Agenda Item No.

Southend-on-Sea Borough Council

Report of Strategic Director (Finance & Resources)
to
Cabinet
on
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Treasury Management Report – Quarter One 2019/20
Policy and Resources Scrutiny Committee
Cabinet Member: Councillor Ron Woodley
A Part 1 Public Agenda Item

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1. Purpose of Report

1.1 The Treasury Management Report for Quarter One covers the treasury management activity for the period from April to June 2019 and compliance with the treasury management strategy for that period.

2. Recommendations

That the following is approved:

2.1 The Treasury Management Report for Quarter One 2019/20.

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 2019.

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 £0.492m of interest was received during this three month period. The total investment income earned including this interest during this three month period was £0.490m, at an average rate of 1.88%. This is 1.31% over the average 7 day LIBID (London Interbank Bid Rate) and 1.13% 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) increased from £267.8m to £277.8m (HRA: £77.0m, GF: £200.8m) during the period from April to June 2019.

2.6 During the quarter the level of financing for 'invest to save' schemes decreased from £8.73m to £8.70m.

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 2019/20 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 2019/20.

3.3 Appendix 1 shows the treasury management position at the end of quarter one of 2019/20.

3.4 Appendix 2 shows the treasury management performance specifically for quarter one of 2019/20.

4. National Context

4.1 In the UK GDP reduced by 0.2% in the three months to the end of June, the first contraction since 2012. This is in contrast with the strong growth of 0.5% in the first three months of the calendar year which was boosted by stockpiling of goods and materials by businesses on both sides of the Channel ahead of the planned Brexit deadline of 29 March. The extra demand disappeared in the next quarter as companies reduced buying and used up parts of those stockpiles, impacting on new output.

4.2 CPI was at 2.1% in April and at 2% throughout May and June. A no-deal outcome to Brexit would add to inflationary pressures from more expensive imports, due to probable Sterling weakness. The unemployment rate for the quarter was 3.9%, an increase on from the rate last quarter of 3.8%.

4.3 The Bank of England kept the bank base rate at 0.75% throughout the quarter and left their Quantitative Easing (QE) programme at £435bn. Monetary policy remains on hold as the Brexit debate continues.

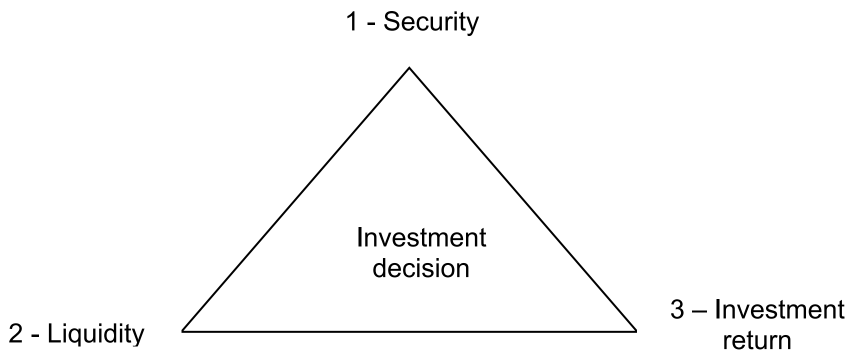
4.4 The economic situation together with the financial market conditions prevailing throughout the quarter continued to provide challenges for treasury management activities. Due to the low interest rate environment, only monies needed for day to day cash flow activities were kept in instant access accounts.

4.5 Low interest rates prevailed throughout the quarter from April to June 2019 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 2019 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 principal of all monies is minimised through the Annual Treasury Management Investment Strategy.

5.4 Pie chart 1 of Appendix 1 shows that at the end of quarter one; 60% of our in-house investments were placed with financial institutions with a long term credit rating of AAA, 37% with a long term rating of A+ and 3% with a long term rating of A.

5.5 As shown in pie chart 2 of Appendix 1 these monies were with various counterparties, 40% being placed directly with banks and 60% 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 At the end of quarter one £34.8m of our in-house monies were available on an instant access basis and £20m was invested in fixed term deposits. 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 £5.1m was invested in these funds during the quarter earning an average rate of 1.48%. More details are set out in Table 3 of Appendix 2.

5.9 The Council had an average of £56.2m of investments managed in-house over the period from April to June 2019, and these earned an average interest rate of 0.85%. Of the in-house managed funds:

- an average of £2.9m was held in the Council's main bank account over the quarter. The new banking contract came into effect at the beginning of the quarter and interest will only be earned through a sweeper account. The sweeper account is in the process of being opened during quarter two;
- an average of £8.8m was held in fixed term deposits and earned an average return of 0.95% over the quarter;
- an average of £44.5m was held in money market funds earning an average of 0.88% 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 0.75% throughout the period from April to June 2019, and the 7 day LIBID rate fluctuated between 0.561% and 0.577%. 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 are paid to the Council. 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 In line with the capital finance and accounting regulations the Council's Financial Instrument Revaluation Reserve will be used to capture all the changes in the unit value of the funds. Members should be aware that 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 distributions paid to the Council 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 increased by £0.030m due to an increase in the unit value. There was also an income distribution relating to that period of £0.029m. The combined return was 3.07%.

