Report No.
FSD15049

London Borough of Bromley

PART 1 - PUBLIC

Decision Maker:	**Resources Portfolio Holder** **Council**
Date:	**For pre-decision scrutiny by Executive and Resources PDS Committee on 3rd September 2015** **Council 19th October 2015**
Decision Type:	Non-Urgent Non-Executive Non-Key
Title:	**TREASURY MANAGEMENT - Q1 PERFORMANCE 2015/16 & INVESTMENT STRATEGY REVIEW**
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Chief Officer:	Director of Finance
Ward:	Alll

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1. Reason for report

1.1 This report summarises treasury management activity during the June quarter and includes recommended changes to the Council's Treasury Management Investment Strategy, which would require the approval of full Council. The report also includes an update on the Council's investment with Heritable Bank (paragraph 3.13). Investments as at 30th June 2015 totalled £275.3m (excluding the balance of the Heritable investment) and there was no outstanding external borrowing. As at the time of writing this report (19th August), the total of investments had risen to £304.4m. For information and comparison, the balance of investments stood at £254.8m as at 31st March 2015 and £287.2m as at 30th June 2014.

RECOMMENDATION(S)

The PDS Committee and the Resources Portfolio Holder are asked to:

(a) Note the actual Treasury Management performance in the quarter ended 30th June 2015; and

(b) Recommend to Council an increase in the total investment limit for pooled investment vehicles from £25m to £40m (see paragraphs 3.16 to 3.18).

Council is requested to approve an increase in the total investment limit for pooled investment vehicles from £25m to £40m (see paragraphs 3.16 to 3.18).

Corporate Policy

1. Policy Status: Existing policy. To maintain appropriate levels of risk, particularly security and liquidity, whilst seeking to achieve the highest rate of return on investments.

2. BBB Priority: Excellent Council.

Financial

1. Cost of proposal: N/A

2. Ongoing costs: N/A.

3. Budget head/performance centre: Interest on balances

4. Total current budget for this head: £2.741m (net) in 2015/16; outturn currently estimated to be £0.6m above budget at this stage

5. Source of funding: Net investment income

Staff

1. Number of staff (current and additional): 0.25 fte

2. If from existing staff resources, number of staff hours: 9 hours per week

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Legal

1. Legal Requirement: Non-statutory - Government guidance.

2. Call-in: Call-in is applicable

Customer Impact

1. Estimated number of users/beneficiaries (current and projected): n/a

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Ward Councillor Views

1. Have Ward Councillors been asked for comments? N/A.

2. Summary of Ward Councillors comments:

3. COMMENTARY

General

3.1 Under the requirements of the CIPFA Code of Practice on Treasury Management, the Council is required, as a minimum, to approve an annual treasury strategy in advance of the year, a mid-year review report and an annual report following the year comparing actual activity to the strategy. In practice, the Director of Finance has reported quarterly on treasury management activity for many years, as well as reporting the annual strategy before the year and the annual report after the year-end. This report includes details of investment performance in the first quarter of 2015/16. The 2015/16 annual treasury strategy, including the MRP (Minimum Revenue Provision) Policy Statement and prudential indicators, was originally approved by Council in February 2015. The annual report for the whole of the financial year 2014/15 was submitted to the Executive & Resources PDS Committee on 9th July and will go to the Council meeting on 19th October.

3.2 The Treasury Management Code of Practice sets out that priority is given to security and liquidity over the return on investments and recent changes in the regulatory environment place a much greater onus on Members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the actual position for treasury activities and highlights compliance with the Council's policies previously approved by Members.

3.3 The Council has approved an Investment Strategy for Treasury Management, which has been regularly reviewed over recent years to provide a wider range of investment options at minimal additional risk. A further change is proposed in this report in the form of an increase of £15m (from £25m to £40m) in the total value of deposits in pooled investment vehicles (see paragraphs 3.16 to 3.18).

Treasury Performance in the quarter ended 30th June 2015

3.5 **Borrowing:** The Council's healthy cashflow position continues and no borrowing has been required for a number of years.

