

By: Peter Oakford, Deputy Leader and Cabinet Member for  
Finance and Trading Services  
Dave Shipton, Acting Corporate Director of Finance

To: Governance and Audit Committee – 24 October 2018

Subject: **TREASURY MANAGEMENT UPDATE**

Classification: Unrestricted

---

Summary: To report a summary of Treasury Management activity

---

## **FOR ASSURANCE**

---

### **INTRODUCTION**

1. This report covers Treasury Management activity for the 3 months to 30 June 2018 and updates on any significant developments since then.

### **INTRODUCTION**

2. 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 yearly (mid-year and at year end). This report provides an additional quarterly update.
3. The Council's Treasury Management Strategy for 2018-19 was approved by full Council on 20 February 2018.
4. The Council has both borrowed and 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. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy. This report covers treasury activity and the associated monitoring and control of risk.

### **TREASURY MANAGEMENT ADVISORY GROUP (TMAG)**

5. The Treasury and Investments Manager produces a monthly report for members of the Treasury Management Advisory Group and a copy of the July report is attached at appendix 1.

### **EXTERNAL CONTEXT**

6. UK Consumer Price Inflation (CPI) index remained steady over the period with the data released for July showing CPI at 2.5%, an increase from the June figure of 2.4%. ONS statistics for the three months to June 2018 show that the unemployment rate fell to 4.0%, its lowest since 1975. The employment rate was 75.6%, unchanged compared with January to March 2018 but higher than a year earlier (75.1%). Real wages excluding bonuses increased by 0.4% and including bonuses increased by 0.1% compared to a year earlier.

7. The first estimate of Q2 GDP data released in August showed economic activity marginally increasing to 0.4%. in line with Market forecasts. The Bank of England made no change to monetary policy at its meetings in May and June, however largely as expected the MPC did decide to raise the base rate by 0.25% to 0.75% in August
8. Money markets rates remained on the low side: 1-month, 3-month and 12-month LIBID rates averaged 0.39%, 0.59% and 0.87% in the quarter respectively. Equity markets rose in the period with the FTSE 100 index closing at 7,432 at the end of August.
9. Having raised rates in March, the US Federal Reserve again increased its target range of official interest rates in June by 0.25% to between 1.75% and 2% and markets now expect two further rises in 2018. Fears rose of a global trade war on the implementation by the Trump Administration of tariffs on \$200bn of imports, notably steel, aluminium, food and chemicals. Canada, the EU and China announced retaliatory tariffs as did Mexico.
10. There were a few credit rating changes during the period affecting those banks on the Council's approved counterparty list as they completed their restructures to be compliant with the UK ring-fencing requirements which come into effect in 2019. Moody's downgraded Barclays Bank Plc's long-term rating to A2 from A1 and the long-term ratings of RBS Plc, which will become the non-ring-fenced NatWest Markets Plc, to Baa2 from A3. Moody's and Fitch upgraded the long-term ratings of NatWest Bank on the view that their credit profiles are expected to improve following ring-fencing.

## LOCAL CONTEXT

11. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, known as internal borrowing, in order to reduce risk and keep interest costs low.

## BORROWING

12. At 30 June 2018 the Council held £942.6m of loans, unchanged from the balance as at 31 March 2018, as part of its strategy for funding previous years' capital programmes. The following table shows the borrowing analysed by lender.

	31/3/2018 Balance £m	2018/19 Movement £m	30/6/2018 Balance £m	Average Rate %	Average Life (yrs)
Public Works Loan Board	472.28	0.00	472.28	5.45	16.90
Banks (LOBO)	150.00	0.00	150.00	4.03	43.95
Banks and other lenders (Fixed Term)	320.32	0.00	320.32	4.07	37.00
<b>Total borrowing</b>	<b>942.60</b>	<b>0.00</b>	<b>942.60</b>	<b>4.75</b>	<b>28.04</b>

13. During August KCC repaid an £18m maturing PWLB loan using cash balances.

14. The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.
15. The benefits of internal borrowing are monitored regularly against the potential for incurring additional costs and the Council's Treasury Advisor, Arlingclose has assisted it with this 'cost of carry' and breakeven analysis. The Council's strategy has enabled it to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.
16. KCC continues to hold LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during the period.

