Agenda Item No.

Southend-on-Sea Borough Council

Report of Executive Director (Finance & Resources)
to
Cabinet
on
5 November 2019

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Treasury Management Report – Mid Year 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 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 2019.

2. Recommendations

That the following is approved:

2.1 The Treasury Management Mid Year Position report for 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 September 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 £1.067m of interest was received during this six month period. The total investment income earned including this interest during this six month period was £1.104m, at an average rate of 1.85%. This is 1.28% over the average 7 day LIBID (London Interbank Bid Rate) and 1.10% 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 £310.3m (Housing Revenue Account (HRA): £75.0m, General Fund: £235.3m) during the period from April to September 2019.

2.6 The level of financing for 'invest to save' schemes decreased from £8.73m to £8.67m during the period from April to September 2019.

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 second quarter report for the financial year 2019/20.

3.3 Appendix 1 shows the in-house investment position at the end of quarter two of 2019/20.

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

4 National Context

4.1 At the time of writing this report there was still a lot of uncertainty with the ongoing debate over how the UK is to achieve Brexit. This is causing uncertainty for business leaders and the financial markets and is leading to investment decisions being delayed.

4.2 The Bank of England have kept the bank base rate at 0.75% and kept their Quantitative Easing (QE) programme at £435bn. The Monetary Policy Committee will continue to wait for an outcome of Brexit before it takes any action. If there is a "no deal" Brexit there may be a requirement to stimulate the economy and in that scenario the markets would expect a rate cut sometime in the next nine months. However, the situation is far from clear.

4.3 Annual CPI was at 1.7% in September, unchanged from August. There was a large upward contribution from restaurants and hotels where prices rose in the year to September, offset by downward contributions form motor fuels and clothing and footwear.

4.4 The unemployment rate for the quarter June to August was at 3.9%, which is lower than a year earlier (4%) but 0.1% higher than the previous quarter.

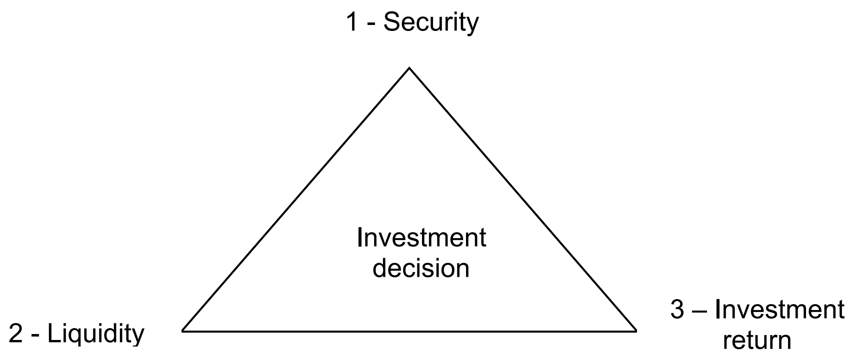
4.5 The economic situation together with the financial market conditions prevailing throughout the quarter continued to provide challenges for treasury management activities. Due to the low interest rate environment, only monies needed for day to day cash flow activities were kept in instant access accounts.

4.6 Low interest rates prevailed throughout the quarter from July to September 2019 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 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 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 two; 13% of our in-house investments were placed with financial institutions with a long term rating of AAA, 52% with a long term rating of A+ and 36% with a long term rating of A.

5.5 As shown in pie chart 2 of Appendix 1, these monies were with various counterparties, 87% being placed directly with banks and 13% 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 At the end of quarter two £17.6m of our in-house monies were available on an instant access basis and £60m 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 our behalf. An average balance of £5.1m was invested in these funds during the quarter earning an average rate of 1.46%. More details are set out in Table 3 of Appendix 2.

5.9 The Council had an average of £85.2m of investments managed in-house over the period from July to September, and these earned an average interest rate of 0.89%. Of the in-house managed funds:

- an average of £4.7m was held in the Council's main bank account over the quarter and earned an average return of 0.12%. Under the new banking contract, interest will only earned through a sweeper account. This account was opened during quarter two.

- an average of £37.3m was held in money market funds earning an average of 0.85% 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;

- an average of £43.2m was held in fixed term deposits and earned an average return of 1.00% over the quarter;

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 0.55% and 0.58%. The bank base remained at 0.75% throughout the quarter. 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 income distributions are paid to the Council. 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 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 £7.7m 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 3.01%.

6.5 The AXA fund started the quarter at £7.666m and increased in value due to the increase in the value of the units, with the fund at the end of the period at £7.696m. 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 £0.038m 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 4.44%.

6.7 The Royal London fund started the quarter at £7.775m and increased in value due to the increase in the value of the units, with the fund at the end of the period at £7.813m. 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: Patrizia 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 £14.7m was managed by Patrizia Property Investment Managers LLP. During the three month period, the value of the fund decreased by

£0.031m due to the decrease in the unit value. There was also an income distribution relating to that period of £0.188m and this distribution will be confirmed and distributed in quarter two. The combined return was 4.25%.

