Agend

Item No.

Southend-on-Sea Borough Council

Report of Executive Director (Finance & Resources)
To

Cabinet

on

25 February 2020

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Quarter Three Treasury Management Report – 2019/20
Policy and Resources Scrutiny Committee
Cabinet Member: Councillor Ron Woodley
Part 1 (Public Agenda Item)

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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 2019.

2. Recommendations

That the following is approved:

2.1. **The Quarter Three Treasury Management 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 December 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. **£1.654m of interest was received during this nine month period. The total investment income earned including this interest during this nine month period was £1.456m (due to the decrease in value of the property funds), at an average rate of 1.56%. This is 0.99% over the average 7 day LIBID (London Interbank Bid Rate) and 0.81% 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, GF: £235.3m) during the period from April to December 2019.

2.6. **The level of financing for 'invest to save' capital schemes decreased from £8.73m to £8.67m during the period from April to December 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 third quarter report for the financial year 2019/20.

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

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

4. National/Global Context

4.1. The outcome of the General Election in December is a Conservative Government with a majority of 80 seats. As a result of this the Brexit bill was passed and the UK left the European Union on 31 January.

4.2. At its recent meeting the Monetary Policy Committee voted 7-2 to keep the bank base rate at 0.75% and is likely to wait and see what happens with the post Brexit trade deals before any further changes. In December CPI was 1.3%, a reduction from 1.5% the previous month. Throughout 2019 the unemployment rate continued at between 3.8% and 3.9%, the lowest since 2011.

4.3. UK GDP grew by 0.1% in the three months to November 2019, with growth in construction offset by weakening services and manufacturing. Average house prices in the UK increased by 2.2% over the year to November, up from 1.3% for the year to October. The annual increase in England was driven by the West Midlands and the North West. The lowest annual growth was in the East of England where prices fell by 0.7% followed by London where prices fell by 0.2% over the year.

4.4. Growth in the Eurozone is still subdued with continued contraction of manufacturing production. Exports are being held back by the global economic situation and there is uncertainty around the imposition of tariffs by the US and the future trade deal with the UK.

4.5. In the US the annualised GDP rate is expected to be 1.5-2.0%. Although net trade could provide a positive contribution to Q4 GDP, it will have been offset by slowing consumption growth and a decline in stock building. This stabilisation of economic growth has reduced the prospects of further rate cuts from the Federal Reserve.

4.6. In China, GDP growth slowed again but economic activity held up relatively well through the year. Trade deal prospects lifted the value of the Renminbi but it remains below pre-trade war levels. Economic growth is now being negatively affected by the recent outbreak of the new strain of coronavirus.

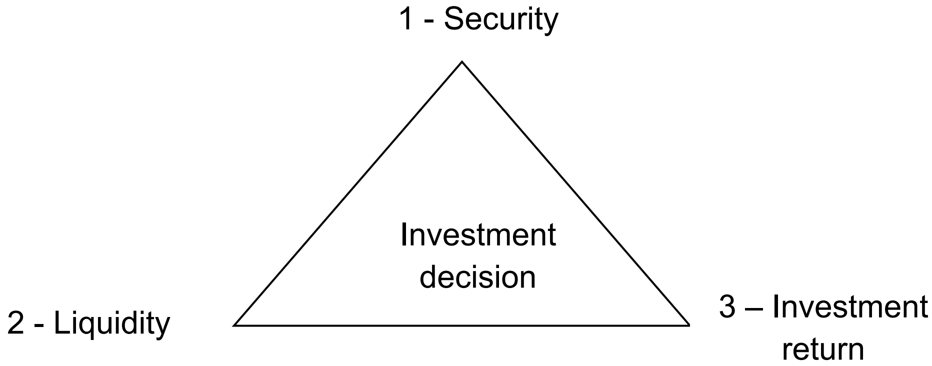
4.7. The economic situation together with the financial market conditions prevailing throughout the quarter continued to provide challenges for treasury management activities. Due to the low interest rate environment, only monies needed for day to day cash flow activities were kept in instant access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

4.8. Low interest rates prevailed throughout the period from April to December 2019 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 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 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; 20% of our in-house investments were placed with financial institutions with a long term rating of AAA, 41% with a long term rating of A+ and 39% with a long term rating of A.

5.5. As shown in pie chart 2 of Appendix 1, these monies were with various counterparties, 80% being placed directly with banks and 20% 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 three £23.7m of our in-house monies were available on an instant access basis and £50m 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 0.91%. More details are set out in Table 3 of Appendix 2.

5.9. The Council had an average of £85.7m of investments managed in-house over the period from October to December, and these earned an average interest rate of 0.95%. Of the in-house managed funds:

- an average of £5.1m was held in the Council’s main bank account over the quarter and earned an average return of 0.49%.

- an average of £22.9m was held in money market funds earning an average of 0.84% 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 £57.7m was held in fixed term deposits and earned an average return of 1.04% over the quarter;

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 0.56% and 0.58%. The bank base rate remained at 0.75% throughout the quarter. 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 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 remained the same due to fluctuations in the fund value netting to nil. There was an income distribution relating to that period of £0.030m. The combined return was 1.55%.

6.5. The AXA fund started the quarter at £7.696m and remained the same due to fluctuations in the fund value netting to nil, 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 quarter three, the value of the fund decreased by £0.015m due to a decrease in the unit value. There was also an income distribution relating to that period of £0.048m. The combined return was 1.64%.

6.7. The Royal London fund started the quarter at £7.813m and decreased in value due to the decrease in the value of the units, with the fund at the end of the period at £7.798m. 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: 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 quarter three, the value of the fund decreased by £0.124m due to a decrease in the unit value. There was also an income distribution relating to that period of £0.183m and this distribution will be confirmed and distributed in quarter four. The combined return was 1.62%.