## INVESTMENT ACTIVITY

17. The Council's average investment balances to date have amounted to £333m, representing income received in advance of expenditure plus balances and reserves held. These balances are forecast to remain relatively stable over the coming months. The investment position during the quarter is shown in the table below.

### Investment Position

	<b>31.3.18 Balance £m</b>	<b>Q1 2018 Movement £m</b>	<b>30.6.18 Balance £m</b>	<b>30.6.18 Rate of Return %</b>
Money Market Fund	79.8	2.1	81.9	
Fixed Deposit	17.1	20.4	37.5	
Covered Bond	64.5	14.8	79.3	
Icelandic Recoveries o/s	0.4	0.0	0.4	
<b>Internally managed cash</b>	<b>161.8</b>	<b>37.3</b>	<b>199.1</b>	<b>0.7</b>
Strategic Pooled Investments	113.7	17.5	131.2	
Cashplus / Short term Bond Funds	20	-10.0	10.0	
Equity	2.1	0.0	2.1	
<b>External Investments</b>	<b>139.8</b>	<b>7.5</b>	<b>143.3</b>	<b>4.58</b>
<b>Total</b>	<b>297.7</b>	<b>44.7</b>	<b>342.4</b>	<b>2.19</b>

18. Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

19. Security of capital has remained the Council's main investment objective. Against a background of increasing uncertainty and given the increasing risk of bail-in and falling returns from short-term unsecured bank investments, the Council has continued to diversify into more secure and/or higher yielding asset classes as set out in its Treasury Management Strategy Statement for 2018-19.
20. KCC's externally managed pooled funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives is regularly reviewed. During the 3 months to end June we invested an additional £10m in the CCLA property fund and £5m in the Schroders Income fund with a further £5m invested in July in the CCLA Diversified Income Fund bringing our total investment in external pooled funds to £135m.

## **STATEMENT OF INVESTMENTS**

21. A statement of investments as at 31 July is attached in Appendix 2. This statement is circulated to members of the Treasury Management Advisory Group every Friday.

## **RECOMMENDATION**

22. Members are asked to note this report for assurance.

**Alison Mings**  
**Treasury and Investments Manager**  
**Ext: 03000 416488**

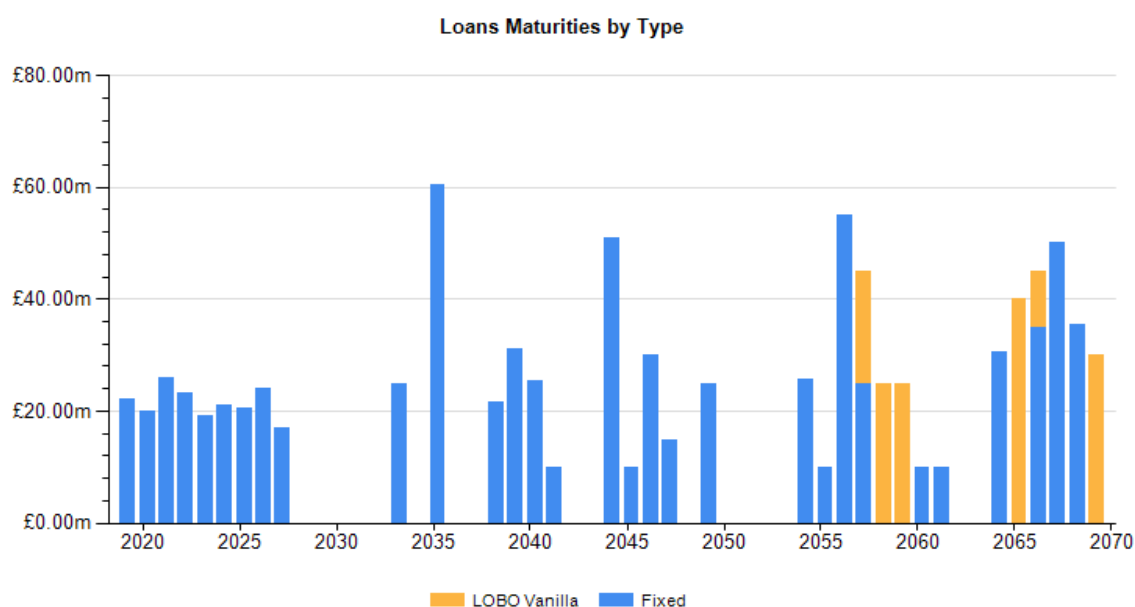
## Treasury Management Report for the month of July 2018

