Overview and Scrutiny Committee

19 January 2016

SPELTHORNE BOROUGH COUNCIL

Title	Treasury Management Half Yearly Report 2015/16		
Purpose of the report	To note		
Report Author	Ryan Maslen		
Cabinet Member	Councillor Tim Evans	**Confidential**	No
Corporate Priority	Value for money Council		
Cabinet Values	Accountability		
Recommendations	**Overview and Scrutiny are asked to note the treasury position achieved during the first six months of 2015/16 and the financial environment in global markets.**		

1. Key issues

1.1 Treasury Management is “the management of the Council’s cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks”.

1.2 The Council has adopted the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code which requires the Council to report on performance of the treasury management function at least twice yearly (mid-year and at year end).

1.3 The Council’s Treasury Management Strategy for 2015/16 was reviewed and approved by Cabinet in January 2015 and has been consistently applied since the beginning of the financial year.

1.4 This report is an interim statement of treasury activities for the first six months of the financial year, to the end of September 2015. The Council has invested 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 risks.

Strategy for the year

1.5 The overall treasury policy objective is the prudent investment of treasury balances. It is our aim to achieve the maximum return commensurate with proper levels of security and liquidity.

1.6 The Council seeks professional advice from Arlingclose and closely adheres to the advice set out in the Department for Communities and Local

Government (DCLG) guidance. Given Spelthorne's dependency on investment returns to balance the budget, the Council's investment strategy is also kept under constant review and regular quarterly review meetings are held with Arlingclose, the Council's treasury advisors. All investment and borrowing decisions are made in consultation with our advisors.

1.7 The credit quality of counter-parties (issuers and issues) and investment instruments is assessed by reference to credit ratings issued by Fitch, Moody's and Standard and Poor's. The Council's counter-party credit policy is based on creditworthiness criteria recommended by our advisors and is reviewed on an ongoing basis to ensure that risk to the Council of counter-party defaults remains low.

1.8 All three credit ratings agencies have reviewed their ratings in the past six months to reflect the loss of government support for most financial institutions and the potential for varying loss given defaults as a result of new bail-in regimes in many countries. Despite reductions in government support many institutions have seen upgrades due to an improvement in their underlying strength and an assessment that that the level of loss given default is low.

Compliance with Treasury Limits

1.9 During the first six months of the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement, and the annual Treasury Management Strategy Statement and Annual Investment Strategy approved by Council in January 2015.

Economic Background

1.10 The UK economy has remained resilient over the last six months. Although economic growth slowed in Q1 2015 to 0.4%, year/year growth to March 2015 was a relatively healthy 2.7%. Q2 2015 GDP growth bounced back and was confirmed at 0.7%, with year/year growth showing slight signs of slowing, decreasing to 2.4%.

1.11 Gross Domestic Product (GDP) has now increased for ten consecutive quarters, breaking a pattern of slow and erratic growth from 2009. The annual rate for Consumer Price Inflation (CPI) briefly turned negative in April, falling to -0.1%, before fluctuating between 0.0% and 0.1% over the next few months. In the August Quarterly Inflation Report, the Bank of England projected that GDP growth will continue around its average rate since 2013.

1.12 The Bank of England's projections for inflation remained largely unchanged from the May report with them expecting inflation to gradually increase to around 2% over the next 18 months and then remain there in the near future. Further improvement in the labour market saw the unemployment rates for the three months to July fall to 5.5%. In the September report, average earnings excluding bonuses for the three months to July rose 2.9% year/year.

1.13 The outcome of the UK general election, largely fought over the parties' approach to dealing with the consequences of the structural deficit and the pace of its removal, saw some very big shifts in the political landscape and put the key issue of the UK's relationship with the EU at the heart of future politics.

1.14 Earlier in the financial year, economic data was largely overshadowed by events in Greece. Whilst the Greek exit from the Euro remained a very serious possibility, it was announced in July that the terms for a third bailout of Greece had been reached. The deal amounting to €86 billion was agreed under the terms that Greece would see tax increases, pension reforms and privatisations. A new coalition Government was formed following a snap election in September 2015, but the continuing economic crisis in the area remains a cause for concern.

1.15 The summer also saw attention shift towards China as the Shanghai composite index (representing China's main stock market), which had risen a staggering 50%+ since the beginning of 2015, dropped by 43% in less than three months with a reported $3.2 trillion loss to investors. On 24th August, Chinese stocks suffered their steepest one-day fall on record, driving down other equity markets around the world and soon becoming known as another 'Black Monday'. Chinese stocks have recovered marginally since and are trading around the same level as the start of the year. Concerns remain about slowing growth and potential deflationary effects.