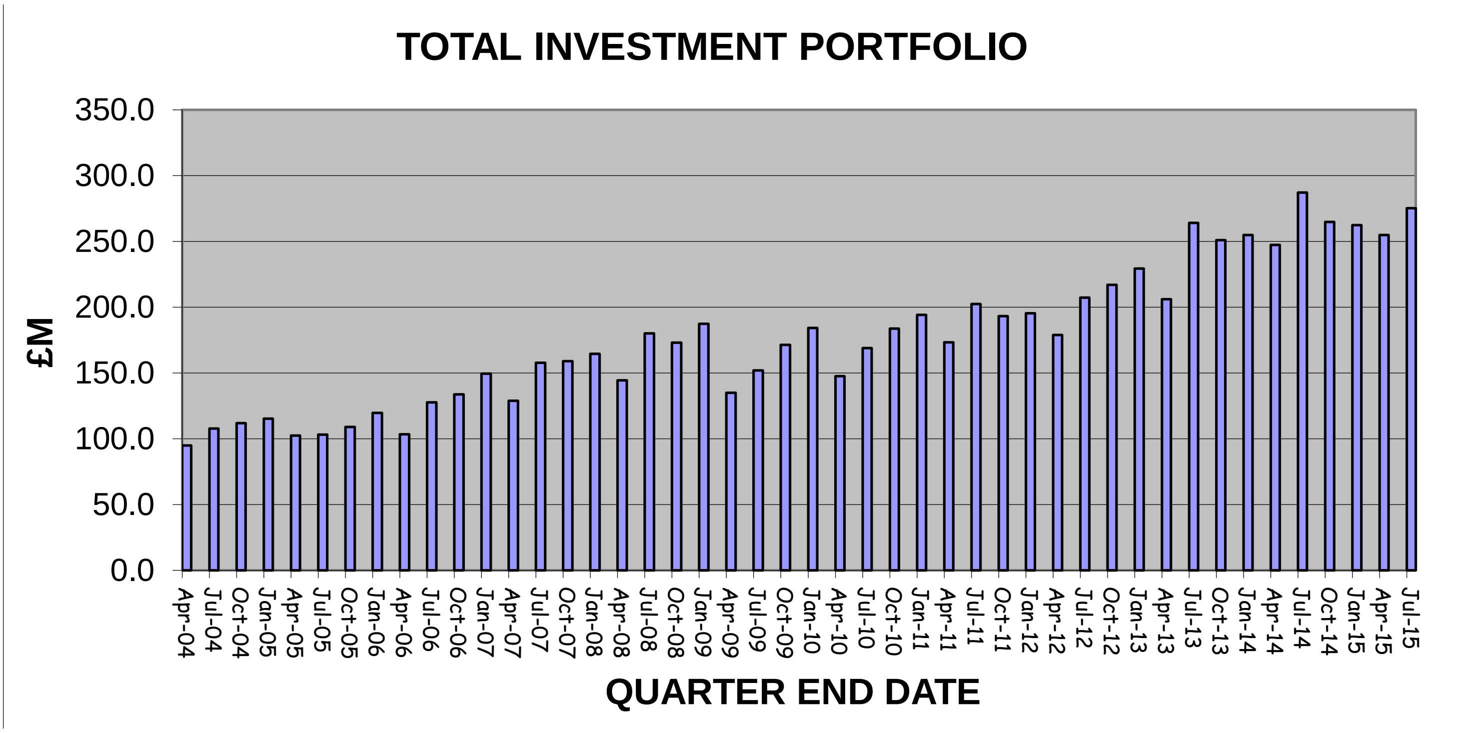
3.6 **Investments:** The following table sets out details of investment activity during the June quarter:-

	£m	%
Balance of "core" investments b/f	207.50	1.29
New investments made in period	35.00	1.42
Investments redeemed in period	-10.00	0.87
"Core" investments at end of period	232.50	1.41
Money Market Funds	17.80	para 3.11
CCLA Property Fund	15.00	para 3.12
Diversified Growth Funds	10.00	para 3.12
Total investments at end of period	**275.30**	**n/a**

3.7 Details of the outstanding investments at 30th June 2015 are shown in maturity date order in Appendix 1 and by individual counterparty in Appendix 2. An average return of 1% was included for new "core" investments (lending to banks and other local authorities) in the 2015/16 budget and the average return on the two new "core" investments during the June quarter was 1.42%. For comparison, the average LIBID rates for the June quarter were 0.36% for 7 days, 0.45% for 3 months, 0.58% for 6 months and 0.87% for 1 year. The improved average rate earned on new investments placed to date in 2015/16 is mainly due to a longer-term (three year) deposit placed in April with Lloyds Bank at 1.49%.