### 1. Borrowing

- 1.1 The total amount of debt outstanding at the end of July was at £940.7m. The following table shows the current borrowing analysed by lender. In August KCC repaid an £18m maturing PWLB loan.

	31/07/2018 Balance £m	Average Rate %	Value weighted Average Life (yrs.)
Public Works Loan Board	472.28	5.45%	16.82
Banks (LOBO)	150.00	4.03%	43.87
Banks and other lenders (Fixed Term)	318.39	4.09%	37.12
<b>Total borrowing</b>	<b>940.67</b>	<b>4.76%</b>	<b>28.01</b>

- 1.2 The maturity profile of KCC's outstanding debt is as follows:



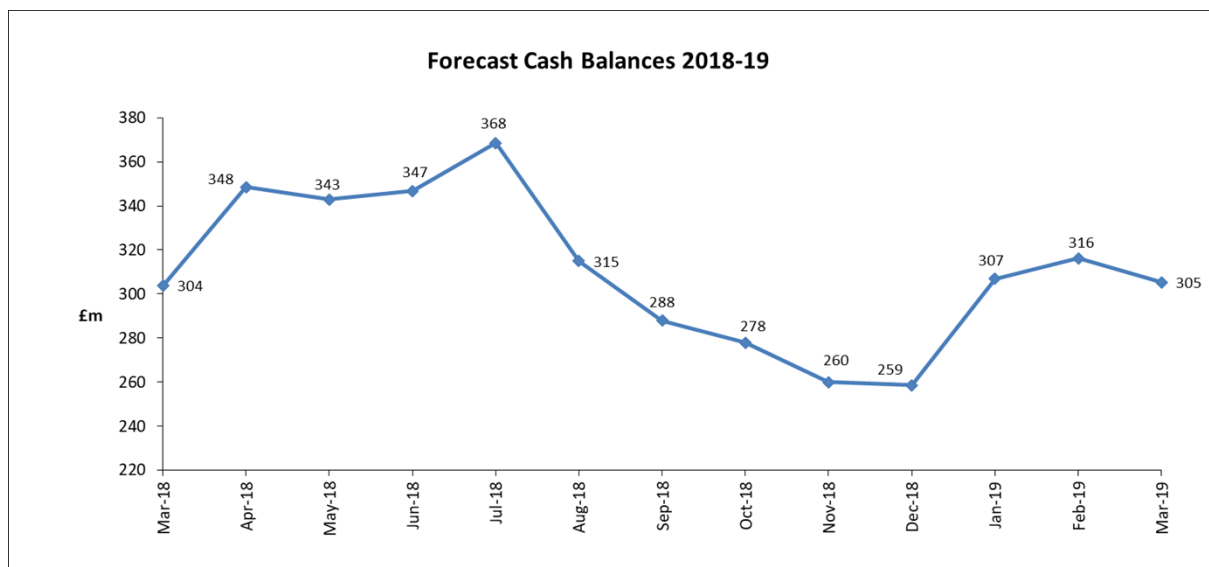
- 1.3 The Council's strategy continues to be to fund its capital expenditure from internal resources as well as consider borrowing at advantageous points in interest rate cycles.