6.5 The AXA fund started the quarter at £7.636m and increased in value due to the increase in the value of the units, with the fund at the end of the period at £7.666m. This is set out in Table 2 of Appendix 2.

6.6 An average of £7.8m was managed by Royal London Asset Management. During the quarter the value of the fund increased by £0.035m due to an increase in the unit value. There was also an income distribution relating to that period of £0.048m. The combined return was 4.26%.

6.7 The Royal London fund started the quarter at £7.740m and increased in value due to the increase in the value of the units, with the fund at the end of the period at £7.775m. This is set out in Table 2 of Appendix 2.

7. Property Funds

7.1 Throughout the quarter long term funds were invested in two property funds: Patrizia Hanover Property Unit Trust (formerly 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 paid to the Council. 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 In line with the capital finance and accounting regulations the Council's Financial Instrument Revaluation Reserve will be used to capture all the changes in the unit value of the funds. Members should be aware that 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 distributions paid to the Council will impact that.

7.4 An average of £14.8m was managed by Patrizia Property Investment Managers LLP (formerly Rockspring Property Investment Managers LLP). During the three month period, the value of the fund decreased by £0.122m due to the decrease in the unit value. There was also an income distribution relating to that period of

£0.178m and this distribution will be confirmed and distributed in quarter two. The combined return was 1.51%.

7.5 The Patrizia fund started the quarter at £14.825m and decreased in value due to the decrease in the value of the units, with the fund at the end of the period at £14.703m. This is set out in Table 1 of Appendix 2.

7.6 An average of £13.6m was managed by Lothbury Investment Management Limited. During the three month period, the value of the fund increased by £0.051m due to the increase in the unit value. There was also an income distribution relating to that period of £0.107m and this distribution will be confirmed and distributed in quarter two. The combined return was 4.65%.

7.7 The Lothbury fund started the quarter at £13.559m and increased in value due to the increase in the value of the units, with the fund at the end of the period at £13.610m. This is set out in Table 1 of Appendix 2.

8. Overall Investment Position

8.1 An average of £56.2m of investments were managed in-house. These earned £0.118m of interest during this three month period at an average rate of 0.85%. This is 0.28% over the average 7-day LIBID and 0.10% over the average bank base rate.

8.2 An average of £5.1m was managed by an enhanced cash fund manager. This earned £0.019m during this three month period at an average rate of 1.48%.

8.3 An average of £15.4m was managed by two short dated bond fund managers. This earned £0.140m 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 3.67%.

8.4 An average of £28.4m was managed by two property fund managers. These earned £0.213m 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 3.01%.

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 2019/20 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. A new PWLB loan was taken out in June 2019: £10m at 2.16% for 48 years. No loans matured during the quarter and 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) increased from £267.8m to £277.8m during quarter one. The average rate of borrowing at the end of the quarter was 4.13%. A profile of the repayment dates is shown in Graph 2 of Appendix 2.

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 2019	267.8	10	0	(0)	277.8
Of which:					
General Fund	190.8	10	0	(0)	200.8
HRA	77.0	0	0	(0)	77.0

All PWLB debt held is repayable on maturity.

9.6 The level of PWLB borrowing at £277.8m 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 £11.3m 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 1.68% and 2.10%; 25 year PWLB rates between 2.25% and 2.58% and 50 year PWLB rates between 2.11% and 2.41%. These rates are after the PWLB 'certainty rate' discount of 0.20%.

9.9 No short term loans for cash flow purposes were taken out or repaid during the quarter. See Table 4 of Appendix 2.

Funding for Invest to Save Schemes

9.10 Capital projects were completed on draught proofing and insulation in the Civic Centre, replacement lighting on Southend Pier 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 £0.287m 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 2019.

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. The balance outstanding at the end of quarter one was £8.59m. There were no repayments during the period from April to June 2019.

9.13 Funding of these invest to save schemes is shown in table 5 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, which has been implemented in the Annual Treasury Management Investment Strategy approved by the Council on 21 February 2019. The investment activity during the quarter conformed to the approved strategy and the cash flow was successfully managed to maintain liquidity. See Table 6 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 2019/20 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 Ambition & Desired Outcomes

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.

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 30 June 2019

Appendix 2 – Treasury Management Performance for Quarter One - 2019/20