Southend-on-Sea Borough Council

Agenda

Item No.

Report of Corporate Director of Corporate Services
to

Cabinet

on
15 March 2016

Report prepared by: Joe Chesterton
Head of Finance and Resources

Quarter Three Treasury Management Report – 2015/16
Policy and Resources Scrutiny Committee
Executive Councillor: Councillor Woodley
A 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 2015.

2. Recommendations

That the following is approved:

2.1 The Quarter Three Treasury Management Report for 2015/16.

2.2 The Revised Minimum Revenue Provision Policy 2015/16 attached at Appendix 3, the changes to which are set out in Section 12.

That the following is noted:

2.3 Treasury management activities were carried out in accordance with the CIPFA (The Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management in the Public Sector during the period from April to December 2015.

2.4 The loan and investment portfolios were actively managed to minimise cost and maximise interest earned, whilst maintaining a low level of risk.

2.5 An average of £62.3m of investments were managed in-house. These earned £0.30m of interest during this nine month period at an average rate of 0.64%. This is 0.28% over the average 7 day LIBID and 0.14% over bank base rate.

2.6 An average of £24.7m of investments were managed by our external fund manager. These earned £0.14m of interest during this nine month period at an average rate of 0.74%. This is 0.38% over the average 7 day LIBID and 0.24% over bank base rate.

2.7 An average of £6.8m was managed by two property fund managers. This earned £0.431m 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 8.95%.

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) decreased from £237.8m to £227.8m (Housing Revenue Account (HRA): £78.0m, GF: £149.8m) during the period from April to December 2015.

2.9 The level of financing for 'invest to save' schemes increased from £0.14m to £1.78m during the period from April to December 2015.

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 2015/16 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 2015/16.

3.3 Appendix 1 shows the treasury management position at the end of quarter three of 2015/16.

3.4 Appendix 2 shows the treasury management performance specifically for quarter three of 2015/16.

4 National/Global Context

4.1 The global economic slowdown adversely affected the UK economy. Although the preliminary estimate for GDP for quarter four of 2015 revealed a small increase to 0.5% quarter-on-quarter from 0.4% in quarter three, on the year GDP fell to 1.9% in quarter four from 2.1% in quarter three. This was the weakest end-of year reading in nearly three years.

4.2 The February Bank of England Inflation Report highlighted that the Monetary Policy Committee (MPC) intends to focus policy on ensuring that growth and employment is sustained in order to meet the 2% inflation target. The outlook for inflation looks unlikely to surpass 1% in 2016, with CPI predicted to exceed 2% after two years. The MPC voted to keep interest rates at their record low of 0.5% in its February meeting. The Bank's decision was influenced by the global outlook amidst significant risks in emerging markets and the continuation of sharp falls in oil prices.

4.3 The headline inflation figure, the consumer price index (CPI), rose to 0.3% year-on-year in January, however the rate fell by 0.8% on the month. This was mainly a result of post-Christmas discounts and a drop in airfares.

4.4 The UK unemployment rate remained at 5.1% in the three months to December, its lowest rate since mid-2005. British wage growth, including bonuses, rose by 1.9% in the three months to December, from November's figure of 2.1%. With wage growth slowing, alongside a weaker outlook for inflation, expectations for the Bank of England to raise rates in the near future have also slowed.

4.5 In the US the quarter four GDP revealed a slowdown to 0.7% at an annualised rate, from 2% in quarter three. This was due to an inventory excess, a strengthening in the dollar and weak global demand affecting exports. In January 2016, the Fed kept interest rates unchanged at 0.25%-0.50% after raising them the previous month for the first time since 2006. The Fed's decision was anticipated after the recent plummet in world equities raised fears of a sudden global slowdown. However, the Fed kept an optimistic outlook of the U.S economy and stated it was "closely monitoring" economic and financial developments around the world. The unemployment rate was 4.9% in January, the lowest it has been for eight years.

4.6 Following the European Central Bank's (ECB) meeting in January, its interest rate remained unchanged at 0.05%. The ECB announced their Quantitative Easing (QE) programme in January 2015 and began the programme in March 2015. They initially planned to inject €1.1trn into the economy but in December 2015, this program was extended for an additional 6 months to March 2017 with €1.5trn now expected to be injected. Year-on-year, the Eurozone grew by 1.5%. The main factors behind growth were greater household spending and increased inventories, which counterbalanced the negative effect experienced by trade.

