Southend-on-Sea Borough Coun

Agenda

Item No.

Report of Chief Executive
to

Cabinet

on
13 March 2018

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Quarter Three Treasury Management Report – 2017/18
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 2017.

2. Recommendations

That the following is approved:

2.1 The Quarter Three Treasury Management Report for 2017/18.

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 December 2017.

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 £47.4m of investments were managed in-house. These earned £0.157m of interest during this nine month period at an average rate of 0.44%. This is 0.27% over the average 7 day LIBID and 0.14% over the average bank base rate.

2.5 An average of £5.0m was managed by an enhanced cash fund manager. This earned £0.023m during this nine month period at an average rate of 0.62%.

2.6 An average of £15.2m was managed by two short dated bond fund managers. This earned £0.176m 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 1.54%.

2.7 An average of £16.3m was managed by two property fund managers. This earned £1.353m 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 11.01%.

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 £227.8m (Housing Revenue Account (HRA): £77.0m, GF: £150.8m) during the period from April to December 2017.

2.9 The level of financing for 'invest to save' capital schemes increased from £7.90m to £8.80m during the period from April to December 2017.

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 2017/18 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 2017/18.

3.3 Appendix 1 shows the treasury management position at the end of quarter three of 2017/18.

3.4 Appendix 2 shows the treasury management performance specifically for quarter three of 2017/18.

4 National/Global Context

4.1 At the beginning of November the Bank of England increased the bank base rate from its historical low of 0.25% to 0.5%. In January CPI was unchanged at 3.0% and the Monetary Policy Committee said interest rates would need to rise sooner than expected as they aim to bring inflation back to 2%.

4.2 There seems to have been a fairly buoyant end to 2017 for the UK economy. The Purchasing Manager Indices eased a little in December but still suggest that growth may have accelerated a little from Q3. This is expected leave growth for the year at around 1.8%.

4.3 The House Price Index for January showed the average UK house price was £227,000, an increase of 5.2% in the year to December. UK core sales rose by just 0.1% in January from the previous month, evidencing further that inflation continues to run at a higher rate than increases in earnings.

4.4 In the US, the economy has followed the pattern of recent years, with a slow opening quarter followed by acceleration thereafter. Q2 and Q3 both posted 3% annualised growth, the first consecutive growth of this magnitude for three years. Surveys are indicative of a similar growth in Q4. The weaker Dollar is benefiting manufacturing and business surveys are upbeat and indicative of further output growth over the next couple of months.

4.5 In the Eurozone, data and surveys are indicative that the economy has at least sustained levels of growth into Q4, but could have picked up. The Q3 decline in GDP growth was the result of consumer spending slowing so the strong November retail sales figures should help to reverse at least some of this downturn. The Economic Sentiment Indicator indicates annualised GDP growth of 4%. Germany’s economy remains robust and there are promising signs of improvement in France, but Italy is a hindrance on overall growth.

4.6 In China, official measures indicate a slight slowing of growth, however actual production volumes would seem to reflect a sharper dip in output growth to the slowest level in nearly two years. Retail sales growth improved but was not broad based. Consumer confidence has soared to a 20 year high, helped by a strong labour market. However, that does not tally with spending measures, though the People’s Bank says that depositors with an inclination to spend rather than save are at an eight year high.

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

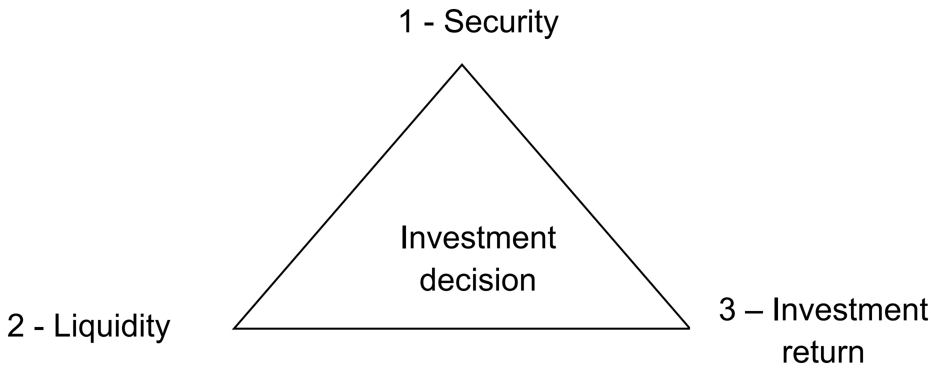
4.8 However, with a restricted list of counterparties, the increased focus on counterparty risk following the Icelandic Banks collapse and the interest rate outlook, monies managed in-house were mainly placed for short periods of time or in instant access accounts, which increased the liquidity of these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

4.9 Low interest rates prevailed throughout the period from April to December 2017 and this led to low investment income earnings from many of 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 2017 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; 35% of our in-house investments were placed with financial institutions with a long term rating of AAA and 65% with a long term rating of A.

