

Southend-on-Sea Borough Council

**Report of Strategic Director (Finance & Resources)
To
Cabinet
on
12 March 2019**

**Agenda
Item No.**

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**Quarter Three Treasury Management Report – 2018/19
Policy and Resources Scrutiny Committee
Cabinet Member: Councillor John Lamb
*Part 1 (Public Agenda Item)***

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 2018.

2. Recommendations

That the following is approved:

- 2.1 The Quarter Three 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 December 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 £0.628m of interest was received during the nine month period. The total investment income earned including this interest during this nine month period was £1.843m, at an average rate of 3.54%. This is 3.06% over the average 7 day LIBID (London Interbank Bid Rate) and 2.90% over the average bank rate. (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, GF: £150.8m) during the period from April to December 2018.

- 2.6 The level of financing for ‘invest to save’ capital schemes decreased from £8.74m to £8.68m during the period from April to December 2018.**
- 2.7 The commercial property investment decision set out in section 14, made under delegated authority by the Strategic Director (Finance and Resources).**

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 third quarter report for the financial year 2018/19.
- 3.3 Appendix 1 shows the in-house investment position at the end of quarter three of 2018/19.
- 3.4 Appendix 2 shows the treasury management performance specifically for quarter three of 2018/19.

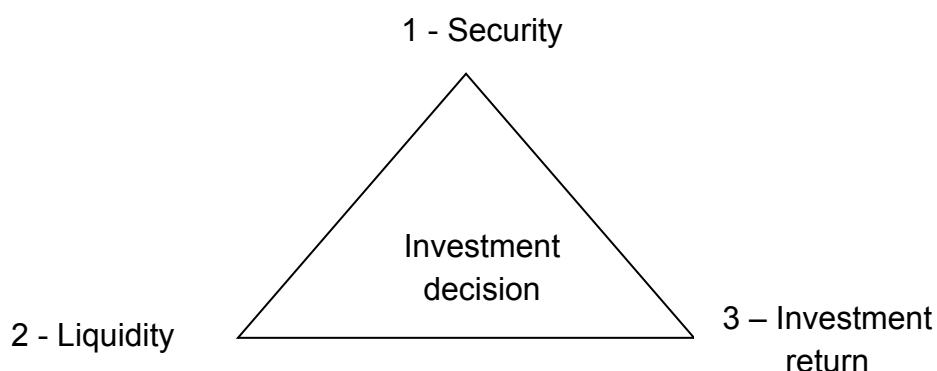
4 National/Global Context

- 4.1 At the beginning of August the Bank of England increased the bank base rate from 0.5% to 0.75%. The Monetary Policy Committee is likely to wait and see that happens with Brexit before any further changes. In January CPI was 1.8%, a reduction from 2.1% the previous month and the lowest since January 2017. The labour market remains buoyant with wage growth improving to a ten year high in October. Together with a lower CPI there is the potential for real wages growth which could boost household spending.
- 4.2 Annual GDP growth for 2018 was 1.4%, the lowest since 2012 due to the uncertainty around Brexit. However, analysts believe that if a solution can be achieved then the economy could fare well.
- 4.3 Average house prices in the UK increased by 2.5% in the year to December, down from 2.7% for the year to November. The lowest annual growth was in the North East, where prices fell by 1.0% over the year to December. This was followed by London where prices fell 0.6% over the year.
- 4.4 Growth in the Eurozone is slowing with slower household consumption growth, along with the weaker demand in China and the UK. Business confidence has been knocked, in part by the China-US trade dispute and also by a potential “no-deal” Brexit.

- 4.5 In the US, falls in oil/gasoline prices have helped to boost consumer spending and real consumption growth. However, the expectation is that this will slow in 2019 and the Federal Reserve may move from increasing rates in 2019 to starting to reduce them in 2020.
- 4.6 In China, the economy is weaker than a year ago with growth of around 5.5%. Weaker external demand is likely to be a factor with industrial sales for export markedly lower. Construction activity, which has underpinned growth, has also slowed. Rising food price inflation has been driving CPI higher over the last couple of years. Non-food inflation has also increased as rising oil prices have pushed fuel prices higher.
- 4.7 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.
- 4.8 Low interest rates prevailed throughout the period from April to December 2018 and this led to low investment income earnings from the in-house 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 2018 investment deposits were limited to those who met the criteria in the Annual Treasury Management 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 Treasury Management Investment Strategy.

- 5.4 Pie chart 1 of Appendix 1 shows that at the end of quarter two; 100% of our in-house investments were placed with financial institutions with a long term rating of A.
- 5.5 As shown in pie chart 2 of Appendix 1, all these monies were placed directly with banks.
- 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. 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 three. 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 0.16%. More details are set out in Table 3 of Appendix 2.
- 5.9 The Council had an average of £19.6m of investments managed in-house over the period from October to December, and these earned an average interest rate of 0.75%. Of the in-house managed funds:
- use was made of call accounts during the quarter because they provide instant access to funds. An average of £9.2m was held in these accounts and earned an average return of 0.65% over the quarter.
 - an average of £10.4m was held in money market funds earning an average of 0.83% 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. The 7 day LIBID rate fluctuated between 0.58% and 0.59%. The bank base rate 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 December 2018. Performance is shown in Graph 1 of Appendix 2.