4.7 China's annual GDP growth slowed as expected to 6.8% in quarter four of 2015 from 6.9% in the previous quarter, the slowest pace of growth since the financial crisis. In an attempt to boost its slowing economy, China surprised markets and devalued the Yuan after a run of poor economic data. It is intended to help combat the large falls seen in exports.

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

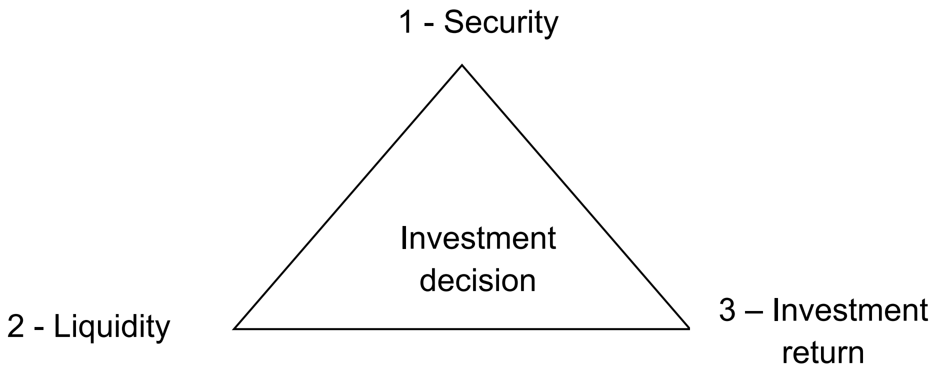
4.9 However, with a restricted list of counterparties, the increased focus on counterparty risk following the Icelandic Banks collapse and the interest rate outlook, monies were mainly placed for short periods of time or in instant access accounts, which increased the liquidity of these funds.

4.10 Low interest rates prevailed throughout the period from April to December 2015 and this led to low investment income earnings from all our investments.

5 Investments – quarter three (October to December)

5.1 A prime objective of our investment activities is the security of the principal sums invested. To ensure this security before a deposit is made an organisation is tested against a matrix of credit criteria and then other relevant information is considered. During the period from October to December 2015 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; 27% of our in-house investments were placed with financial institutions with a long term rating of AAA, 22% with a long term rating of A and 51% with a long term rating of A-.

5.5 As shown in pie chart 2 of Appendix 1, these monies were with various counterparties, 73% being placed directly with banks and 27% 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 100 day notice account, £5m in a 95 day notice account and £5m which had been placed in a 9 month fixed term deposit. The maturity profile of our investments is shown in pie chart 4 of Appendix 1.

Investment return:

5.8 During the quarter the Council continued to use the external fund manager Aberdeen Asset Management to manage monies on our behalf. An average balance of £24.1m was invested in these funds during the quarter earning an average rate of 0.91%.

5.9 The Council had an average of £55.1m of investments managed in-house over the period from October to December, and these earned an average interest rate of 0.68%. Of the in-house managed funds:

- an average of £14.7m was held in notice accounts that earned an average interest rate of 0.74%.

- an average of £5.0m was held in fixed term deposits that earned an average interest rate of 0.88%;

- use was also made of call accounts during the quarter, because they provide instant access to funds. An average of £8.9m was held in these accounts and earned an average return of 0.64% over the quarter.

- an average of £26.5m was held in money market funds earning an average of 0.61% 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 0.50% throughout the period from October to December 2015, and the 7 day LIBID rate fluctuated between 0.35% and 0.37%. Performance is shown in Graph 1 of Appendix 2.