3.8 Reports to previous meetings have highlighted the fact that options with regard to the reinvestment of maturing deposits have become seriously limited in recent years following bank credit rating downgrades. Changes to lending limits and eligibility criteria, most recently in October 2014 (an increase of £40m (from £40m to £80m) in the lending limits of both Lloyds and RBS and an increase in the maximum period from 2 years to 3 years) have alleviated this to some extent, but we have still found ourselves in the position of not having many investment options other than placing money with instant access accounts at relatively low interest rates. Active UK banks on our list now comprise only Lloyds, RBS, HSBC, Barclays, Santander UK and Nationwide and all of these have reduced their interest rates significantly in recent years. The Director of Finance will continue to monitor rates and counterparty quality and take account of external advice prior to any investment decisions.

3.9 The graph below shows total investments at quarter-end dates back to 1st April 2004 and shows how available funds have increased steadily over the years. This has been a significant contributor to the over-achievement of investment income against budgeted income in recent years.



Interest Rate Forecast

3.10 Base rate has now been 0.5% since March 2009 and the latest forecast by Capita Treasury Solutions (in August 2015) is for it to begin to slowly rise from mid-2016 (no change from the previous estimate given in May 2015). Capita's forecasts are shown below.

Date	LATEST FORECAST (Aug 15)				PREVIOUS FORECAST (May 15)			
		3 month	6 month	1 year		3 month	6 month	1 year
	Base Rate	Libid	Libid	Libid	Base Rate	Libid	Libid	Libid
Sep-15	0.50%	0.50%	0.70%	1.00%	0.50%	0.50%	0.70%	1.00%
Dec-15	0.50%	0.60%	0.80%	1.10%	0.50%	0.60%	0.80%	1.10%
Mar-16	0.50%	0.70%	0.90%	1.20%	0.50%	0.70%	0.90%	1.20%
Jun-16	0.75%	0.80%	1.00%	1.30%	0.75%	0.80%	1.00%	1.30%
Sep-16	0.75%	0.90%	1.10%	1.40%	0.75%	0.90%	1.10%	1.40%
Dec-16	1.00%	1.10%	1.30%	1.60%	1.00%	1.10%	1.30%	1.60%
Mar-17	1.00%	1.30%	1.50%	1.80%	1.00%	1.30%	1.50%	1.80%
Jun-17	1.25%	1.40%	1.60%	1.90%	1.25%	1.40%	1.60%	1.90%
Sep-17	1.50%	1.50%	1.70%	2.00%	1.50%	1.50%	1.70%	2.00%
Dec-17	1.50%	1.80%	2.00%	2.30%	1.50%	1.80%	2.00%	2.30%
Mar-18	1.75%	1.90%	2.10%	2.40%	1.75%	1.90%	2.10%	2.40%
Jun-18	1.75%	1.90%	2.10%	2.40%	n/a	n/a	n/a	n/a

Other accounts

3.11 Money Market Funds

The Council currently has 7 AAA-rated Money Market Fund accounts, with Prime Rate, Ignis, Insight, Morgan Stanley, Blackrock, Fidelity and Legal & General, all of which have a maximum investment limit of £15m. In common with market rates for fixed-term investments, interest rates on money market funds have fallen considerably in recent years. The Ignis and LGIM funds currently offer the best rate (around 0.49%). The total balance held in Money Market Funds fluctuates considerably, moving from £22.3m as at 1st April 2015 to £17.8m as at 30th June 2015 and currently stands at £41.9m (as at 19th August 2015). The Money Market Funds currently offer the lowest interest of all our eligible investment vehicles with the exception of the Government Debt Management and Deposit Fund (currently 0.25%). During the year, funds have been and will continue to be withdrawn to fund other, more attractive investments, most recently in late-July/early-August when £10m was invested for one year with both Barclays and Santander at 1.02% and 1.00% respectively. If Members agree to the increase of £15m in the limit for pooled investment vehicles proposed in this report, then the additional investment will be funded by reducing holdings with money market funds. Funds will continue to be held in money market funds, however, as there is a need to have cash available for general Council activities and to support the strategy of investment property acquisitions.

Money Market Fund	Date Account Opened	Actual Balance 01/04/15	Actual Balance 30/06/15	Ave. Rate Q1 2015/16	Actual Balance 19/08/15	Ave. Daily balance to 19/08/15	Current Rate 19/08/15
		£m	£m	%	£m	£m	%
Prime Rate	15/06/2009	7.3	-	0.45	10.4	3.0	0.47
Ignis	25/01/2010	15.0	15.0	0.47	15.0	5.8	0.49
Insight	03/07/2009	0.0	-	0.44	4.2	1.0	0.45
Morgan Stanley	01/11/2012	0.0	-	0.43	-	-	0.42
Legal & General	23/08/2012	0.0	2.8	0.46	12.3	3.9	0.49
Blackrock	16/09/2009	0.0	-	-	-	-	0.37
Fidelity	20/11/2002	0.0	-	-	-	-	0.37
TOTAL		22.3	17.8		41.9		