1.16 The US economy slowed to 0.6% in Q1 2015 due to bad weather, spending cuts by energy firms and the effects of a strong dollar. However, Q2 GDP showed a large improvement at a twice-revised 3.9% (annualised). The decision on whether to raise US interest rate remains key not only to the US but the global economy as well. The Committee decided not to act at its September meeting as many had been anticipating but have signalled rates rising before the end of the year.

2. Options analysis and proposal

Borrowing Activity to 30th September 2015

2.1 At 30th September 2015, the Council had no outstanding short term borrowings. Activity in this area is limited and is currently restricted to meeting daily cash flow requirements. However, short term borrowing may occur during February and March when levels of Council Tax and Business Rate instalments significantly reduce.

Investment Activity to 30th September 2015

2.2 The ability to maximise interest returns is paramount to generate sufficient funds to support the General Fund. The Council have therefore in consultation with Arlingclose made a few minor changes to the pooled investment fund portfolio, with the aim of maximising return. Fixed rate deposits have also been made when cash flow requirements permit.

2.3 As at 30th September 2015, the Council's investment portfolio was a total of £25.815m and a breakdown of the investments is attached as **Appendix A**. The availability of funds for investment is dependent upon the timing of precept payments, receipt of grants and progress on the capital programme. Consequently the core cash balance available for longer term investment is £20.74m. The cash flow investments, £4.9m in the table in Appendix A, are only available on a temporary basis pending cash flow activities.

2.4 Since the beginning of the financial year the Council has made an investment of £175,000 in a company called Funding Circle, who provide a peer-to-peer lending platform which is an alternative borrowing mechanism for small businesses. This is being viewed as a diversification tool within the treasury management investment portfolio, and also an economic development opportunity enabling the Council to support local businesses when demand exists. As shown in Appendix A, the investment is proving successful with the average return to date being 6.61%. A further small additional investment in this area has recently been agreed with the portfolio holder and will be made imminently.

2.5 The core investment portfolio of £20.74m now includes £9.49m in pooled equity, bond and property funds and a list of the individual investments and their current performance is detailed in **Appendix B**.

Investment Performance Monitoring

2.6 All investment performance is monitored on a monthly basis. The original estimate for net investment income to be credited to the General Fund in 2015/16 was £635,000, a significant increase from 2014/15 (£335,300). This reflected the significant capital receipts that were anticipated by the Council within 2015/16 when the budget was originally agreed. These would have been received and immediately re-invested.

2.7 As at 30th September 2015 the total net investment income earned to date was £199,000 of which £142,600 was from pooled funds. With interest rates continuing to remain at historically low levels (0.5% since March 2009), these pooled investment funds are fundamental to meeting the investment income target for the year. Investment income is always received in arrears, sometimes on a half yearly basis. This explains why income received to date seems at such a low level when compared to the annual budget.

2.8 Assuming that interest rates remain static in this financial year and pooled fund dividends remain at their current levels, the outturn for the full year is estimated to be £580,000. Action will be taken wherever possible to maximise return by taking advantage of enhanced deposit rates that may be available.

2.9 At the end of the financial year, any shortfall in interest received when compared to the annual budget will be funded from the interest equalisation reserve. This is a reserve that has been accumulated in previous financial years when interest earnings have exceeded the annual budget, and can be used to mitigate situations such as the one outlined above.

2.10 The overall average annualised rate of return for the first six months is 2.25%. This is 0.42% higher than for the equivalent period last year. This improved performance is due to the continued positive performance of the Council's current pooled funds and bond investments and also the usage of newly identified investment opportunities when possible to maximise return.

Conclusions and Outlook for 2016/17

2.11 The investment strategy is kept under constant review so that the Council can adapt quickly to the constantly changing environment. The Council continues to be proactive in seeking ways of maintaining and improving current levels of return against a very challenging global investment environment.

2.12 Arlingclose believes that Bank Rate will remain at 0.50% until quarter three of the 2016 calendar year and cash rates for deposits are likely to remain at historically low levels for the foreseeable future.

2.13 The pace of interest rate rises will be gradual and the extent of rises limited. The appropriate level for Bank Rate for the post-crisis UK economy is likely to be lower than the previous norm. We would suggest this is between 2.0% and 3.0%.

2.14 Arlingclose provides a monthly update of the credit ratings of major financial institutions. Counterparty credit quality is assessed and monitored with reference to the rating agencies Fitch, Moody’s and Standard and Poor’s; credit default swaps; GDP of the country in which the institution operates; the country’s net debt as a percentage of GDP; sovereign support mechanisms and potential support from a well-resourced parent institution and share price. This information is used for reference and decision making purposes and will continue to be monitored closely.