6 Investments – quarter three cumulative position

6.1 During the period from April to December 2015 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 2015:

Table 1: Investment position

	At 31 March 2015	At 31 December 2015	April to December 2015	
	Actual Balance (£000s)	Actual Balance (£000s)	Average Balance (£000s)	Average Rate (%)
Notice accounts	10,000	15,000	11,559	0.70
Fixed term deposits	0	5,000	2,204	0.88
Call accounts	8,037	13,102	8,280	0.64
Money market funds	33,000	12,000	40,278	0.60
Total investments managed in-house	**51,037**	**45,102**	**62,321**	**0.64**
Investments managed by external fund manager	24,858	22,496	24,652	0.74
Property funds	0	12,665	6,838	8.95
Total investments managed externally	**24,858**	**35,161**	**31,490**	**2.52**
Total investments	**75,895**	**80,263**	**93,811**	**1.27**

6.4 The majority of the cash balances held by the Council are required to meet short term cash flow requirements and therefore throughout the nine month period monies were placed 44 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)	18	75
Goldman Sachs	Money Market Fund (Various Counterparties)	16	77
Standard Life Investment	Money Market Fund (Various Counterparties)	7	33
Insight Investment Management Ltd	Money Market Fund (Various Counterparties)	1	6
Santander UK Plc	UK Bank	1	5
Goldman Sachs International Bank (Fixed Term Deposit)*	UK Bank	1	5

*This fixed term deposit is shown in Table 1 of Appendix 2.

6.5 In addition to the above, use was also made of call accounts during the year, because they provide instant access or 7-day notice to funds while paying bank base rate or better. 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 2015 an average of £8.3m was held in such accounts.

7 Property Funds – quarter three (October to December)

7.1 Following a tender exercise, two property funds were chosen for the investment of long term 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 will be 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 £5.6m was managed by Rockspring Property Investment Management Limited. During quarter three, the value of the fund increased by £0.024m due to the increase in the unit value. There was also an income distribution relating to that period of £0.072m and this distribution will be confirmed and distributed in quarter four. The value of the fund also increased by £2.505m due to the purchase of more units.

7.5 The Rockspring fund earned £0.096m 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 6.76%. The fund started the quarter at £5.174m and increased in value with the fund at the end of the quarter at £7.775m. This is set out in Table 2 of Appendix 2.

7.6 An average of £4.8m was managed by Lothbury Property Investment Management Limited. During quarter three, the value of the fund increased by £4.751m due to the initial purchase of units and by £0.104m due to the increase in the unit value. There was also an income distribution relating to that period of £0.035m and this distribution will be confirmed and distributed in quarter four.

7.7 The Lothbury fund earned £0.139m 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 12.21%. The fund started the quarter at nil and increased in value with the fund at the end of the quarter at £4.890m. This is set out in Table 3 of Appendix 2.

8 Property Funds – quarter three cumulative position

8.1 An average of £5.2m was managed by Rockspring Property Investment Management Limited. During the period from April to December 2015, the value of the fund increased by £0.086m due to the increase in the unit value. There was also an income distribution relating to that period of £0.206m and the quarter three part of this distribution will be confirmed and distributed in quarter four. The value of the fund also increased by £2.494m due to the value of new units purchased after fees.

8.2 The Rockspring fund earned £0.292m 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 7.40%. The fund started the nine month period at £4.989m and increased in value with the fund at the end of the period at £7.775m.

8.3 An average of £1.6m was managed by Lothbury Property Investment Management Limited. During the period from April to December 2015, the value of the fund increased by £0.104m due to the increase in the unit value and by £4.751m due to the initial purchase of units. There was also an income distribution relating to that period of £0.035 and the quarter three part of this distribution will be confirmed and distributed in quarter four.

8.4 The Lothbury fund earned £0.139m 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 12.21%. The fund started the nine month period at nil and increased in value with the fund at the end of the period at £4.890m.

9 Borrowing – quarter three

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 quarter two in the second of the above scenarios, with actual borrowing below CFR.

9.3 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.

9.4 During quarter three, no new PWLB loans were taken out. £10m of loans were repaid on maturity during the quarter.

9.5 The level of PWLB borrowing (excluding debt relating to services transferred from Essex County Council on 1st April 1998) decreased from £237.8m to £227.8m during quarter three. The average rate of borrowing at the end of the quarter was 4.56%. A profile of the repayment dates is shown in Graph 2 of Appendix 2.

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 Interest rates from the PWLB fluctuated throughout the quarter in response to economic events: 10 year PWLB rates between 2.60% and 2.93%; 25 year PWLB rates between 3.29% and 3.57% and 50 year PWLB rates between 3.10% and 3.43%. These rates are after the PWLB 'certainty rate' discount of 0.20%.

