

PART 1 - PUBLIC

Decision Maker: Resources Portfolio Holder

Date: For pre-decision scrutiny by Executive and Resources PDS Committee on 3rd February 2016

Decision Type: Non-Urgent Executive Non-Key

Title: TREASURY MANAGEMENT - PERFORMANCE Q3 2015/16

Contact Officer: Martin Reeves, Principal Accountant (Technical & Control)
Tel: 020 8313 4291 E-mail: martin.reeves@bromley.gov.uk

Chief Officer: Director of Finance

Ward: All

1. Reason for report

- 1.1 This report summarises treasury management activity during the quarter ended 31st December 2015 and the period 1st April 2015 to 31st December 2015. It also updates Members on the Council's investment with Heritable Bank (paragraph 3.17). The report ensures that the Council is implementing best practice in accordance with the CIPFA Code of Practice for Treasury Management. Investments as at 31st December 2015 totalled £301.9m (excluding the balance of the Heritable investment) and there was no outstanding external borrowing. For information and comparison, the balance of investments stood at £282.6m as at 30th September 2015 and £262.5m as at 31st December 2014 and, at the time of writing this report (22nd January), it stood at £308.0m.

RECOMMENDATION(S)

- 2.1 The PDS Committee and Portfolio Holder are asked to note the report and to note that three months' notice to terminate the contract with Tradition UK was given in December 2015 (see paragraph 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 interest earnings) in 2015/16; currently forecast to be £1.0m over budget
 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
-

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
-

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 treasury management activity during the quarter ended 31st December 2015 and the period 1st April 2015 to 31st December 2015. 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 financial year 2014/15 was submitted to the Executive & Resources PDS Committee on 9th July 2015 and was approved by Council on 19th October 2015. Amendments to the strategy (comprising an increase in the total investment limit for pooled investment vehicles from £25m to £40m) were approved by Council in October 2015. No further changes are proposed in this report.
- 3.2 In recent years, the Council has regularly reviewed its Investment Strategy for Treasury Management to provide a wider range of investment options, ranging from investment in corporate bonds to various investment choices over a 3 to 5 year timeframe, including investments in a property fund and in Diversified Growth Funds. The Treasury Management Code of Practice requires that priority be given to security and liquidity over return on investments and recent changes in the regulatory environment place a 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 Council policies previously approved by Members.
- 3.3 The Council has monies available for Treasury Management investment as a result of the following:
- (a) Positive cash flow;
 - (b) Monies owed to creditors exceed monies owed by debtors;
 - (c) Receipts (mainly from Government) received in advance of payments being made;
 - (d) Capital receipts not yet utilised to fund capital expenditure;
 - (e) Provisions made in the accounts for liabilities e.g. provision for outstanding legal cases which have not yet materialised;
 - (f) General and earmarked reserves retained by the Council.
- 3.4 Some of the monies identified above are short term and investment of these needs to be highly “liquid”, particularly if it relates to a positive cash flow position, which can change in the future. Future monies available for Treasury Management investment will depend on the budget position of the Council and whether the Council will need to substantially run down capital receipts and reserves. Against a backdrop of unprecedented cuts in Government funding (which will require the Council to make revenue savings to balance the budget in future years), there is a likelihood that such actions may be required in the medium term, which will reduce the monies available for investment.
- 3.5 The Council has also identified an alternative investment strategy relating to property investment. To date, this has resulted in actual and planned acquisitions potentially generating income of £3.7m per annum and a further £1.3m is anticipated in the Draft 2016/17 Budget report to the Executive on 13th January from further investment property purchases in 2016/17. This is based on a longer term investment timeframe of at least 3 to 5 years. After allowing for foregone treasury management interest earnings (£0.5m), the financial forecast assumes net increased income of £4.5m from the acquisitions. This alternative investment ensures that the monies available can attract higher yields over the longer term.

- 3.6 A combination of lower risk investment relating to Treasury Management and a separate investment strategy in the form of property acquisitions (generating higher yields and risks) provides a balanced investment strategy. Any investment decisions will also need to consider the likelihood that interest rates will increase at some point. The available resources for the medium term, given the ongoing reductions in Government funding, will need to be regularly reviewed.