Total long-term debt managed by KCC includes £34.95m pre-LGR debt managed by KCC on behalf of Medway Council and pre-1990 debt managed on behalf of Magistrates Courts (£0.193m).

## 2 Investments

### 2.1 Cash Balances

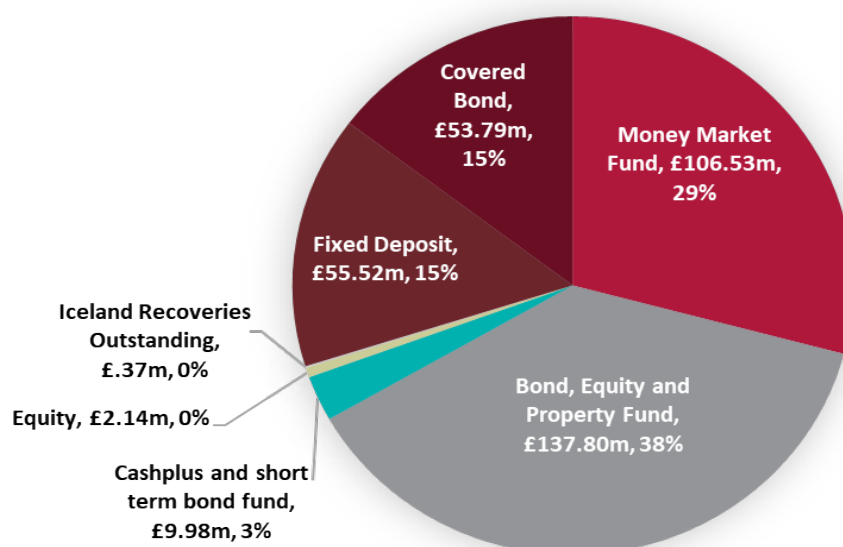
During July the value of cash under management increased by £21m to £368m. Future cashflows are forecast as follows.



### 2.2 Type of investment at month end

The following chart shows that at the end of July a total of £147.8m, 40.4%, of total cash was invested in external pooled funds. The increase of £5m from the end of June is due to a new investment of £5m in the CCLA Diversified Income Fund.

