Southend-on-Sea Borough Council

Agenda Item No.

Report of Strategic Director (Finance & Resources)
to

Cabinet

on
6 November 2018

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Treasury Management 2018/19 – Mid Year Position
Policy and Resources Scrutiny Committee
Cabinet Member: Councillor John Lamb
A Part 1 Public Agenda Item

1. Purpose of Report

1.1 The Mid-Year Treasury Management Report covers the treasury management activity and compliance with the treasury management strategy for both quarter two and the period from April to September 2018.

2. Recommendations

That the following is approved:

2.1 The Treasury Management Mid Year Position 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 September 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 £1.285m of interest was earned during this six month period at an average rate of 3.70%. This is 3.26% over the average 7 day LIBID (London Interbank Bid Rate) and 3.12% 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 (Housing Revenue Account (HRA): £77.0m, General Fund: £150.8m) during the period from April to September 2018.

2.6 The level of financing for 'invest to save' schemes decreased from £8.74m to £8.70m during the period from April to September 2018.

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 second quarter report for the financial year 2018/19.

3.3 Appendix 1 shows the in-house investment position at the end of quarter two of 2018/19.

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

4 National Context

4.1 There is still a lot of uncertainty around the likely outcome of the Brexit negotiations and whether a deal will be agreed in time for the UK's departure. This is causing uncertainty for business leaders and the financial markets and is leading to investment decisions being delayed.

4.2 The boost to manufacturing from the weaker Sterling post the Brexit referendum seems to have run its course but this was more than offset by the strength in the services sector. Annual CPI was at 2.4% in September down from 2.5% in July.

4.3 The unemployment rate for the quarter June to August was at 4%, with 261,000 more people in work that the same quarter last year. Job switching is back to pre-crisis levels but earnings are not reflective of this so far, with annual income growth not increasing in line.

4.4 On 2nd August the Bank of England increased the bank base rate from 0.50% to 0.75% and kept their Quantitative Easing (QE) programme at £435bn. The markets are not expecting the next rate rise to be until 2019 but there is uncertainty around the timing.

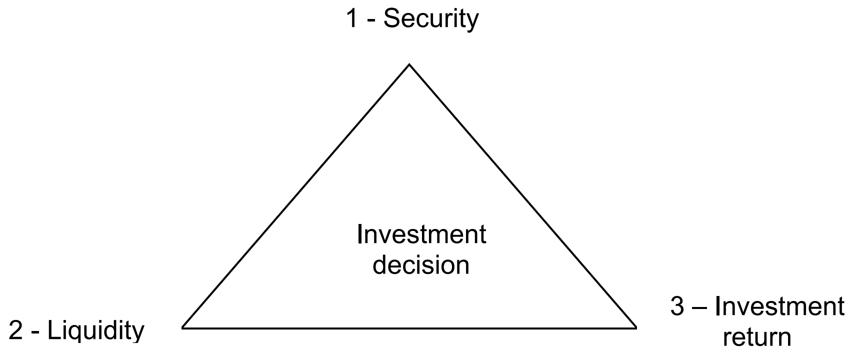
4.5 The economic situation together with the financial market conditions prevailing throughout the quarter continued to provide challenges for treasury management activities. Due to the low interest rate environment, only monies needed for day to day cash flow activities were kept in instant access accounts.

4.6 Low interest rates prevailed throughout the quarter from July to September 2018 and this led to low investment income earnings from the in-house investments.

5 Investments – quarter two (July to September)

5.1 A prime objective of our investment activities is the security of the principal sums invested. To ensure this security before a deposit is made an organisation is tested against a matrix of credit criteria. During the period from July to September 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 monies is minimised through the Annual Investment Strategy.

5.4 Pie chart 1 of Appendix 1 shows that at the end of quarter two; 50% of our in-house investments were placed with financial institutions with a long term rating of AAA, and 50% with a long term rating of A.

5.5 As shown in pie chart 2 of Appendix 1, these monies were with various counterparties, 50% being placed directly with banks and 50% placed with a range of counterparties via money market funds.

5.6 Pie chart 3 of Appendix 1 shows the 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 all available on an instant access basis at the end of quarter two. 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 £5.1m was invested in these funds during the quarter earning an average rate of 0.33%. More details are set out in Table 2 of Appendix 2

5.9 The Council had an average of £22.4m of investments managed in-house over the period from July to September, and these earned an average interest rate of 0.70%. Of the in-house managed funds:

- use was made of call accounts during the year, because they provide instant access to funds. An average of £8.3m was held in these accounts and earned an average return of 0.64% over the quarter;
- an average of £14.1m was held in money market funds earning an average of 0.74% 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 in-house performance during the quarter is compared to the average 7 day LIBID (London Interbank Bid Rate). Overall, investment performance was higher than the average 7 day LIBID. The 7 day LIBID rate fluctuated between 0.35% and 0.59%. The bank base remained at 0.50% until 2nd August when the Bank of England increased it to 0.75% and it remained at that level throughout the rest of the period to September 2018. Performance is shown in Graph 1 of Appendix 2.