Treasury Performance in the quarter ended 31st December 2015

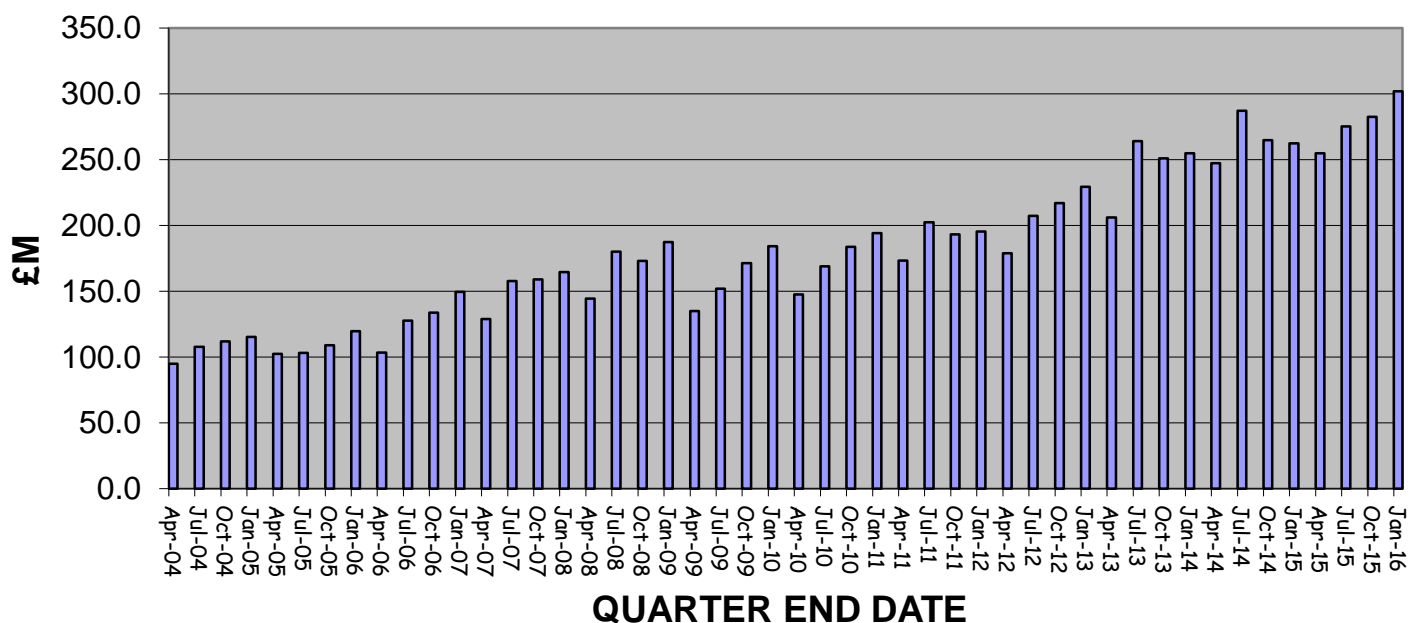
- 3.7 **Borrowing:** The Council's healthy cashflow position continues and no borrowing has been required for a number of years.
- 3.8 **Investments:** The following table sets out details of investment activity during the December quarter and during the financial year 2015/16 to date:-

Main investment portfolio	Qtr ended 31/12/15		1/4/15 to 31/12/15	
	Deposits	Ave Rate	Deposits	Ave Rate
	£m	%	£m	%
Balance of "core" investments b/f	237.50	1.40	207.50	1.29
New investments made in period	15.00	1.62	70.00	1.33
Investments redeemed in period	-5.00	1.00	-30.00	0.83
"Core" investments at end of period	247.50	1.41	247.50	1.41
Money Market Funds	9.40	para 3.13	9.40	para 3.13
Santander 180 day notice account	10.00	para 3.14	10.00	para 3.14
CCLA Property Fund	25.00	para 3.15	25.00	para 3.15
Diversified Growth Funds	10.00	para 3.16	10.00	para 3.16
Total investments at end of period	301.90	n/a	301.90	n/a