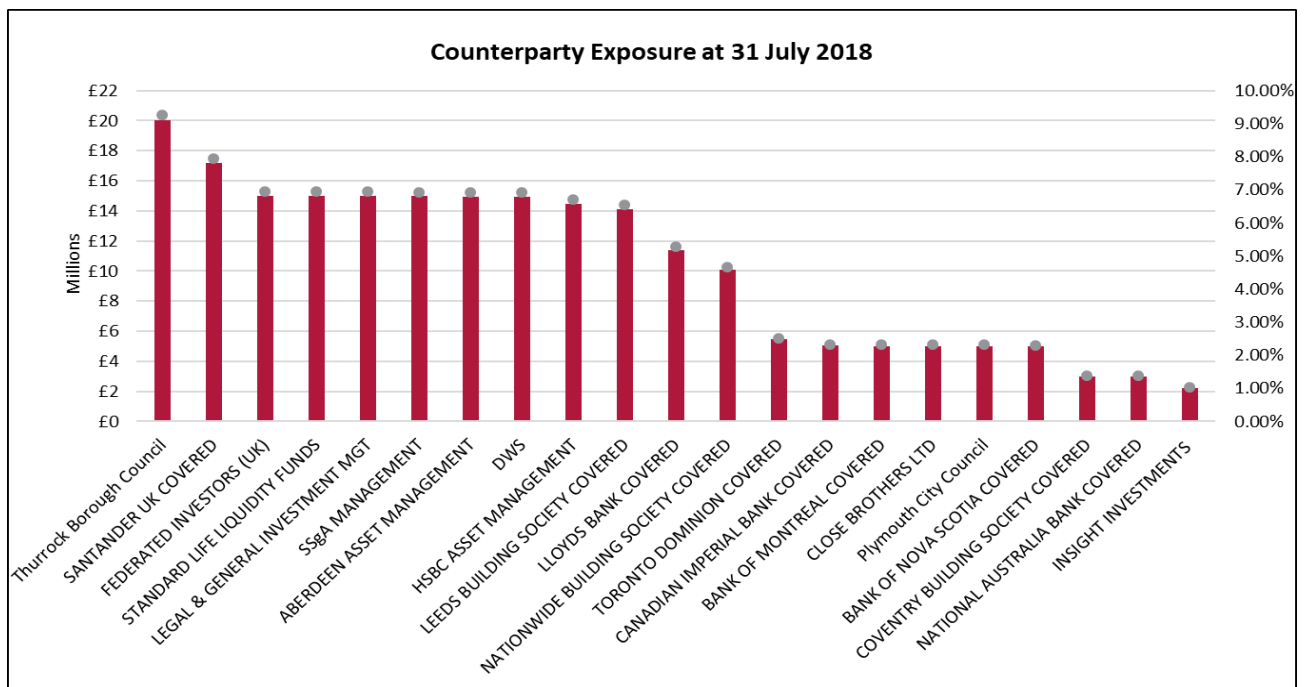
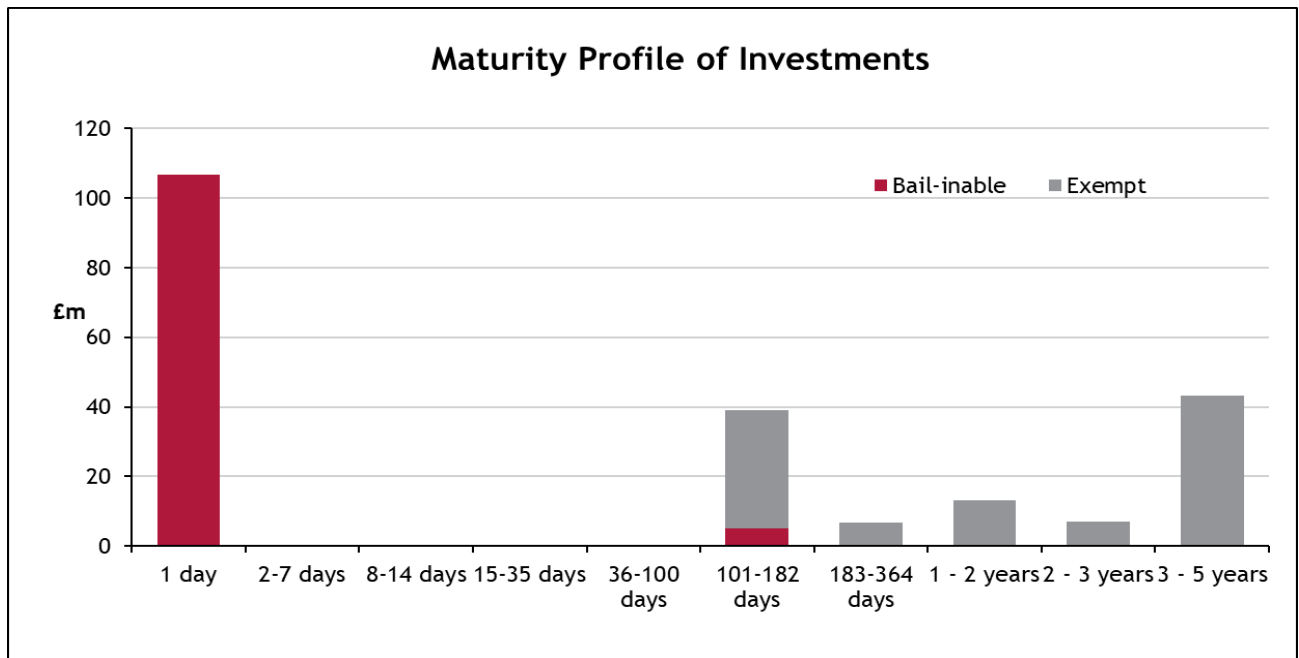
**Investments as at 31 July 2018**



## 2.3 Internally managed cash

2.3.1 The rate of return on investments held at month end was 0.71% vs the target returns 7-day LIBID of 0.3612%.

2.3.2 The maturity profile of KCC's investments and counterparty exposure are shown in the following charts.



### 2.3.3 Credit Score matrix

The Council's credit scores are detailed in the following table.