7.5. The Patrizia fund started the quarter at £14.672m and decreased in value due to the decrease in the value of the units, with the fund at the end of the period at £14.548m. 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 quarter three, the value of the fund decreased by £0.093m 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 0.33%.

7.7. The Lothbury fund started the quarter at £13.604m and decreased in value due to the decrease in the value of the units, with the fund at the end of the period at £13.511m. 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 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 nine 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 December 2019:

Table 1: Investment position

	At 31 March 2019	At 31 December 2019	April to December 2019	
	Actual Balance (£000s)	Actual Balance (£000s)	Average Balance (£000s)	Average Rate (%)
Call accounts#	8,080	8,715	4,231	0.25
Fixed term deposits	0	50,000	36,582	1.02
Money market funds	33,000	15,000	34,888	0.86
Total investments managed in-house	**41,080**	**73,715**	**75,701**	**0.91**
Enhanced Cash Funds	5,066	5,077	5,078	1.29
Short Dated Bond Funds	15,377	15,494	15,446	3.02
Property Funds	28,385	28,059	28,361	2.54
Total investments managed externally	**48,828**	**48,630**	**48,885**	**2.56**
Total investments	**89,908**	**122,345**	**124,586**	**1.56**

#This includes the council's main current account.

8.4. In summary the key factors to note are:

- An average of £75.7m of investments were managed in-house. These earned £0.516m of interest during this nine month period at an average rate of 0.91%. This is 0.34% over the average 7 day LIBID and 0.16% over the average bank base rate.

- An average of £5.1m was managed by an enhanced cash fund manager. This earned £0.049m during this nine month period at an average rate of 1.29%.

- An average of £15.4m was managed by two short dated bond fund managers. This earned £0.350m 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 3.02%.

- An average of £28.4m was managed by two property fund managers. This earned £0.541m during this nine month period from a combination of a decrease in the value of the units and income distribution, giving a combined return of 2.54%.

8.5. Some cash balances managed in-house are required to meet short term cash flow requirements and therefore throughout the nine month period monies were placed 34 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)	12	64
BlackRock	Money Market Fund (Various Counterparties)	10	68
Insight Investment Management Ltd	Money Market Fund (Various Counterparties)	7	39
Aberdeen Liquidity Fund	Money Market Fund (Various Counterparties)	5	33

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 2019 an average of £4.2m 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 the period from April to December 2019.

Table 3: Fixed Term Deposits

Counterparty	Date of Deposit	Return Date	Number of days	Interest rate (%)	Amount (£m)
Goldman Sachs International	12/06/2019	11/12/2019	182	0.95	10
Santander UK plc	15/07/2019	15/01/2020	184	1.00	10
Goldman Sachs International	14/08/2019	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 three cumulative position

9.1. An average of £7.7m was managed by AXA Investment Managers UK Limited. During the period from April to December 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 £0.090m. The combined return was 2.59%.

9.2. The AXA fund started this nine 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 December, the value of the fund increased by £0.058m due to an increase in the unit value. There was also an income distribution relating to that period of £0.144m. The combined return was 3.44%.

9.4. The Royal London fund started this nine 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 £7.798m.

10. Property Funds – quarter three cumulative position

10.1. An average of £14.7m was managed by Patrizia Property Investment Managers LLP. During the period from April to December, the value of the fund decreased by £0.277m due to a decrease in the unit value. There was also an income distribution relating to that period of £0.549m and the quarter three part of this distribution will be confirmed and distributed in quarter four. The combined return was 2.46%.

10.2. The Patrizia fund started the nine 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 £14.548m.

10.3. An average of £13.6m was managed by Lothbury Investment Management Limited. During the period from April to December, the value of the fund decreased by £0.048m due to a decrease in the unit value. There was also an income distribution relating to that period of £0.318 and the quarter three part of this distribution will be confirmed and distributed in quarter four. The combined return was 2.63%.

10.4. The Lothbury fund started the nine month period at £13.559m and decreased in value due to the decrease in the value of the units, with the fund at the end of the period at £13.511m.

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 three 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 £310.3m during quarter three. The average rate of borrowing at the end of the quarter was 3.93%. A profile of the repayment dates is shown in Graph 2 of Appendix 2.

11.6. 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.

11.7. Interest rates from the PWLB fluctuated throughout the quarter in response to economic events: 10 year PWLB rates between 1.22% and 2.70%; 25 year PWLB rates between 1.78% and 3.22% and 50 year PWLB rates between 1.61% and 3.05%. These rates are after the PWLB 'certainty rate' discount of 0.20%.

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

12. Borrowing – quarter three 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)**
Operational Boundary	290	350
Authorised Limit	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 Investment 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 31st December 2019 was:

- Southend-on-Sea Borough Council £319.0m
  - PWLB: £310.3m
  - Invest to save: £8.7m
- ECC transferred debt £10.7m

Repayments in the first 9 months of 2019/2020 were:

- Southend-on-Sea Borough Council £7.6m
  - PWLB: £7.5m
  - Invest to save: £0.1m
- 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 December 2019 were £7.537m which is higher than the original budget for the same period of £7.326m. This is due to borrowing being undertaken earlier than planned in order to take advantage of the historically low rates available.

12.5. The table below summarises the PWLB borrowing activities over the period from April to December 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
October to December 2019	310.3	0	0	(0)	310.3
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 (included in Section 12)

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 £0.295m 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. £0.040m of these loans were repaid during the period from April to December 2019.

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 £8.56m. A repayment of £0.024m was made during the period from April to December 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 three

14.1. 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. 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 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.

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 Impact Assessment

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 31 December 2019

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