7.5 The Patrizia fund started the quarter at £14.703m and decreased in value due to the decrease in the value of the units, with the fund at the end of the period at £14.672m. 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 decreased by £0.006m due to the decrease in the unit value. There was also an income distribution relating to that period of £0.106m and this distribution will be confirmed and distributed in quarter two. The combined return was 2.92%.

7.7 The Lothbury fund started the quarter at £13.610m and decreased in value due to the decrease in the value of the units, with the fund at the end of the period at £13.604m. 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 2019 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 2019:

Table 1: Investment position

	At 31 March 2019	At 30 September 2019	April to September 2019	
	Actual Balance (£000s)	Actual Balance (£000s)	Average Balance (£000s)	Average Rate (%)
Call accounts[#]	8,080	7,566	3,792	0.08
Fixed term deposits	0	60,000	26,002	1.01
Money market funds	33,000	10,000	40,880	0.87
Total investments managed in-house	**41,080**	**77,566**	**70,674**	**0.88**
Enhanced Cash Funds	5,066	5,078	5,077	1.47
Short Dated Bond Funds	15,377	15,509	15,427	3.70
Property funds	28,385	28,276	28,396	3.31
Total investments managed externally	**48,828**	**48,863**	**48,900**	**3.24**
Total investments	**89,908**	**126,429**	**119,574**	**1.85**

[#]The council's main current account.

8.4 In summary the key factors to note are:

- An average of £70.7m of investments were managed in-house. These earned £0.310m of interest during this six month period at an average rate of 0.88%. This is 0.31% over the average 7 day LIBID (London Interbank Bid Rate) and 0.13% over the average bank base rate.

- An average of £5.1m was managed by an enhanced cash fund manager. This earned £0.037m during this six month period at an average rate of 1.47%.

- An average of £15.4m was managed by two short dated bond fund managers. This earned £0.286m 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 3.70%.

- An average of £28.4m was managed by two property fund managers. This increased in value by £0.471m during this six month period from a combination of a decrease in the value of the units and by income distribution, giving a combined return of 3.31%.

8.5 Some 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 into Money Market Funds 25 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)
Goldman Sachs	Money Market Fund (Various Counterparties)	10	50
BlackRock	Money Market Fund (Various Counterparties)	7	50
Insight Investment Management Ltd	Money Market Fund (Various Counterparties)	6	34
Aberdeen Liquidity Fund	Money Market Fund (Various Counterparties)	2	34

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 2019 an average of £3.8m was held in such accounts.

8.7 For cash balances that are not needed to meet immediate or very short term cash flow requirements, monies were invested in fixed term deposits of up to one year, depending on the liquidity requirements. The table below shows the fixed term deposits held during quarter two.

Table 3: Fixed Term Deposits

Counterparty	Date of Deposit	Return Date	Number of days	Interest rate (%)	Amount (£m)
Lloyds Bank plc	01/05/2019	05/08/2019	96	0.95	10
Goldman Sachs International	12/06/2019	11/12/2019	182	0.95	10
Santander UK plc	15/07/2019	15/01/2020	182	1.00	10
Goldman Sachs International	15/08/2019	14/02/2020	184	0.90	10
Santander UK plc	14/08/2019	14/08/2020	366	1.15	10
Lloyds Bank plc	14/08/2019	14/08/2020	366	1.10	20

9. Short Dated Bond Funds – quarter two cumulative position

9.1 An average of £7.7m was managed by AXA Investment Managers UK Limited. During the period from April to September the value of the fund increased by £0.060m due to an increase in the unit value. There was also an income distribution relating to that period of £0.057m. The combined return was 3.04%.

9.2 The AXA fund started this six month period 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 £7.696m.

9.3 An average of £7.8m was managed by Royal London Asset Management. During the period from April to September the value of the fund increased by £0.073m due to an increase in the unit value. There was also an income distribution relating to that period of £0.096m. The combined return was 4.35%.

9.4 The Royal London fund started this six month period 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 £7.813m.

10 Property Funds – quarter two cumulative position

10.1 An average of £14.8m was managed by Patrizia Property Investment Managers LLP. During the period from April to September 2019, the value of the fund decreased by £0.153m due to the decrease in the unit value. There was also an income distribution relating to that period of £0.366m and the quarter two part of this distribution will be confirmed and distributed in quarter three. The combined return was 2.88%.

10.2 The Patrizia fund started the six month period 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 £14.672m.

10.3 An average of £13.6m was managed by Lothbury Investment Management Limited. During the period from April to September 2019, the value of the fund increased by £0.045m due to an increase in the unit value. There was also an income distribution relating to that period of £0.213m and the quarter two part of this distribution will be confirmed and distributed in quarter three. The combined return was 3.78%.