	Credit Rating	Credit Risk Score
Value Weighted Average	AA	3.3
Time Weighted Average	AAA	1.1

## 3. Externally managed Investments

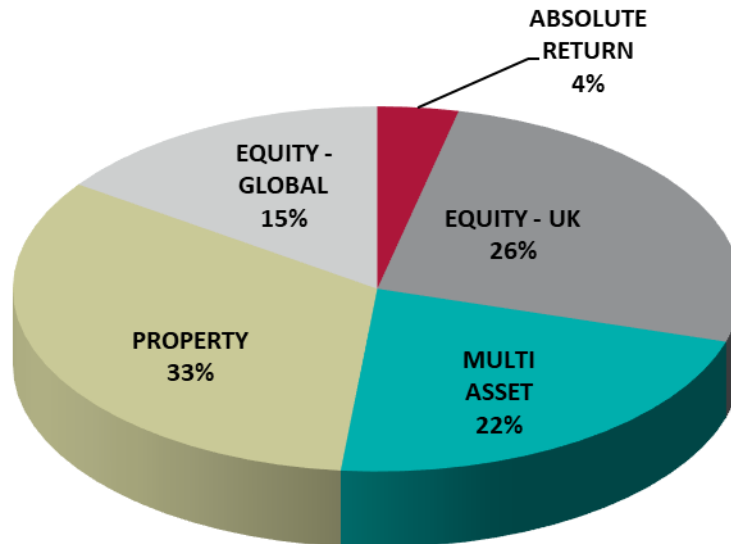
3.1 The following table shows details of investments in Externally managed funds.

	Book cost	Market Value 31 July 2018	12 months return to 31 July 2018	
	£000's	£000's	Income	Total
CCLA Diversified Income Fund	5,000	5,024	0.00%	0.48%
CCLA Property Fund	45,000	45,602	3.74%	4.49%
Fidelity Multi Asset Income Fund	25,000	25,167	4.03%	1.86%
M&G Global Dividend Fund	10,000	10,959	3.01%	12.57%
Pyrford Global Total Return Sterling Fund	5,000	4,947	3.63%	0.67%
Schroder Income Maximiser Fund	25,000	25,665	5.95%	10.77%
Threadneedle Global Equity Institutional Income Fund	10,000	10,139	3.61%	5.00%
Threadneedle UK Equity Income Fund	10,000	10,299	3.89%	6.89%
<b>Total Strategic Pooled Funds</b>	<b>135,000</b>	<b>137,803</b>	<b>4.67%</b>	<b>6.31%</b>
Cashplus / Short Term Bond Funds	10,000	9,992	0.42%	0.42%
<b>Total Bond, Equity and Property Funds</b>	<b>145,000</b>	<b>147,795</b>	<b>4.38%</b>	<b>5.91%</b>

