

# Cabinet

21 June 2017



<b>Title</b>	Treasury Management Annual Report 2016-17		
<b>Purpose of the report</b>	To note		
<b>Report Author</b>	Richard Mcfarlane		
<b>Cabinet Member</b>	Councillor Howard Williams	<b>Confidential</b>	No
<b>Corporate Priority</b>	Financial Sustainability		
<b>Recommendations</b>	<b>The Committee is asked to note the contents of this report.</b>		
<b>Reason for Recommendation</b>	<b>Not applicable</b>		

## 1. Key issues

### Background

- 1.1 The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that authorities report on the performance of the treasury management function at least twice a year (mid-year and at year end).
- 1.2 The Council's Treasury Management Strategy for 2016/17 was fully approved by Cabinet in February 2017 and Council in February 2017.
- 1.3 The Authority has invested and borrowed substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. This report covers treasury activity and the associated monitoring and control of risk.

### Compliance with Treasury Limits

- 1.4 During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement and annual Treasury Strategy Statement. The outturn Prudential Indicators for 2016/17 are shown in Appendix A.

### Strategy for the Year 2016/17

- 1.5 The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.
- 1.6 Currently the Bank of England base rate remains at 0.25% with no increase expected by our treasury advisors. Arlingclose central case is that the rate will remain at 0.25% but there is a low possibility of a drop close to zero with a

very small chance of a reduction below zero. The general consensus by Arlingclose is that the base rate will remain at 0.25% for at least another year.

- 1.7 Investments are managed in house and the Council has continued to place part of its core investment portfolio in pooled investment funds to achieve higher returns. The total investment in such an arrangement stands at £17.5m in 2016-17 and covers a range of equity, property and corporate bond funds. With an average rate of return of 5.18% for 2016-17 these continue to out-perform the current returns available for cash and fixed term deposits which generate an average return of just under 1.03%.
- 1.8 This performance fully supports the decision taken a number of years ago to widen the investment strategy. In addition to the annual return generated, there are also significant capital gains of £1.77m on the initial investments made and a breakdown of these is shown in paragraph 2.11 below.
- 1.9 Although money can be redeemed from the pooled funds at short notice, the Authority's intention is to hold them for the medium-term. Their performance and suitability in meeting the Authority's investment objectives are monitored regularly and discussed with Arlingclose.

The Council's remaining funds are managed from an overall cash flow perspective, although maturities are extended wherever possible to improve returns. Fixed term deposits in the form of a loan to Network Housing Group along with deposits in instant access accounts and money market funds has achieved the aim of increasing the return received and achieving greater diversification.

## **2. Options analysis and proposal**

### **Performance in 2016/17**

- 2.1 As part of the councils plan to achieve a sustainable future, progress has been embarked on three strands: (1) use of assets and income generation (2) the Knowle Green programme and new ways of working and (3) structural review. In order to be fully self-financing by 2020 and to continue to generate significant additional income streams Council approved supplementary capital expenditure of £400m, increasing the capital provision for property acquisitions to £445.455m for 2016/17. A very considerable portion of this was spent on acquiring the main site at BP in Sunbury, along with the subsequent purchase of BP's South West Corner site, and Elmbrook House in Sunbury.
- 2.2 The Council manages its investments in-house and invests with the most highly rated counterparties. During the year all investments were made in full compliance with the Council's treasury management policies and practices and in consultation with Arlingclose.
- 2.3 As at 31<sup>st</sup> March 2017 the net investment portfolio held by the Council was £26.79m. Full details of all investments held are shown in Appendix B.
- 2.4 The Council had originally estimated net investment income of £1,15m to be credited to the General Fund in 2016/17. This was a prudent estimate based on historical performance (interest income was £586k in 2015/16) and this also took into consideration the significant capital investments that occurred during the financial year. The non-Disposal of Bridge Street gave rise to the under-recovery of income against Budget.