3.12 Pooled Investment Schemes

CCLA Property Fund
Following consultation between the Director of Finance and the Resources Portfolio Holder, an account was opened in January 2014 with the CCLA Local Authorities' Property Fund and an initial deposit of £5m was made. Following further consultation, another £5m deposit was made at the end of July 2014 and, finally, a third £5.0m was deposited in March 2015. This is viewed as a medium to long-term investment and dividends are paid quarterly. In 2014/15, the investment returned 5.25% net of fees and, in the June 2015 quarter, it returned 4.81% (net).

Diversified Growth Funds
In October 2014, the Council approved the inclusion of investment in diversified growth funds in our strategy and, in December, £5m was invested with both Newton and Standard Life. The Funds both performed very well in just over three months to 31st March 2015; the Newton Fund returning 21.5% (a gain of £294k) and the Standard Life Fund returning 21.9% (a gain of £299k). In accordance with the Council decision, interest equivalent to 27% (£160k) of the total dividend was transferred to the Parallel Fund, set up in 2014/15 with an opening balance of £2.7m to mitigate the potential revenue impact of future actuarial Pension Fund valuations. In the first four months of 2015/16, however, both Funds lost value and, as at 31st July (7 months since inception), the Newton Fund had returned 5.76% (net – an overall gain of £175k) and the Standard Life Fund had returned 9.05% (net – an overall gain of £275k).

3.13 Investment with Heritable Bank

Members will be aware from regular updates to the Resources Portfolio Holder and the Executive that the Council had £5m invested with the Heritable Bank, a UK subsidiary of the Icelandic bank, Landsbanki. In October 2008, the bank was placed in administration and our investment was frozen. An initial dividend was paid to the Council in July 2009 and, since then, a further 13 dividends have been received (most recently in August 2013). To date, a total of £4,783k has been received (94% of our total claim of £5,087k), leaving a balance of £304k (6.0%). Council officers and our external advisers remain hopeful of a full recovery and, in May 2015, the administrator advised that a further distribution (as yet unspecified) will be made to creditors in August. A verbal update may need to be provided at the meeting.

3.14 External Cash Management

External cash managers, Tradition UK Ltd, currently manage £20m of our cash portfolio and provide useful advice and information on treasury management matters. In 2014/15, Tradition UK achieved a return of 1.28%, which compared with the in-house team rate of 1.06% for "core" investments (1.55% including investments with the pooled vehicles). Tradition UK work to the same counterparty list as the Council's in-house team and so have also been constrained by strategy changes approved after the Icelandic Bank crisis and by ratings downgrades in recent years. Details of externally managed funds placed on deposit as at the time of writing this report are shown below. All of their current deposits have been placed for periods of two years or three years.

Bank	**Sum**	**Start Date**	**Maturity**	**Period**	**Rate**
Lloyds	£7.5m	18/08/14	18/08/16	2 years	1.28%
RBS	£5.0m	26/08/14	26/08/16	2 years	Min 1.52%; max 2.00% (linked to 3 month Libor)
West Dumbartonshire Council	£2.5m	26/03/14	24/03/17	3 years	1.60%
Perth & Kinross Council	£5m	23/03/14	24/03/17	3 years	1.45%

Economic Background (provided by Sector)

3.15 Comments on the economic background during the first quarter of 2015/16 and on the outlook are attached at Appendix 3.

Proposed change to the Annual Investment Strategy

3.16 As is outlined in paragraph 3.8, counterparty credit rating downgrades in recent years have resulted in the removal of (or the placing of restrictions on) many of our established counterparties from our lending list and it has become increasingly difficult to identify institutions to place money with. The restrictions on our lending list mean that we are almost always full to limit on eligible counterparties that are in the market for local authority cash. As a result, we have had to place large sums in low interest accounts and this has had a significant impact on the Council's interest earnings. At the time of writing this report (19th August 2015), around £42m is invested in instant access (Money Market Fund) accounts.

3.17 In an attempt to increase options, a number of changes to the approved strategy have been agreed in recent years, most recently in October 2014, when the total investment limit for the two part-nationalised banks, Lloyds and Royal Bank of Scotland, was increased to £80m and the maximum investment period was increased to 3 years.

