading the cost of this element of the debt liability.

14.4 A Revised Minimum Revenue Provision Policy for 2016/17 is attached as Appendix 3.

15 Compliance with Treasury Management Strategy – quarter three

15.1 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 25th February 2016. 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 5 of Appendix 2.

16 Other Options

16.1 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.

17 Reasons for Recommendations

17.1 The CIPFA Code of Practice on Treasury Management recommends that Local Authorities should submit reports regularly. The Treasury Management Policy Statement for 2016/17 set out that reports would be submitted to Cabinet quarterly on the activities of the treasury management operation.

18 Corporate Implications

18.1 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.

18.2 Financial Implications

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

18.3 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.

18.4 People Implications

None.

18.5 Property Implications

None.

18.6 Consultation

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

18.7 Equalities Impact Assessment

None.

18.8 Risk Assessment

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

18.9 Value for Money

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

18.10 Community Safety Implications

None.

18.11 Environmental Impact

None.

19 Background Papers

None.

20 Appendices

Appendix 1 – Treasury Management Position as at the end of Quarter Three - 2016/17

Appendix 2 – Treasury Management Performance for Quarter Three – 2016/17

Appendix 3 – Revised Minimum Revenue Provision Policy 2016/17