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

- 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. Until November these income distributions were being reinvested back into the fund but are now being paid into the Council's bank account. This change was driven by a change in the capital finance and accounting regulations. The price of units can rise and fall, so these funds are invested over the medium term with the aim of realising higher yields than short term investments.
- 6.3 Following the change in the capital finance and accounting regulations a Financial Instrument Revaluation reserve will be used to capture all the changes in the unit value of the funds. Members should be aware 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 only the income distributions paid into the Council's bank account will impact that.
- 6.4 An average of £7.6m was managed by AXA Investment Managers UK Limited. During the quarter the value of the fund decreased by £0.012m due to a decrease in the unit value. There was also an income distribution relating to that period of £0.027m. The combined return was 0.75%.
- 6.5 The AXA fund decreased by £0.012m during this three month period due to the decrease in the value of the units. The fund started the quarter at £7.582m and decreased in value with the fund at the end of the quarter at £7.570m. This is set out in Table 2 of Appendix 2.
- 6.6 An average of £7.7m was managed by Royal London Asset Management. During quarter three, the value of the fund decreased by £0.050m due to a decrease in the unit value. There was also an income distribution relating to that period of £0.047m. The combined return was -0.18%.
- 6.7 The Royal London fund decreased by £0.050m during this three month period due to the decrease in the value of the units. The fund started the quarter at £7.711m and decreased in value with the fund at the end of the quarter at £7.661m. This is set out in Table 2 of Appendix 2.

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. Until November these income distributions were being reinvested back into the fund but are now being

paid into the Council's bank account. This change was driven by a change in the capital finance and accounting regulations. 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 Following the change in the capital finance and accounting regulations a Financial Instrument Revaluation reserve will be used to capture all the changes in the unit value of the funds. Members should be aware 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 only the income distributions paid into the Council's bank account will impact that.
- 7.4 An average of £14.7m was managed by Rockspring Property Investment Management Limited. During quarter three, the value of the fund increased by £0.244m due to an increase in the unit value. There was also an income distribution relating to that period of £0.186m and this distribution will be confirmed and distributed in quarter four. The combined return was 11.59%.
- 7.5 The Rockspring fund increased by £0.244m during this three month period due to the increase in the value of the units. The fund started the quarter at £14.724m (excluding the income distribution for quarter two of £0.155m that was forecast at the time but is now paid into the Council's bank account) and increased in value with the fund at the end of the quarter at £14.968m. This is set out in Table 1 of Appendix 2.
- 7.6 An average of £13.9m was managed by Lothbury Property Investment Management Limited. During quarter three, the value of the fund decreased by £0.028m due to a decrease in the unit value. There was also an income distribution relating to that period of £0.105 and this distribution will be confirmed and distributed in quarter four. The combined return was 2.23%.
- 7.7 The Lothbury fund decreased by £0.028m during this three month period due to the decrease in the value of the units. The fund started the quarter at £13.833m and increased in value with the fund at the end of the quarter at £13.805m. This is set out in Table 1 of Appendix 2.

8 Investments – quarter three cumulative position

- 8.1 During the period from April to December 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 nine month period with the support of its treasury management advisers.

- 8.3 The table below summarises the Council's investment position for the period from April to December 2018:

Table 1: Investment position

	At 31 March 2018	At 31 December 2018	April to December 2018	
	Actual Balance (£000s)	Actual Balance (£000s)	Average Balance (£000s)	Average Rate (%)
Call accounts [#]	8,186	16,376	8,603	0.64
Money market funds	13,000	0	12,017	0.73
Total investments managed in-house	21,186	16,376	20,620	0.69
Enhanced Cash Funds	5,038	5,057	5,050	0.48
Short Dated Bond Funds	15,193	15,231	15,277	0.96
Property Funds	22,625	28,773	28,151	7.57
Total investments managed externally	42,856	49,061	48,478	4.75
Total investments	64,042	65,437	69,098	3.54

[#]This includes the council's main current account.

- 8.4 In summary the key factors to note are:

- An average of £20.6m of investments were managed in-house. These earned £0.108m of interest during this nine month period at an average rate of 0.69%. This is 0.21% over the average 7 day LIBID and 0.05% over the average bank base rate.
- An average of £5.1m was managed by an enhanced cash fund manager. This earned £0.018m during this nine month period at an average rate of 0.48%.
- An average of £15.3m was managed by two short dated bond fund managers. This earned £0.111m 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 0.96%.
- An average of £28.2m was managed by two property fund managers. This earned £1.606m 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 7.57%.

