Southend-on-Sea Borough Coun

Agenda Item No.

Report of Chief Executive
to
Cabinet
on
18 September 2018

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Quarter One Treasury Management Report – 2018/19
Policy and Resources Scrutiny Committee
Cabinet Member: Councillor John Lamb
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 to June 2018 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 2018/19.

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 2018.

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 £0.826m of interest was earned during this three month period at an average rate of 4.90%. This is 4.54% over the average 7 day LIBID (London Interbank Bid Rate) and 4.40% over the average bank rate. The breakdown of this overall investment position is set out in section 8.

2.5 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 (HRA: £77.0m, GF: £150.8m) during the period from April to June 2018.

2.6 During the quarter the level of financing for 'invest to save' schemes decreased from £8.74m to £8.72m.

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 2018/19 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 2018/19.

3.3 Appendix 1 shows the treasury management position at the end of quarter one of 2018/19.

3.4 Appendix 2 shows the treasury management performance specifically for quarter one of 2018/19.

4. National Context

4.1 In the UK the rate of GDP growth was 0.4% in the three months to the end of June, double that of the first quarter. On an annual basis the economy grew by 1.3% mainly driven by the services sector which grew by 0.5%. Overall consumer spending grew by 0.3% with consumers taking advantage of the warm weather and the football World Cup. The construction sector also recovered in quarter two after the freezing weather conditions earlier in the year. However, manufacturing output decreased by 0.9%.

4.2 CPI was at 2.4% throughout the quarter. The increase in recent months is down to the import intensive areas of the basket of goods used to measure price changes. The unemployment rate for the quarter was 4%, a reduction from the rate in quarter one of 4.2%.

4.3 The Bank of England kept the bank base rate at 0.50% throughout the quarter and left their Quantitative Easing (QE) programme at £435bn. On 2nd August they raised the base rate from 0.5% to 0.75% on an assessment that the economy was in better health.

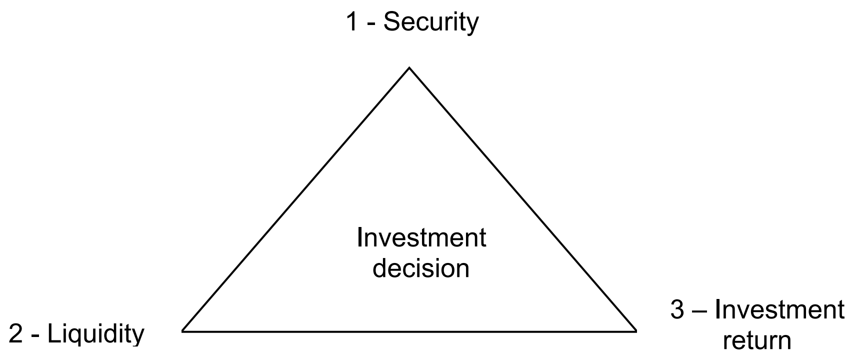
4.4 The economic situation together with the financial market conditions prevailing throughout the quarter continued to provide challenges for treasury management activities. Due to the low interest rate environment, only monies needed for day to day cash flow activities were kept in instant access accounts.

4.5 Low interest rates prevailed throughout the quarter from April to June 2018 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 an in-house 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 2018 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 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; 17% of our in-house investments were placed with financial institutions with a long term credit rating of AAA and 83% with a long term rating of A.

5.5 As shown in pie chart 2 of Appendix 1 these monies were with various counterparties, 83% being placed directly with banks and 17% 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. 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 its behalf. An average balance of £5.0m was invested in these funds during the quarter earning an average rate of 0.96%. More details are set out in Table 2 of Appendix 2.

5.9 The Council had an average of £19.8m of investments managed in-house over the period from April to June 2018, and these earned an average interest rate of 0.63%. Of the in-house managed funds:

- an average of £8.3m was held in call accounts and earned an average return of 0.63% over the quarter;
- an average of £11.5m was held in money market funds earning an average of 0.63% 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 2018, and the 7 day LIBID rate fluctuated between 0.356% and 0.370%. Performance is shown in Graph 1 of Appendix 2.

6. Short Dated Bond Funds

6.1 During the quarter two short dated bond funds were used for the investment of medium term funds: Royal London Investment Grade Short Dated Credit Fund and the AXA Sterling Credit Short Duration Bond Fund.

6.2 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 bonds in the fund so these funds are invested over the medium term with the aim of realising higher yields than short term investments.

6.3 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.

6.4 An average of £7.6m was managed by AXA Investment Managers UK Limited. During the quarter the value of the fund increased by £0.019m due to an increase in the unit value, giving a return of 1.02%. The fund started the quarter at £7.563m and increased in value with the fund at the end of the period at £7.582m.