2.5 The actual interest outturn for the year was £977,764 made up as follows:

<b>Investment Income</b>	<b>Actual £</b>	<b>Budget £</b>
Temporary Investments & Cash Deposits	103,017	150,000
Pooled Equity & Bond Funds	874,747	1000,000
<b>Total Investment Income</b>	<b>977,764</b>	<b>1,150,000</b>

The outturn position largely reflects the impact of the Council not realising a capital receipt for Bridge Street car park site which the Budget when set had anticipated being re-invested.. Every effort has been made to maximise the return achieved and minimise the shortfall in meeting the budget expectation.

### **Investment Performance Monitoring**

- 2.6 Regular quarterly meetings of officers and the Portfolio holder are held with Arlingclose and in-house performance is monitored monthly. The Council is heavily dependent on investment returns to support the General Fund and the stability of those returns is an important part of our ongoing financial objectives.
- 2.7 Creditworthiness is also monitored regularly. The Council uses Arlingclose's suggested criteria to assist in the selection of suitable investment counterparties. This is based on credit ratings, including sovereign ratings, provided by the three main ratings agencies and supplemented by additional market data including rating outlooks, credit default swaps, bank equity prices etc. to assist the Council in making more informed decisions about which counterparties to invest with. However, the final selection decision always rests with the Council.
- 2.8 The end of bank bail-outs, the introduction of bail-ins, and the preference being given to large numbers of depositors other than local authorities means that the risks of making unsecured deposits continues to be elevated relative to other investment options. The Authority therefore increasingly favoured secured investment options or diversified alternatives such as non-bank investments and pooled funds over unsecured bank and building society deposits.

### **Debt Management**

- 2.9 In September and December 2016 the council undertook the purchase of the BP main site and the SW corner. This was funded via the PWLB at highly competitive borrowing rates of sums borrowed of £377.5m and £28.2m respectively. The result being that the investment was configured so that a provision was set aside over the course of the lease and generating surplus balances to support the revenue budget. To date this has met projected expectation. Despite the increase in debt on the balance sheet this is countered by the significant extra revenue supporting the revenue budget.

### **Conclusions for 2016/17 and Prospects for 2017/18**

- 2.10 Market interest rates remain at historically low levels and Arlingclose believe these are unlikely to increase in 2017-2018 despite significant changes in the global environment. The return on investments achieved in 2016/17 has therefore been very good considering the external economic conditions the

Council has to operate within. The major contributing factor to this has been the Pooled Investment Funds.

- 2.11 As at 31st March 2017 the Council had £17.49m invested in these longer term arrangements. In addition to this, as at 31<sup>st</sup> March 2017 there was a capital gain of £1.77m on these funds and this is detailed in the table below:

<b>Pooled Fund Asset Class</b>	<b>Original Investment</b>	<b>Market Value at 31/3/17</b>
Equity Funds	£11.80m	£12.83
Corporate Bond Funds	£3.19m	£3.44m
Property Funds	£2.5m	£2.99m
<b>Total Investment</b>	<b>£17.49m</b>	<b>£19.26m</b>

- 2.12 Capital gains can vary on a daily basis and cannot be realised unless the investments are sold. Past performance is also no guide to the future but no treasury management activity is without risk so a balanced portfolio containing a good mix of asset classes can help to mitigate and manage risk effectively.
- 2.13 The Council's portfolio will continue to be kept under constant review in consultation with our treasury advisors to optimise investment performance whilst keeping risk to a minimum. The Council is proactive in its treasury management strategy so that it can act quickly when market conditions change.
- 2.14 With significant purchase acquisitions to be undertaken in the future by the council planning work has already commenced in conjunction with the most effective way to reinvest these funds and fund future revenue gaps.
- 2.15 With diversification of the overall portfolio also in mind, the Council had made a fixed term loan for a period of five years at a rate of 3.6% to Network Housing Group. Full due diligence was completed before this arrangement was entered into to ensure suitability, and the Council may look to make similar loans to other Housing Associations in the future if an appropriate opportunity becomes available.
- 2.16 The Council will also be working closely with Knowle Green Estates Ltd in the future, offering finance to the new entity at commercial rates. This will provide the Council with an additional fixed income stream and further diversification of the portfolio.