- 3.9 Details of the outstanding investments at 31st December 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 December quarter was 1.62%. For comparison, the average LIBID rates for the December quarter were 0.36% for 7 days, 0.45% for 3 months, 0.62% for 6 months and 0.93% for 1 year. The average rate achieved on new investments placed in the period 1st April to 30th September 2015 was 1.33%, compared to the average LIBID rates of 0.36% for 7 days, 0.45% for 3 months, 0.62% for 6 months and 0.92% for 1 year. The improved average rate earned on new investments so far this year is mainly due to 3-year deposits placed with Lloyds Bank (in April and November) and with Lancashire County Council (in December).
- 3.10 Reports to previous meetings have highlighted the fact that options for the reinvestment of maturing deposits have been seriously limited in recent years following bank credit rating downgrades. Changes to lending limits and eligibility criteria in recent 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. Lloyds and RBS, both still part-nationalised, are the only banks with which we can invest for more than one year (up to 3 years is permitted under our strategy) and they offer the highest rates for the longer periods. As a result, we are always full to limit (£80m each) with those banks. The Director of Finance will continue to monitor rates and counterparty quality and take account of external advice prior to any investment decisions.
- 3.11 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.

TOTAL INVESTMENT PORTFOLIO



Interest Rate Forecast

3.12 The bank base rate has remained at 0.5% since March 2009 and the latest forecast by Capita Treasury Solutions (on 20th January 2016, the day after the Bank of England Governor Carney definitively ruled out an increase in Bank Rate in the very near future) is for it to begin to slowly rise from the end of 2016 (two quarters later than the previous estimate given in November 2015). Capita's forecasts are shown below.

Date	LATEST FORECAST (Jan 16)				PREVIOUS FORECAST (Nov 15)			
	Base Rate	3 month Libid	6 month Libid	1 year Libid	Base Rate	3 month Libid	6 month Libid	1 year Libid
Jan-16	0.50%	0.52%	0.66%	0.98%	0.50%	0.60%	0.80%	1.10%
Mar-16	0.50%	0.50%	0.70%	1.00%	0.50%	0.70%	0.90%	1.20%
Jun-16	0.50%	0.50%	0.70%	1.00%	0.75%	0.80%	1.00%	1.30%
Sep-16	0.50%	0.60%	0.80%	1.10%	0.75%	0.90%	1.10%	1.40%
Dec-16	0.75%	0.80%	0.90%	1.20%	1.00%	1.10%	1.30%	1.60%
Mar-17	0.75%	0.90%	1.00%	1.30%	1.00%	1.30%	1.50%	1.80%
Jun-17	1.00%	1.00%	1.20%	1.50%	1.25%	1.40%	1.60%	1.90%
Sep-17	1.00%	1.10%	1.30%	1.60%	1.50%	1.50%	1.70%	2.00%
Dec-17	1.25%	1.30%	1.50%	1.80%	1.50%	1.80%	2.00%	2.30%
Mar-18	1.25%	1.40%	1.60%	1.90%	1.75%	1.90%	2.10%	2.40%
Jun-18	1.50%	1.50%	1.70%	2.00%	1.75%	1.90%	2.10%	2.40%
Sep-18	1.50%	1.60%	1.80%	2.10%	2.00%	2.00%	2.20%	2.50%
Dec-18	1.75%	1.80%	2.00%	2.30%	2.00%	2.00%	2.20%	2.50%
Mar-19	1.75%	1.90%	2.20%	2.40%	2.00%	2.10%	2.30%	2.70%

Other accounts

3.13 Money Market Funds

The Council currently has 7 AAA-rated Money Market Fund accounts, with Federated, 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 Federated, Insight and Ignis funds currently offer the best rate (at around 0.50%). 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, to £20.1m as at 30th September 2015 and then to £9.4m as at 31st December 2015. It peaked at £57.2m in mid-October and currently stands at £17.5m (as at 22nd January 2016). 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 more attractive investments, most recently towards the end of November, when the Council invested £10m in Santander's 180 day notice account at 1.15%. 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 Fund	Market	Date Account Opened	Actual Balance 01/04/15	Actual Balance 31/12/15	Ave. Rate 2015/16 to 22/01/16	Actual Balance 22/01/16	Ave. Daily balance to 22/01/16	Current Rate 22/01/16
			£m	£m	%	£m	£m	%
Federated		15/06/2009	7.3	-	0.47	-	7.4	0.50
Ignis		25/01/2010	15.0	3.2	0.48	11.7	11.1	0.50
Insight		03/07/2009	0.0	6.2	0.47	5.8	2.7	0.50
Morgan Stanley		01/11/2012	0.0	-	-	-	-	0.44
Legal & General		23/08/2012	0.0	-	0.46	-	5.4	0.46
Blackrock		16/09/2009	0.0	-	-	-	-	0.37
Fidelity		20/11/2002	0.0	-	-	-	-	0.37
TOTAL			22.3	9.4		17.5		

3.14 Santander 180 Day Notice Account

In November 2015, £10m was placed with Santander UK in their 180 day notice account at a rate of 1.15%. This is a very good rate for (potentially) 6 month money, but it will be kept under review and notice will be given as soon as it is felt that future interest rate movements are likely to mean it no longer offers good value.