6.5 An average of £7.7m was managed by Royal London Asset Management. During the quarter the value of the fund decreased by £0.015m due to an decrease in the unit value and increased due to income distributions of £0.080m.

6.6 The Royal London fund earned £0.065m during the year from a combination of the decrease in the value of the units and the income distribution, giving a combined return of 3.41%. The fund started the quarter at £7.630m and increased in value with the fund at the end of the period at £7.695m.

7. Property Funds

7.1 Throughout the quarter long term funds were invested in two property funds: Rockspring Hanover Property Unit Trust and Lothbury Property Trust.

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 are 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 £14.2m was managed by Rockspring Property Investment Managers LLP. During the three month period, the value of the fund increased by £0.251m due to the increase in the unit value. There was also an income distribution relating to that period of £0.169m and this distribution will be confirmed and distributed in quarter two.

7.5 The Rockspring fund earned £0.420m 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 11.88%. The fund started the quarter at £14.198m and increased in value with the fund at the end of the quarter at £14.618m.

7.6 An average of £13.3m was managed by Lothbury Investment Management Limited. During the three month period, the value of the fund increased by £4.989m due to the additional purchase of units in April 2018 and by £0.171m due to the increase in the unit value. There was also an income distribution relating to that period of £0.108m and this distribution will be confirmed and distributed in quarter two.

7.7 The Lothbury fund earned £0.279m 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 8.40%. The fund started the quarter at £8.427m and increased in value with the fund at the end of the quarter at £13.695m.

8. Overall Investment Position

8.1 An average of £19.8m of investments were managed in-house. These earned £0.031m of interest during this three month period at an average rate of 0.63%. This is 0.27% over the average 7-day LIBID and 0.13% over the bank base rate.

8.2 An average of £5.0m was managed by an enhanced cash fund manager. This earned £0.012m during this three month period at an average rate of 0.96%.

8.3 An average of £15.3m was managed by two short dated bond fund managers. This earned £0.084m 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 2.22%.

8.4 An average of £27.5m was managed by two property fund managers. These earned £0.699m 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 10.20%.

9 Borrowing

PWLB and short term borrowing

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 2018/19 in the second of the above scenarios, with actual borrowing below CFR.

9.3 This, together with the Council's cash flows, 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 and no loans matured during the quarter. No debt restructuring was carried out during the quarter.

9.4 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 one. 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. All PWLB debt held is repayable on maturity.

9.5 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 2018	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

9.6 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.

9.7 These figures exclude debt held by Essex County Council of £11.9m 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.

9.8 Interest rates from the PWLB fluctuated throughout the quarter in response to economic events: 10 year PWLB rates between 2.13% and 2.47%; 25 year PWLB rates between 2.52% and 2.79% and 50 year PWLB rates between 2.25% and 2.53%. These rates are after the PWLB 'certainty rate' discount of 0.20%.

9.9 No short term loans were taken out for cash flow purposes during the quarter and one short term loan for cash flow purposes was repaid during the quarter. See Table 3 of Appendix 2.

Funding for Invest to Save Schemes

9.10 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.

9.11 To finance these projects in total the Council has taken out interest free loans of £0.22m 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 a period 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. £0.026m of these loans were repaid during the period from April to June 2018.

9.12 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 L1 Renewables Finance Limited (formerly the Green Investment Bank). The balance outstanding at the end of quarter one was £8.61m. There were no repayments during the period from April to June 2018.

9.13 Funding of these invest to save schemes is shown in table 3 of Appendix 2.

10. Compliance with Treasury Management Strategy

10.1 The Council’s investment policy is governed by the CIPFA Code of Practice for Treasury Management in the Public Sector (revised in December 2017), which has been implemented in the Annual Investment Strategy approved by the Council on 22 February 2018. The investment activity during the quarter conformed to the approved strategy and the cash flow was successfully managed to maintain liquidity. See Table 4 of Appendix 2.

11 Other Options

11.1 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.

12. Reasons for Recommendations

12.1 The CIPFA Code of Practice on Treasury Management recommends that Local Authorities should submit reports regularly. The Treasury Management Policy Statement for 2018/19 set out that reports would be submitted to Cabinet quarterly on the activities of the treasury management operation.

13. Corporate Implications

13.1 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.

13.2 Financial Implications

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

13.3 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.

13.4 People Implications

None.

13.5 Property Implications

None.

13.6 Consultation

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

13.7 Equalities and Diversity Implications

None.

13.8 Risk Assessment

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

13.9 Value for Money

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

13.10 Community Safety Implications

None.

13.11 Environmental Impact

None.

14. Background Papers

None.

15. Appendices

Appendix 1 – In-house Investment Position as at 30th June 2018

Appendix 2 – Treasury Management Performance for Quarter One - 2018/19