2.15 The full list of approved investment instruments is attached in **Appendix C and D**; this reflects the application of the creditworthiness criteria recommended by the Council’s advisors, Arlingclose.

Proposals

2.16 The use of pooled investment funds within the portfolio has been fundamental to the continued positive performance and should help maintain overall investment returns into the future. These investments will also enable the Council to diversify the assets and underlying risk in the investment portfolio and should provide the potential for enhanced returns.

2.17 Further diversification and growth of the investment portfolio is planned, especially considering the significant capital receipts the Council are expecting in the near future. Recent discussions have been held with Arlingclose and the portfolio holder to ensure that a planned approach for this is agreed and implemented.

2.18 In order to realise potential income generating asset related opportunities including the purchase of new Council office accommodation, it may be necessary for the Council to borrow if there is a robust business case. It is likely that borrowing costs would be at a lower rate than would be forgone if we drew down on some of our existing long term investments. The Council is therefore also having ongoing discussions with Arlingclose to develop a potential borrowing strategy, again in conjunction with the portfolio holder.

3. Financial implications

3.1 The financial implications are as set out in this report. The ability to maximise interest returns is paramount to generate sufficient funds to support the General Fund and even a small move in interest rates can mean a significant reduction in cash returns. Therefore, it is our aim to continue to maintain flexibility commensurate with the high level of security and liquidity and minimal risk when making investment decisions.

4. Other considerations

4.1 The Council fully complies with best practice as set out in the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities, the Department for Communities and Local Government (DCLG) Guidance on Investments issued in March 2004 and the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management in the Public Sector 2009 and Cross Sectional Guidance Notes.

4.2 Nothing in the Council's current strategy is intended to preclude or inhibit capital investment in local projects deemed beneficial to the local community and which have been approved by the Council.

5. Timetable for implementation

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

Background papers: There are none

Appendices: Appendices A – D are attached

Appendix A

Details of Investments Held as at 30th September 2015

Investment Type	Initial Inv. Amount £m	Yield %	Start Date	Maturity Date
Pooled Investment Funds (see Appendix B for details)				
Charteris Elite Equity Income	0.8	3.91*	11 May 2012	N/A
Schroders UK Corporate Bond	1.5	6.38*	11 May 2012	N/A
M&G Optimal Income Sterling	1.69	3.00*	13 Apr 2015	N/A
M&G Global Dividend	1.0	3.98*	27 Jun 2012	N/A
Schroders Income Maximiser	1.0	6.72*	06 Jul 2012	N/A
Schroders Income Maximiser	1.0	6.72*	24 Jul 2015	N/A
CCLA Property Fund (LAMIT)	1.5	5.53*	31 Mar 2013	N/A
CCLA Property Fund (LAMIT)	1.0	5.53*	30 Apr 2014	N/A
Total	**9.49**	**4.89***		
Variable Rate Deposits				
Yorkshire Building Society	1.0	2.20	09 Apr 2014	23 Mar 2016
Fixed Rate Deposits (short term)				
Nordea Bank AB	1.25	0.80	29 Jul 2015	15 Dec 2015
Landesbank Hessen-Thuringen	2.0	0.69	31 Jul 2015	29 Jan 2016
Santander	2.0	0.73	04 Aug 2015	04 Feb 2016
Nationwide Building Society	2.0	0.66	15 Sep 2015	15 Mar 2016
Newbury Building Society	1.0	0.50	14 Aug 2015	16 Nov 2015
Standard Chartered CD	2.0	0.72	06 May 2015	06 Nov 2015
Total	**10.25**	**0.69**		
Total - Core Inv. Portfolio	**20.74**	**2.51**	**Average**	
Cash Flow Investments				
Standard Life Investments	1.1	0.49		Instant Access
Insight Investments	0.7	0.51		Instant Access
BNP Paribas	3.1	0.53		Instant Access
Total	**4.9**	**0.52**		
Funding Circle				
Loans to small businesses	0.175	6.61	16 Apr 2015	
Total Investments at 30.9.15	**25.815**	**2.25**	**Overall Average**	