5.5 As shown in pie chart 2 of Appendix 1, these monies were with various counterparties, 65% being placed directly with banks and 35% 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. Notice has been given on this account, so the monies are due back within 57 days of the quarter end. 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 0.90%. More details are set out in Table 2 of Appendix 2.

5.9 The Council had an average of £48.5m 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 0.57%.

- use was also made of call accounts during the quarter because they provide instant access to funds. An average of £8.8m was held in these accounts and earned an average return of 0.64% over the quarter.

- an average of £29.7m was held in money market funds earning an average of 0.40% 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% until 2nd November when the Bank of England raised it to 0.5% and it remained at that level throughout the rest of the period to December 2017. The 7 day LIBID rate fluctuated between 0.11% and 0.36%. Performance is shown in Graph 1 of Appendix 2.

6 Investments – quarter three cumulative position

6.1 During the period from April to December 2017 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 2017:

Table 1: Investment position

	At 31 March 2017	At 31 December 2017	April to December 2017	
	Actual Balance (£000s)	Actual Balance (£000s)	Average Balance (£000s)	Average Rate (%)
Notice accounts	10,000	10,000	10,000	0.48
Call accounts#	7,992	16,175	8,468	0.63
Money market funds	23,000	14,000	28,975	0.37
Total investments managed in-house	**40,992**	**40,175**	**47,443**	**0.44**
Enhanced Cash Funds	5,022	5,045	5,032	0.62
Short Dated Bond Funds	15,125	15,302	15,200	1.54
Property Funds	15,859	17,211	16,314	11.01
Total investments managed externally	**36,006**	**37,558**	**36,546**	**5.64**
Total investments	**76,998**	**77,733**	**83,989**	**2.70**

#This includes the council's main current account.

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 28 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)
BlackRock	Money Market Fund (Various Counterparties)	12	70
Goldman Sachs	Money Market Fund (Various Counterparties)	12	62
Insight Investment Management Ltd	Money Market Fund (Various Counterparties)	3	18
Standard Life Investment	Money Market Fund (Various Counterparties)	1	2

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 2017 an average of £8.5m was held in such accounts.

7 Property Funds – quarter three (October to December)

7.1 Throughout the quarter long term funds were invested in two property funds: Rockspring Property Investment Management Limited and Lothbury Investment Management Limited.

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 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 £8.7m was managed by Rockspring Property Investment Management Limited. During quarter three, the value of the fund increased by £0.157m due to the increase in the unit value. There was also an income distribution relating to that period of £0.100m and this distribution will be confirmed and distributed in quarter four.

7.5 The Rockspring fund earned £0.257m 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 11.78%. The fund started the quarter at £8.669m and increased in value with the fund at the end of the quarter at £8.926m. This is set out in Table 1 of Appendix 2.

7.6 An average of £8.1m was managed by Lothbury Property Investment Management Limited. During quarter three, the value of the fund increased by £0.182m due to the increase in the unit value. There was also an income distribution relating to that period of £0.068 and this distribution will be confirmed and distributed in quarter four.

7.7 The Lothbury fund earned £0.250m 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 12.30%. The fund started the quarter at £8.035 and increased in value with the fund at the end of the quarter at £8.285m. This is set out in Table 1 of Appendix 2.

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

8.1 Throughout the quarter medium term funds were invested in two short dated bond funds: Royal London Investment Grade Short Dated Credit Fund and the AXA Sterling Credit Short Duration Bond Fund.

8.2 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.

8.3 The 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.

8.4 An average of £7.6m was managed by AXA Investment Managers UK Limited. During the quarter the value of the fund increased by £0.038m due to an increase in the unit value, giving a return of 2.03%. The fund started the quarter at £7.557m and increased in value with the fund at the end of the quarter at £7.595m. This is set out in Table 2 of Appendix 2

8.5 An average of £7.7m was managed by Royal London Asset Management. During quarter three, the value of the fund increased by £0.015m due to the increase in the unit value. There was also an income distribution relating to that period of £0.045m.

8.6 The Royal London fund earned £0.060m 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 3.11%. The fund started the quarter at £7.646m and increased in value with the fund at the end of the quarter at £7.706m. This is set out in Table 2 of Appendix 2.