6 Short Dated Bond Funds – quarter two (July to September)

6.1 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.

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 the price of units can rise and fall, depending on the value of the corporate bonds in the fund. So these investments would be over the medium term with the aim of realising higher yields than short term investments.

6.3 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 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 remained the same due to increases in the unit value during July and August being offset by a decrease in the unit value in September, giving a return of 0%. The fund started the quarter at £7.582m and increased in value with the fund at the end of the quarter at £7.582m. This is set out in Table 2 of Appendix 2.

6.5 An average of £7.7m was managed by Royal London Asset Management. During the quarter the value of the fund decreased by £0.047m due to a decrease in the unit value and increased due to income distributions of £0.063m.

6.6 The Royal London fund earned £0.016m during the quarter from a combination of the decrease in the value of the units and the income distribution, giving a combined return of 0.80%. The fund started the quarter at £7.695m and increased in value with the fund at the end of the quarter at £7.711m. This is set out in Table 2 of Appendix 2.

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

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 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 £14.6m was managed by Rockspring Property Investment Management Limited. During quarter two, the value of the fund increased by £0.112m due to the increase in the unit value. There was also an income distribution relating to that period of £0.149m and this distribution will be confirmed and distributed in quarter three.

7.5 The Rockspring fund increased by £0.261m 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 7.09%. The fund started the quarter at £14.618m and increased in value with the fund at the end of the quarter at £14.879m. This is set out in Table 1 of Appendix 2.

7.6 An average of £13.7m was managed by Lothbury Property Investment Management Limited. During quarter two, the value of the fund increased by £0.037m due to the increase in the unit value. There was also an income distribution relating to that period of £0.101m and this distribution will be confirmed and distributed in quarter three.

7.7 The Lothbury fund increased by £0.138m 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 3.98%. The fund started the quarter at £13.695m and increased in value with the fund at the end of the quarter at £13.833m. This is set out in Table 1 of Appendix 2.

8 Investments – quarter two cumulative position

8.1 During the period from April to September 2018 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.

8.2 The Council is aware of the risks of passive management of the treasury portfolio and has proactively managed levels of debt and investments over the six month period with the support of its treasury management advisers.

8.3 The table on the next page summarises the Council's investment position for the period from April to September 2018:

Table 1: Investment position

	At 31 March 2018	At 30 September 2018	April to September 2018	
	Actual Balance (£000s)	Actual Balance (£000s)	Average Balance (£000s)	Average Rate (%)
Call accounts#	8,186	5,969	8,323	0.64
Money market funds	13,000	6,000	12,810	0.69
Total investments managed in-house	**21,186**	**11,969**	**21,133**	**0.67**
Enhanced Cash Funds	5,038	5,055	5,047	0.64
Short Dated Bond Funds	15,193	15,293	15,275	1.31
Property funds	22,625	28,712	27,926	7.84
Total investments managed externally	**42,856**	**49,060**	**48,248**	**5.02**
Total investments	**64,042**	**61,029**	**69,381**	**3.70**

#This includes the council's main current account.

8.4 In summary the key factors to note are:

- An average of £21.1m of investments were managed in-house. These earned £0.071m of interest during this six month period at an average rate of 0.67%. This is 0.23% over the average 7 day LIBID (London Interbank Bid Rate) and 0.09% over the average bank base rate.

- An average of £5.0m was managed by an enhanced cash fund manager. This earned £0.016m during this six month period at an average rate of 0.64%.

- An average of £15.3m was managed by two short dated bond fund managers. This earned £0.100m during this six month period from a combination of an increase in the value of the units and income distribution, giving a combined return of 1.31%.

- An average of £27.9m was managed by two property fund managers. This increased in value by £1.098m during this six month period from a combination of an increase in the value of the units and by income distribution, giving a combined return of 7.84%.

8.5 The majority of the cash balances held by the Council are required to meet short term cash flow requirements and therefore throughout the six month period monies were placed 16 times for periods of one year or less. The table on the next page shows the most used counterparties overall and the countries in which they are based. All deals are in sterling despite the country the counterparties are based in.
Table 2: Counterparties used

Counterparty	Country	No. of Deals	Value of Deals (£m)
BlackRock	Money Market Fund (Various Counterparties)	9	53
Aberdeen Liquidity Fund (formerly Standard Life Investment)	Money Market Fund (Various Counterparties)	7	37

8.6 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 unexpected cash flow events to avoid having to pay higher rates to borrow from the market. During the period from April to September 2018 an average of £8.3m was held in such accounts.