3.15 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, followed by further deposits of £5m in July 2014, £5m in March 2015 and £10m in October 2015. The investment in the CCLA Fund is viewed as a medium to long-term investment and dividends are paid quarterly. The investment returned 5.25% net of fees in 2014/15 and 4.83% (net) in the first two quarters of 2015/16. The dividend for the December quarter was not known at the time of writing this report and will be updated orally at the meeting.

3.16 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 nine months of 2015/16, however, both Funds lost value and, as at 31st December 2015

(12 months since inception), the Newton Fund had returned 2.68% (net – an overall gain of £138k) and the Standard Life Fund had returned 4.23% (net – an overall gain of £217k).

3.17 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 14 dividends have been received. To date, a total of £4,985k has been received (98% of our total claim of £5,087k), leaving a balance of £102k (2%). Council officers and our external advisers remain hopeful of a full recovery.

3.18 External Cash Management

Since 2003, external cash managers, Tradition UK Ltd, have managed a proportion of our cash portfolio (£10m up to 2010 and £20m from then) and have provided 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). In the first half of 2015/16, Tradition UK returned 1.42% against the in-house team return of 1.38% for “core” investments (1.25% including pooled vehicles). Tradition UK have had to 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. However, the Council’s in-house team has a requirement to keep a proportion of the lending short (at lower rates) to cover cashflow, while Tradition have been able to place their whole £20m for long periods. In the days when interest rates were high and the market was buoyant, their team was very proactive, finding good deals for our money and giving us good advice on investment strategy and opportunities. In recent years, however, as the market has slowed down significantly, they have had less chance to “shine”, but have continued to provide sound advice. Last summer, their two main advisers retired after a combined 90 years in the financial markets and, while they have been replaced, the new people do not possess anywhere near the same level of experience and have been relatively quiet in terms of advice and strategy. As a result, officers terminated the contract with them in December 2015, resulting in a fee saving of £12,500 per annum. The table below shows details of their current deposits, all of which have been placed for periods of two 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%

Mid-Year Review of Treasury Management Strategy Statement and Annual Investment Strategy for 2015/16

3.19 The CIPFA Code of Practice on Treasury Management requires the Council to receive a mid-year review report on performance against the approved strategy. The Annual Investment Strategy was originally approved by Council in February 2015 and was updated in October 2015 and the Mid-Year Review was also reported to the PDS Committee in October.

Regulatory Framework, Risk and Performance

3.20 The Council's treasury management activities are regulated by a variety of professional codes, 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 placed to date);
- 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 achieve the highest rate of return on investments whilst maintaining appropriate levels of risk, particularly security and liquidity.

5. FINANCIAL IMPLICATIONS

5.1 There is still no real sign of interest rates improving and an average rate of 1% was 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. Capita now expect the base rate to begin to rise from the final quarter of 2016, but this could be later. There have been no improvements to counterparty credit ratings, as a result of which the restricted investment opportunities that followed downgrades in recent years have still been in place. However, the Council has benefited from the increases in the limits for the two part-nationalised banks (Lloyds and RBS) approved by the Council in October 2014, 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. It is currently forecast that the 2015/16 outturn will be around £3.75m compared to the budget of £2.74m; i.e. a surplus of £1.0m.

5.2 With regard to the draft 2016/17 budget, an average rate of 1% has again been assumed for new investments. The medium to long-term investments with the CCLA Property Fund and with the part-nationalised banks and with other local authorities, together with a continuing increase in the average balance available for investments, have improved our estimated interest earnings in 2016/17 by around £1.25m. As is outlined in paragraph 3.5, this is partly offset by interest foregone as a result of Council balances being used to fund property acquisitions (£0.5m) and, as a result, the 2016/17 draft budget has been set at £3,491k (an increase of £0.75m on the 2015/16 budget).

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