- 8.5 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 26 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)	14	81
Aberdeen Liquidity Fund (formerly Standard Life)	Money Market Fund (Various Counterparties)	10	51
Goldman Sachs	Money Market Fund (Various Counterparties)	1	3
Insight Investment Management Ltd	Money Market Fund (Various Counterparties)	1	3

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

9 Short Dated Bond Funds – quarter three cumulative position

- 9.1 An average of £7.6m was managed by AXA Investment Managers UK Limited. During the period from April to December 2018 the value of the fund increased by £0.007m due to an increase in the unit value. There was also an income distribution relating to that period of £0.027m. The combined return was 0.59%.
- 9.2 The AXA fund increased by £0.007m during this nine month period due to the increase in the value of the units. The fund started the nine month period at £7.563m and increased in value with the fund at the end of the period at £7.570m.
- 9.3 An average of £7.7m was managed by Royal London Asset Management. During the period from April to December 2018, the value of the fund decreased by £0.113m due to a decrease in the unit value. There was also an income distribution relating to that period of £0.191m. The combined return was 1.33%.
- 9.4 The Royal London fund increased by £0.031m during this nine month period due to the combination of the decrease in the value of the units and the part of the income distribution that was reinvested. The fund started the nine month period at £7.630m and increased in value with the fund at the end of the period at £7.661m.

10 Property Funds – quarter three cumulative position

- 10.1 An average of £14.5m was managed by Rockspring Property Investment Management Limited. During the period from April to December 2018, the value of the fund increased by £0.607m due to an increase in the unit value. There was also an income distribution relating to that period of £0.505m and the quarter three part of this distribution will be confirmed and distributed in quarter four. The combined return was 10.17%.
- 10.2 The Rockspring fund increased by £0.770m during this nine month period due to a combination of the increase in the value of the units and the part of the income distribution that was reinvested. The fund started the nine month period at £14.198m and increased in value with the fund at the end of the period at £14.968m.
- 10.3 An average of £13.7m was managed by Lothbury Property Investment Management Limited. During the period from April to December 2018, the value of the fund increased by £4.989m due to the purchase of additional units in April and £0.181m due to an increase in the unit value. There was also an income distribution relating to that period of £0.313 and the quarter three part of this distribution will be confirmed and distributed in quarter four. The combined return was 4.81%.
- 10.4 The Lothbury fund increased by £0.389m during this nine month period due to the combination of the increase in the value of the units and the part of the income distribution that was reinvested. The fund started the nine month period at £8.427m and increased in value with the fund at the end of the period at £13.805m.

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 investment 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 2.04% and 2.53%; 25 year PWLB rates between 2.56% and 2.93% and 50 year PWLB rates between 2.39% and 2.79%. These rates are after the PWLB 'certainty rate' discount of 0.20%.
- 11.8 During quarter three short term borrowing was undertaken for cash flow purposes. Two loans were taken out for £7m and £3m respectively, both at a rate of 0.80%. See Table 4 of Appendix 2.

12 Borrowing – quarter three cumulative position

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

	2018/19 Original (£m)	2018/19 Revised (£m)
Operational Boundary	285	280
Authorised Limit	295	290

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 2018 was:

- Southend-on-Sea Borough Council £236.5m
 - PWLB: £227.8m
 - Invest to save: £8.7m
- ECC transferred debt £11.3m

Repayments in the first 9 months of 2018/2019 were:

- Southend-on-Sea Borough Council £0m
- ECC transferred debt £0.59m

- 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 2018 were £6.951m 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 December 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
October to December 2018	227.8	0	0	(0)	227.8
<i>Of which:</i>					
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. £0.052m of this loan was repaid during the period from April to December 2018.

- 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 £8.60m. A repayment of £0.011m was made during the period from April to December 2018.
- 13.4 Funding of these invest to save schemes is shown in Appendix 2, with Table 5 showing the Salix Finance repayment.

14 Commercial Property Investment

- 14.1 In order for the Council to optimise its existing investment assets and to build the portfolio the investment portfolio requires active management in terms of acquisition, management and disposal decisions. Decisions need to be made commercially and often quickly and efficiently and the Council's Constitution already delegates authority to the Strategic Director (Finance and Resources) "to take all steps that are considered appropriate for the administration of the financial affairs of the Council includingto borrow and invest...." These investments are a logical application for those powers which will be enacted by the Strategic Director (Finance and Resources) and will be reported in these quarterly treasury management reports to Cabinet.
- 14.2 The Maplin business went into administration and the unit they occupied in Fossetts Way became vacant. In quarter three the unit was re-let to PureGym Limited, a leading gym operator in the UK. Some investment will be needed to upgrade the electrical supply at the substation which will increase the electrical capacity for this and future occupiers, increasing the Council's asset value and ability to let the space. This investment will be from the Commercial Property Investment capital budget.

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, which has been implemented in the Annual Treasury Management Investment Strategy approved by the Council on 22nd 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 6 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 2018/19 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 the Southend 2050 Road Map

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 ambition and desired outcomes.

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 – In-House Investment Position as at 31st December 2018

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