9.8 During quarter three, £5m of short term borrowing activity was taken out for cash flow purposes. See Table 4 of Appendix 2.

10 Borrowing – quarter three cumulative position

10.1 The Council's borrowing limits for 2015/16 are shown in the table below:

	2015/16 Original (£m)	2015/16 Revised (£m)
Operational Boundary	270	260
Authorised Limit	280	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.

10.2 The Council's outstanding borrowing as at 31st December 2015 was:

- Southend-on-Sea Borough Council £229.6m
  - PWLB: £227.8m
  - Invest to save: £1.8m
- ECC transferred debt £13.1m

Repayments in the first 9 months of 2015/2016 were:

- Southend-on-Sea Borough Council £10.02m
- ECC transferred debt £0.67m

10.3 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.

10.4 The interest payments for PWLB and excluding transferred debt, during the period from April to December 2015 were £7.172m which was unchanged from the original budget for the same period.

10.5 The table below summarises the PWLB borrowing activities over the period from April to December 2015:

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 2015	237.8	0	0	(0)	237.8
July to September 2015	237.8	0	0	(0)	237.8
October to December 2015	237.8	0	0	(10)	227.8
Of which:					
General Fund	157.0	0	0	(7.2)	149.8
HRA	80.8	0	0	(2.8)	78.0

All PWLB debt held is repayable on maturity.

11 Funding for Invest to Save Schemes (included in Section 10)

11.1 During 2014/15 a capital project was completed on draught proofing and insulation in the Civic Centre which will generate on-going energy savings. This is an invest-to-save project and the predicted revenue streams cover the financing costs of the project.

11.2 To finance this project the Council took out an interest free loan of £0.14m with Salix Finance Ltd which is an independent, not for profit company, funded by the Department for Energy and Climate Change that delivers interest-free capital to the public sector to improve their energy efficiency and reduce their carbon emissions. The loan is for a period of four years with equal instalments to be repaid every six months. There are no revenue budget implications of this funding as there are no interest payments to be made and the revenue savings generated are expected to exceed the amount needed for the repayments. £0.018 of this loan was repaid during the period from April to December 2015.

11.3 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 £1.66m. There were no repayments during the period from April to December 2015.

11.4 Funding of these invest to save schemes is shown in Appendix 2, with Table 5 showing the Salix Finance repayment.

12 Revised Minimum Revenue Provision Policy

12.1 The Minimum Revenue Provision (MRP) Policy for 2015/16 has been revised to set out that under the regulations capital receipts may be used to repay the principal of any amount borrowed and that if capital receipts are utilised to repay debt in year, the value of MRP chargeable will be reduced by the value of the receipts utilised.

12.2 The policy has also been revised to set out that the Department of Communities and Local Government (DCLG) guidance specifies that MRP would not have to be charged until an asset came into service and would begin in the financial year following the one in which the asset became operational.

12.3 A Revised Minimum Revenue Provision Policy for 2015/16 is attached as Appendix 3.

13 Compliance with Treasury Management Strategy – quarter three

13.1 The Council's investment policy is governed by the CIPFA Code of Practice for Treasury Management in the Public Sector (revised in November 2009), which has been implemented in the Annual Investment Strategy approved by the Council on 26th February 2015. 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.

14 Other Options

14.1 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.

15 Reasons for Recommendations

15.1 The CIPFA Code of Practice on Treasury Management recommends that Local Authorities should submit reports regularly. The Treasury Management Policy Statement for 2015/16 set out that reports would be submitted to Cabinet quarterly on the activities of the treasury management operation.

16 Corporate Implications

16.1 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.

16.2 Financial Implications

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

16.3 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.

16.4 People Implications

None.

16.5 Property Implications

None.

16.6 Consultation

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

16.7 Equalities Impact Assessment

None.

16.8 Risk Assessment

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

16.9 Value for Money

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

16.10 Community Safety Implications

None

16.11 Environmental Impact

None

17 Background Papers

None

18 Appendices

Appendix 1 – Treasury Management Position as at the end of Quarter Three - 2015/16

Appendix 2 – Treasury Management Performance for Quarter Three – 2015/16

Appendix 3 – Revised Minimum Revenue Provision Policy 2015/16