### **3. Financial implications**

- 3.1 This report is a review of past investment performance and the financial implications are as set out in this report. The ability of the Council to generate maximum net investment returns with minimal risk provides significant resources for funding the Council's services.

### **4. Other considerations**

- 4.1 There are none.

### **5. Timetable for implementation**

5.1 Treasury management is an ongoing activity and normally there is no specific timetable for implementation.

**Background papers:** None

**Appendices:** A & B

## Appendix A

### PRUDENTIAL INDICATORS

#### ACTUALS 2016/17

<b>Capital Expenditure Prudential Indicators</b>	<b>2015/16 Original Estimate</b>	<b>2015-16</b>	<b>2016/17 Draft</b>	<b>2016/17 Actual</b>
Prudential Indicator	£'000	£'000	£'000	£'000
Capital Expenditure	10,955	1,551	16,455	422,414
Ratio Financing Costs to Revenue Stream	(4.65)	(4.38)	(8.43%)	(10.98%)
Net Longer-term Borrowing	£0	£0	£0	£413,000
In year Capital Financing Requirement	£0	£0	£0	£422,414
Capital Financing Requirement as at 31 <sup>st</sup> March	£0	£0	£0	422,414

<b>Treasury Management Prudential Indicators</b>	<b>2015/16 Original Estimate</b>	<b>2015/16 Actual Outturn</b>	<b>2016/17 Draft</b>	<b>2017/18 Estimate</b>
Prudential Indicator	£'000	£'000	£'000	£'000
Authorised Limit for external debt	12,000	12,000	12,000	750,000
Operational Boundary for external debt	10,000	10,000	10,000	720,000
Gross Debt to Capital Finance Requirement	£0	£0	42,000	487,964
Upper limit for fixed rate exposure	100%	100%	100%	100%
Upper limit on variable rate exposure	100%	100%	100%	50%
Upper limit principal invested for over 364 days	12,000	12000	12,000	40,000

<b>Maturity structure of fixed rate borrowing</b>	<b>Upper limit</b>	<b>Lower limit</b>
Under 12 months	£550,000,000	£500,000,000
12 months but within 24 months	£82,500,000	£0
24 months but within 5 years	£110,000,000	£0
5 years but within 10 years	£137,500,000	£0
10 years and above	£275,000,000	£0

<b>Actual External Debt as at 31/3/17</b>	£413m
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## Appendix B

### Details of Investments Held as at 31<sup>st</sup> March 2017

Investment Type	Amount £m	Interest Rate %	Start Date	Maturity Date
<u>Pooled Investment Funds</u>				
Charteris Elite Equity Income	0.8	3.92%	May 2012	N/A
Schroeders UK Corporate Bond	1.5	5.17%	May 2012	N/A
M&G Optimal Income Sterling	1.69	3.72%	Apr 2015	N/A
M&G Global Dividend	1.0	4.43%	Jun 2012	N/A
Schroders Income Maximiser	3.0	7.88%	Jul12 / Jul15	N/A
CCLA LAMIT Property Fund	2.5	6.92%	Mar13 / Apr14	N/A
M&G Extra Income Fund Sterling	2.0	4%	August 2016	N/A
Investee Diversified Income	3.0	4%	August 2016	N/A
Threadneedle Inv Services	2.00	4%	September 2016	N/A
<b>Total Pooled Investment Funds</b>	<b>17.49</b>	<b>5.18%</b>		
<u>Fixed Rate Deposits (Short Term)</u>				
Network Housing Group	2.0	3.60%	28 April 2016	27 Apr 2021
<u>Other Deposits</u>				
Funding Circle	0.3	5.00%	Apr / May 2015	N/A
<b>Total Other Deposits</b>	<b>2.3</b>	<b>3.76%</b>		
<u>Cash Flow Investments</u>				
Invesco	5.6	0.30%		Instant Access
BNP Paribas MMF	1.4	0.31%		Instant Access
<b>Total Cash Flow Investments</b>	<b>7.00</b>	<b>0.30%</b>		
<b>Total Investments at 31/03/17</b>	<b>26.79%</b>	<b>3.92%</b>		