9. Short Dated Bond Funds – quarter two cumulative position

9.1 An average of £7.6m was managed by AXA Investment Managers UK Limited. During the period from April to September 2018 the value of the fund increased by £0.019m due to an increase in the unit value, giving a return of 0.51%. The fund started the six month period at £7.563m and increased in value with the fund at the end of the period at £7.582m.

9.2 An average of £7.7m was managed by Royal London Asset Management. During the period from April to September 2018 the value of the fund decreased by £0.063m due to a decrease in the unit value and increased due to income distributions of £0.144m.

9.3 The Royal London fund earned £0.081m during the six month period from a combination of the decrease in the value of the units and the income distribution, giving a combined return of 2.09%. The fund started the six month period at £7.630m and increased in value with the fund at the end of the period at £7.711m.

10 Property Funds – quarter two cumulative position

10.1 An average of £14.4m was managed by Rockspring Property Investment Management Limited. During the period from April to September 2018, the value of the fund increased by £0.363m due to the increase in the unit value. There was also an income distribution relating to that period of £0.318m and the quarter two part of this distribution will be confirmed and distributed in quarter three.

10.2 The fund earned £0.681m during this six month period from a combination of the increase in the value of the units and the income distribution, giving a combined return of 9.44%. The fund started the six month period at £14.198m and increased in value with the fund at the end of the period at £14.879m.

10.3 An average of £13.5m was managed by Lothbury Property Investment Management Limited. During the period from April to September 2018, the value of the fund increased by £4.989m due to the purchase of additional units in April and by £0.209m due to an increase in the unit value. There was also an income distribution relating to that period of £0.208m and the quarter two part of this distribution will be confirmed and distributed in quarter three.

10.4 The fund increased by £0.417m during this six month period from a combination of the increase in the value of the units and the income distribution, giving a combined return of 6.14%. The fund started the six month period at £8.427m and increased in value with the fund at the end of the period at £13.833m.

11. Borrowing – quarter two

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 new PWLB loans were taken out and no loans matured during the quarter. No debt restructuring was carried out during the quarter.

11.4 The level of borrowing from the Public Works Loan Board (PWLB) (excluding debt relating to services transferred from Essex County Council on 1st April 1998) remained at £227.8m during the quarter. A profile of the repayment dates is shown in Graph 2 of Appendix 2.

11.5 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.

11.6 Interest rates from the PWLB fluctuated throughout the quarter in response to economic events: 10 year PWLB rates between 2.13% and 2.45%; 25 year PWLB rates between 2.50% and 2.83% and 50 year PWLB rates between 2.31% and 2.64%. These rates are after the PWLB 'certainty rate' discount of 0.20%.

11.7 During quarter two, no short term loans were taken out for cash flow purposes. This is shown in Table 3 of Appendix 2.

12. Borrowing – quarter two cumulative position

12.1 The Council's borrowing limits for 2018/19 are shown in the table below:

	2018/19 (£m)
Authorised Limit	295
Operational Boundary	285

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

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

12.2 The Council's outstanding borrowing as at 30 September 2018 was:

- Southend-on-Sea Borough Council £227.8m
- ECC transferred debt £11.9m

Repayments in the first 6 months of 2018/2019 were:

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

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 September 2018 were £5.263m which is the same as the original budget for the same period.

12.5 The table below summarises the PWLB borrowing activities over the period from April to September 2018:

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
July to September 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

All PWLB debt held is repayable on maturity.

13 Funding for Invest to Save Schemes

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 these projects 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. £0.026m of this loan was repaid during the period from April to September 2018.

13.3 At the meeting of Cabinet on 23 June 2015 the LED Street Lighting and Illuminated Street Furniture Replacement Project was approved which was to be partly funded by 25 year reducing balance ‘invest to save’ finance from the Green Investment Bank (GIB). The balance outstanding at the end of quarter two was £8.60m. A repayment of £0.011m was made during the period from April to September 2018.

13.4 Funding of these invest to save schemes is shown in Table 4 of Appendix 2.

14 Compliance with Treasury Management Strategy – quarter two

14.1 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. 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 2018/19 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 and Diversity Implications

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 – In-House Investment Position as at 30th September 2018

Appendix 2 – Treasury Management Performance for Quarter Two – 2018/19