10.4 The Lothbury fund started the six month period 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 £13.604m.

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 With the uncertainty around the expected Brexit leave date, PWLB rates continued to be volatile and reached advantageously low levels in early June and as a consequence a £10m PWLB loan was taken to capture that good rate. With the continued uncertainty around Brexit and the ongoing volatility in PWLB rates it was approved at July Council that the limits on external borrowings were revised to allow the headroom to undertake further borrowing as required given the historic low PWLB rates. It was agreed at July Council that the operational boundary for 2019/20 be increased from £290m to £350m and the authorised limit for 2019/20 be increased from £300m to £360m (see paragraph 12.1). It should be noted that these limits do not indicate the planned levels of borrowing but do allow scope in exceptional circumstances.

11.4 This, together with the Council's cash flow, the prevailing Public Works Loans Board (PWLB) at historically low interest rates and the future requirements of the capital programme, were taken into account when deciding the amount and timing of any further loans. Four new PWLB loans were therefore taken out in August:

- £10m at 1.99% for 45 years and one month;
- £10m at 1.99% for 46 years;
- £10m at 1.84% for 47½ years;
- £10m at 1.84% for 49 years;

Additionally, a £7.5m loan taken out in December 1989 at 9.875% matured in September and was repaid. No debt restructuring was carried out during the quarter.

11.5 The Council does not take out PWLB loans for individual projects but instead uses borrowing as one of the ways to finance the whole of the capital investment programme. This can be achieved by internal borrowing where cash balances are used instead of taking out any loans, or by external borrowing where loans are taken out. In practice these £50m of new loans partly finance the current capital investment programme and partly catch up the under-borrowing from prior years where internal borrowing has been used. The type of capital projects financed by borrowing has included schemes such as the Commercial Property investments and investment in the pier, the culture assets and the Council's ICT infrastructure.

11.6 At the beginning of the 2019/20 financial year the average rate of the Council's overall PWLB borrowing was 4.61%. After the above borrowing in 2019 this average rate for 2019/20 has fallen to 3.93%.

11.7 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 £277.8m to £310.3m during the quarter. A profile of the repayment dates is shown in Graph 2 of Appendix 2.

11.8 The level of PWLB borrowing at £310.3m 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.

11.9 Interest rates from the PWLB fluctuated throughout the quarter in response to economic and political events: 10 year PWLB rates between 1.15% and 2.10%; 25 year PWLB rates between 1.73% and 2.58% and 50 year PWLB rates between 1.57% and 2.41%. These rates are after the PWLB 'certainty rate' discount of 0.20%.

11.10 Since 1 November 2012 HM Treasury implemented a 'certainty rate' of the Government gilt rate plus 0.8% for those authorities providing improved information and transparency on their locally-determined long-term borrowing and associated capital spending plans. As the cost of borrowing has fallen to record lows and local authorities have been increasing their use of the PWLB in recent months, HM Treasury took the decision to increase the margin that applies to new loans from the PWLB by 1% on top of the usual lending terms, with immediate effect from 9th October.

11.11 During quarter two, no short term loans were taken out for cash flow purposes. This is shown in Table 4 of Appendix 2.

12. Borrowing – quarter two cumulative position

12.1 The Council's borrowing limits for 2019/20 are shown in the table below:

	2019/20 Original (£m)	2019/20 Revised (£m)
Authorised Limit	290	350
Operational Boundary	300	360

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 2019 was:

- Southend-on-Sea Borough Council £310.3m
- ECC transferred debt £10.7m

Repayments in the first 6 months of 2019/2020 were:

- Southend-on-Sea Borough Council £7.5m
- ECC transferred debt £0.6m

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 2019 were £5.741m which is the higher than the original budget for the same period of £5.513m due to the rescheduling of planned borrowing.

12.5 The table below summarises the PWLB borrowing activities over the period from April to September 2019:

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
July to September 2019	277.8	40	0	(7.5)	310.3
Of which:					
General Fund	190.8	50	0	(5.5)	235.3
HRA	77.0	0	0	(2.0)	75.0

All PWLB debt held is repayable on maturity.

13 Funding for Invest to Save Schemes

13.1 Capital projects were completed on lighting replacements on Southend Pier and 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 £0.287m 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 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. £0.032m of this loan was repaid during the period from April to September 2019.

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 L1 Renewables Finance Limited. The balance outstanding at the end of quarter two was £8.56m. A repayment of £0.024m was made during the period from April to September 2019.

13.4 Funding of these invest to save schemes is shown in Table 5 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 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. This is shown in Table 6 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 2019/20 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 ambition and desired outcomes.

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 30 September 2019

Appendix 2 – Treasury Management Performance for Quarter Two – 2019/20