3.18 In September 2013, the Portfolio Holder and Full Council approved the inclusion of collective (pooled) investment schemes as eligible investment vehicles in the Council's Investment Strategy with an overall limit of £25m and a maximum duration of 5 years. As is outlined above (in paragraph 3.12), pooled investment schemes have performed well to date and have earned a rate of return considerably higher than other forms of investment that are currently available. ***It is proposed, therefore, that the total limit for these investments (currently comprising the CCLA Property Fund and the two Diversified Growth Fund investments with Newton and Standard Life) be increased from £25m to £40m***. Such investments would continue to require the approval of the Director of Finance in consultation with the Resources Portfolio Holder. Although past performance is no guarantee of future performance, this should enable us to get a higher return on cash currently placed in low-earning money market funds.

3.19 For information, pooled investment vehicles must meet the following criterai:

- In recognition of the need to protect capital, a longer term period of 3 – 5 years will be required, where the capital risk is expected to be minimal;
- The returns will be expected to be higher than normal secured fixed term lending to eligible financial institutions by at least 2%;
- Investments must be able to be sold within 6 months (9 months for property), which provides more flexibility than lending to banks for longer periods;
- The investment vehicle must have a proven track record over a 3 – 5 year period, although it is accepted that looking back is no guarantee of returns for the future;
- Historically, volatility has been low; and
- The Council's external advisers, Sector, must support the proposals using their extensive financial expertise.

Regulatory Framework, Risk and Performance

3.20 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions have been made in any year(s);
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the CLG has issued Investment Guidance to structure and regulate the Council's investment activities;
- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007.

3.21 The Council has complied with all of the above relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

4. POLICY IMPLICATIONS

4.1 In line with government guidance, the Council's policy is to seek to ensure the security of the Council's investments, to achieve liquidity and to achieve the highest rate of return on investments whilst maintaining appropriate levels of risk.

5. FINANCIAL IMPLICATIONS

5.1 There is still no real sign of interest rates improving and an average rate of 1% has again been prudently assumed for interest on new fixed term deposits (lending to banks and other local authorities) in the 2015/16 revenue budget, in line with the estimates provided by the Council's external treasury advisers, Capita, and with officers' views. The Bank of England base rate is still expected to rise, but the expected start of the rise has been put back to mid-2016 and could be even later. There have been no improvements to counterparty credit ratings, as a result of which the restrictions to investment opportunities that followed ratings downgrades in recent years have still been in place. However, the increases in the limits for the two part-nationalised banks (Lloyds and RBS) approved by the Council in October, together with higher rates from longer-term deals placed with other local authorities, higher average balances than anticipated and the strong performance of the CCLA Property Fund and the Diversified Growth Fund investments enabled the budget to be increased from £1,591k in 2014/15 to £2,741k in

2015/16. At this stage in the year, it is forecast that the 2015/16 outturn will be around £3.35m; i.e. a surplus of £0.6m, mainly due to good returns on the CCLA Property Fund.

Non-Applicable Sections:	Legal and Personnel Implications
Background Documents: (Access via Contact Officer)	CIPFA Code of Practice on Treasury Management CIPFA Prudential Code for Capital Finance in Local Authorities CLG Guidance on Investments External advice from Capita Treasury Solutions

APPENDIX 3

CAPITA COMMENTARY ON ECONOMIC BACKGROUND

After strong UK GDP growth in 2013 at an annual rate of 2.7% and 3.0% in 2014, quarter 1 of 2015 was disappointing at only 0.4%, though subsequent data indicates that this could well be revised up further down the line and also indicates a return to stronger growth in quarter 2. In its May quarterly Inflation Report, the Bank of England reduced its GDP forecast for 2015 from 2.9% to 2.5% and from 2.9% to 2.7% in 2016, while increasing its forecast for 2017 from 2.4% to 2.7%.

Uncertainty around the likely result of the UK general election in May has obviously now evaporated although this has been replaced by some uncertainty around the potential impact on the UK economy of the EU referendum promised by, or in, 2017. In addition, the firm commitment of the Conservative Government to eliminating the deficit within the term of this Parliament will have an impact on GDP growth rates. However, the MPC is fully alert to this and will take that into account, and also the potential spill over effects from the Greek crisis, in making its decisions on the timing of raising Bank Rate.

As for the American economy, confidence has improved markedly in this quarter that the US will start increasing the Fed funds rate by the end of 2015 due to a return to strong economic GDP growth after a disappointing start to the year in quarter 1, (a contraction of 0.2%), after achieving 2.4% growth in 2014.

In the Eurozone, the ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This already appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in economic growth, though it remains to be seen whether this will have an enduring effect as strong as the recovery in the US and UK.