9 Property Funds – quarter three cumulative position

9.1 An average of £8.4m was managed by Rockspring Property Investment Management Limited. During the period from April to December 2017, the value of the fund increased by £0.454m due to the increase in the unit value. There was also an income distribution relating to that period of £0.295m and the quarter three part of this distribution will be confirmed and distributed in quarter four.

9.2 The Rockspring fund earned £0.749m 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 11.84%. The fund started the nine month period at

£8.177m and increased in value with the fund at the end of the period at £8.926m.

9.3 An average of £7.9m was managed by Lothbury Property Investment Management Limited. During the period from April to December 2017, the value of the fund increased by £0.413m due to the increase in the unit value. There was also an income distribution relating to that period of £0.190m and the quarter three part of this distribution will be confirmed and distributed in quarter four.

9.4 The Lothbury fund earned £0.603m 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 10.13%. The fund started the nine month period at £7.682m and increased in value with the fund at the end of the period at £8.285m.

10 Short Dated Bond Funds – quarter three cumulative position

10.1 An average of £7.6m was managed by AXA Investment Managers UK Limited. During the period from April to December 2017 the value of the fund increased by £0.058m due to an increase in the unit value, giving a return of 1.02%. The fund started the six month period at £7.537m and increased in value with the fund at the end of the period at £7.595m.

10.2 An average of £7.6m was managed by Royal London Asset Management. During the period from April to December 2017, the value of the fund decreased by £0.023m due to the decrease in the unit value. There was also an income distribution relating to that period of £0.141m.

10.3 The Royal London fund earned £0.118m 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 2.05%. The fund started the nine month period at £7.588m and increased in value with the fund at the end of the period at £7.706m.

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 2.24% and 2.50%; 25 year PWLB rates between 2.77% and 3.05% and 50 year PWLB rates between 2.49% and 2.79%. These rates are after the PWLB 'certainty rate' discount of 0.20%.

11.8 During quarter three no short term borrowing 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 2017/18 are shown in the table below:

	2017/18 Original (£m)	**2017/18 Revised (£m)**
Operational Boundary	285	260
Authorised Limit	295	270

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 2017 was:

- Southend-on-Sea Borough Council £236.6m
  - PWLB: £227.8m
  - Invest to save: £8.8m
- ECC transferred debt £11.9m

Repayments in the first 9 months of 2017/2018 were:

- Southend-on-Sea Borough Council £0m
- ECC transferred debt £0.63m

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 2017 were £6.951m compared to the original budget of £7.066m for the same period. These interest payments are lower than budgeted as, due to the reasons set out in paragraph 11.3, no new loans were taken out during 2016/17 or during the first three quarters of 2017/18.

12.5 The table below summarises the PWLB borrowing activities over the period from April to December 2017:

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 2017	227.8	0	0	(0)	227.8
July to September 2017	227.8	0	0	(0)	227.8
October to December 2017	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 Capital projects were completed on draught proofing and insulation in the Civic Centre, and lighting replacements at University Square Car Park and Westcliff Library which will generate on-going energy savings. These are invest-to-save projects and the predicted revenue streams cover as a minimum the financing costs of the project.

13.2 To finance this project the Council has taken out interest free loans of £0.223m 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 loans are for periods of four and five 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. £0.043m of this loan was repaid during the period from April to December 2017.

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 £8.67m. There were no repayments during the period from April to December 2017.

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

14 Compliance with Treasury Management Strategy – quarter three

14.1 The Council's investment policy is governed by the CIPFA Code of Practice for Treasury Management in the Public Sector, which has been implemented in the Annual Investment Strategy approved by the Council on 23rd February 2017. 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.

15 Other Options

15.1 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.

16 Reasons for Recommendations

16.1 The CIPFA Code of Practice on Treasury Management recommends that Local Authorities should submit reports regularly. The Treasury Management Policy Statement for 2017/18 set out that reports would be submitted to Cabinet quarterly on the activities of the treasury management operation.

17 Corporate Implications

17.1 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.

17.2 Financial Implications

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

17.3 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.

17.4 People Implications

None.

17.5 Property Implications

None.

17.6 Consultation

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

17.7 Equalities Impact Assessment

None.

17.8 Risk Assessment

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

17.9 Value for Money

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

17.10 Community Safety Implications

None.

17.11 Environmental Impact

None.

18 Background Papers

None.

19 Appendices

Appendix 1 – Treasury Management Position as at the end of Quarter Three - 2017/18

Appendix 2 – Treasury Management Performance for Quarter Three – 2017/18