**** Yields on pooled funds are estimates based on the returns on initial investment achieved in 2013/14 and 2014/15.***

Appendix B

Pooled Funds as at 30th September 2015

Fund	Date of Purchase	Initial Investment	Dividends Received to 30/9/15	Annualised Dividend Yield	Capital Gain at 30/9/15	Total Return at 30/9/15
		£	£	£	£	£
Charteris Elite Income Fund	11/05/12	800,000	16,239	4.06%	- 101,365	- 85,126
Schroders UK Corporate Bond Fund	11/05/12	1,500,000	35,808	4.77%	74,648	110,456
Schroders Income Maximizer Fund	06/07/12	1,000,000	32,423	6.48%	82,957	115,380
Schroders Income Maximizer Fund	24/07/15	1,000,000	-	0.00%	- 119,625	- 119,625
M&G Optimal Income Sterling	13/04/15	1,690,636	-	0.00%	- 53,675	- 53,675
M&G Global Dividend Fund	27/06/16	1,000,000	22,616	4.52%	94,720	117,336
CCLA Property Fund (LAMIT)	31/03/13	1,500,000	21,813	2.91%	400,573	422,386
CCLA Property Fund (LAMIT)	30/04/14	1,000,000	12,455	2.49%	85,197	97,652
Value 30/9/2015		**9,490,636**	**141,355**	**2.98%**	**463,428**	**604,783**

Pooled Fund Performance to 30th September 2015

The Capital appreciation of these investments as at 30/9/15 equates to 4.88%. However, capital gains and losses may fluctuate throughout the period the investments are held. Any gains would only be realised when the funds are sold.

Dividends are received at various times during the year, some are paid quarterly and others half yearly. For two of the recent investment amendments we have made dividends are yet to be received. The income yield as at 30/9/15 is 1.49% and the estimated annualised income yield on these funds is expected to be in the region of 4.9%.

Appendix C

Approved Counterparties

The Council may invest its surplus funds with any of the counterparty types in the table below, subject to the cash limits (per counterparty) and the time limits shown.

The cash limits shown reflect the capital receipt that the Council may receive during 2015/16. This approach has been agreed in conjunction with our treasury advisors, to enable the Council to have sufficient flexibility within the strategy being set to manage the funds appropriately if they are received. If and when this is realised the Council will manage the funds appropriately, looking to diversify investments as much as possible and keep exposure to approximately 5% per counterparty wherever possible.

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£5m 5 years	£5m 20 years	£5m 50 years	£5m 20 years	£5m 20 years
AA+	£5m 5 years	£5m 10 years	£5m 25 years	£5m 10 years	£5m 10 years
AA	£5m 4 years	£5m 5 years	£5m 15 years	£5m 5 years	£5m 10 years
AA-	£5m 3 years	£5m 4 years	£5m 10 years	£5m 4 years	£5m 10 years
A+	£5m 2 years	£5m 3 years	£5m 5 years	£5m 3 years	£5m 5 years
A	£5m 13 months	£5m 2 years	£5m 5 years	£5m 2 years	£5m 5 years
A-	£5m 6 months	£5m 13 months	£5m 5 years	£5m 13 months	£5m 5 years
BBB+	£5m 100 days	£5m 6 months	£5m 2 years	£5m 6 months	£5m 2 years
BBB or BBB-	£5m next day only	£5m 100 days	n/a	n/a	n/a
None	£1m 6 months	n/a	£1m 25 years	£1m 5 years	£1m 5 years
Pooled funds	£5m per fund at point of investment				

This table must be read in conjunction with the notes below

Banks Unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. Unsecured investment with banks rated BBB or BBB- are restricted to overnight deposits at the Authority's current account bank, Lloyds Bank plc.

Banks Secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely.

Registered Providers: Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain a high likelihood of receiving government support if needed.

Pooled Funds: Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Money Market Funds that offer same-day liquidity and aim for a constant net asset value will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

Appendix D

Specified Investments

The DCLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local authority, parish council or community council, or
  - a body or investment scheme of "high credit quality".

The Council defines "high credit quality" organisations and securities as those having a credit rating of [A-] or higher that are domiciled in the UK or a foreign country with a sovereign rating of [AA+] or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of [A-] or higher.

Non-Specified Investments

Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality.

Investment Limits

The maximum that will be lent to any one organisation (other than the UK Government) will be £5 million, to mitigate the risk in the case of a single default. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as shown below. As detailed in Appendix C, the cash limits shown reflect the capital receipt that the Council may receive during 2015/16 and have been agreed in conjunction with our treasury advisors to provide the Council with an element of flexibility to be able to invest the funds in the most appropriate manner at the time.

	Cash limit
Any single organisation, except the UK Central Government	£5m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£5m per group
Any group of pooled funds under the same management	£5m per manager at point of investment
Negotiable instruments held in a broker's nominee account	£30m per broker
Foreign countries	£5m per country
Registered Providers	£10m in total
Unsecured investments with Building Societies	£20m in total
Loans to unrated corporates	£2m in total
Money Market Funds	£20m in total