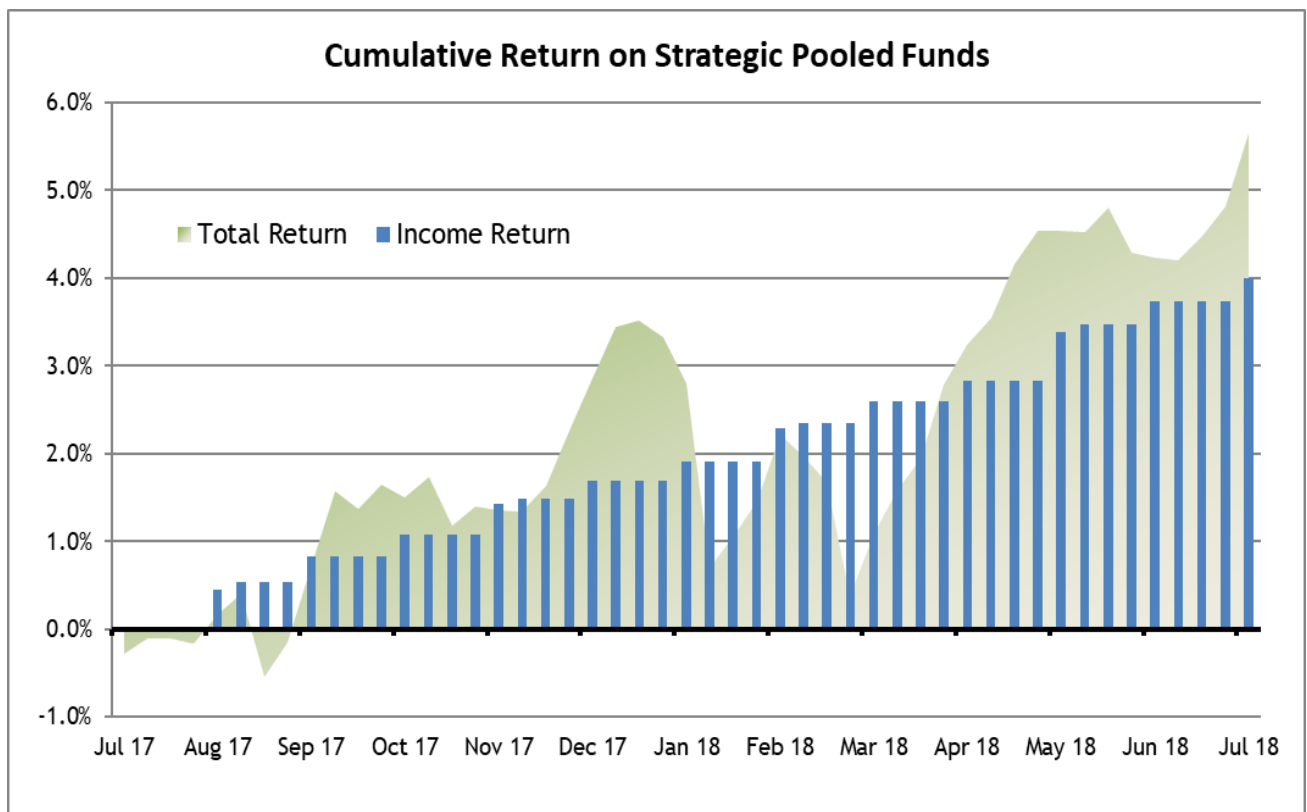
3.2 A breakdown of the strategic pooled funds by asset class is as follows:



## Asset Class Allocation



3.3 The following chart tracks the returns earned on external funds over the 12 months to end July 2018.



**Alison Mings**  
**Treasury and Investments Manager**  
**13 August 2018**

## Investments as at 31 July 2018

## 1. Internally Managed Investments

## 1.1 Term deposits, Call accounts and Money Market Funds

Instrument Type	Counterparty	Principal Amount	Interest Rate	End Date
Fixed Deposit	Plymouth City Council	£5,000,000	0.60%	29/11/2018
Fixed Deposit	Thurrock Borough Council	£20,000,000	0.60%	30/11/2018
Fixed Deposit	Close Brothers	£5,000,000	0.80%	05/09/2018
<b>Total UK Bank Deposits</b>		<b>£30,000,000</b>		
Money Market Fund	Aberdeen Sterling Liquidity Fund	£14,964,243	0.42% (variable)	n/a
Money Market Fund	Deutsche Managed Sterling Fund	£14,952,128	0.52% (variable)	n/a
Money Market Fund	Federated (PR) Short-term GBP Prime Fund	£14,985,420	0.50% (variable)	n/a
Money Market Fund	HSBC Global Liquidity Fund	£14,459,330	0.78% (variable)	n/a
Money Market Fund	Insight Sterling Liquidity Fund	£2,226,782	0.46% (variable)	n/a
Money Market Fund	LGIM Liquidity Fund	£14,980,359	0.54% (variable)	n/a
Money Market Fund	SSgA GBP Liquidity Fund	£14,972,823	0.48% (variable)	n/a
Money Market Fund	Standard Life Liquidity Fund	£14,984,569	0.77% (variable)	n/a
<b>Total Money Market Funds</b>		<b>£106,525,654</b>		
<b>Equity and Loan Notes</b>	Kent PFI (Holdings) Ltd	<b>£2,135,741</b>		n/a
<b>Icelandic Recoveries outstanding</b>	Heritable Bank Ltd	<b>£366,905</b>		n/a

## 1.2 Bond Portfolio

Bond Type	Issuer	Adjusted Principal	Net Yield	Maturity Date
Floating Rate Note	Leeds BS FRN Covered Bond	5,000,000.00	1.0797%	01/10/19
Floating Rate Note	Toronto Dom Covered FRN Bond	5,452,202.68	1.1129%	01/02/19
Floating Rate Note	Lloyds Covered FRN Bond	1,401,376.20	0.9538%	18/07/19
Floating Rate Note	Coventry BS Covered FRN Bond	3,003,626.98	0.8605%	17/03/20
Floating Rate Note	Nationwide BS Covered FRN Bond	4,505,733.77	0.9628%	12/04/23
Floating Rate Note	Bank of Montreal Covered FRN Bond	5,006,366.28	1.0050%	17/04/23
Floating Rate Note	Santander UK FRN Covered Bond	3,752,795.61	0.9290%	13/04/21
Floating Rate Note	Lloyds Covered FRN Bond	5,008,200.58	0.8781%	27/03/23
Floating Rate Note	CIBC Covered FRN Bond	5,042,778.27	0.8982%	10/01/22
Floating Rate Note	Santander UK Covered FRN Bond	5,003,909.26	0.8388%	16/11/22

Floating Rate Note	Nationwide BS Covered FRN Bond	5,589,450.30	0.9457%	12/04/23
Floating Rate Note	Santander UK Covered FRN	5,013,550.65	0.8012%	05/05/20
Floating Rate Note	Lloyds Covered FRN	2,503,479.85	0.8835%	27/03/23
Floating Rate Note	Lloyds Covered FRN	2,504,643.39	0.8734%	27/03/23
Fixed Rate Covered Bond	Leeds BS Fixed Covered Bond	5,579,420.89	0.6263%	17/12/18
Fixed Rate Covered Bond	Santander Fixed Covered Bond	3,397,332.07	0.6524%	14/04/21
Fixed Rate Covered Bond	Bank of Nova Scotia Fixed Bond	4,987,435.66	0.8799%	14/09/21
Fixed Rate Covered Bond	NAB Fixed Covered Bond	3,002,504.31	1.1035%	10/11/21
Fixed Rate Covered Bond	Leeds BS Fixed Covered Bond	2,043,410.73	2.0293%	17/12/18
Fixed Rate Covered Bond	Leeds BS Fixed Covered Bond	1,514,308.18	1.1915%	17/12/18
		<b>79,312,525.66</b>		

<b>Total Internally managed investments</b>	<b>£ 218,340,826</b>
---	----------------------

## 2. Externally Managed Investments

Investment Fund / Equity	Market Value 31 July 2018	12 months return to 31 July 2018	
		Income	Total
	£000's		
CCLA Diversified Income Fund	£5,024,000	0.00%	0.48%
CCLA Property Fund	£45,602,000	3.74%	4.49%
Fidelity Multi Asset Income Fund	£25,167,000	4.03%	1.86%
M&G Global Dividend Fund	£10,959,000	3.01%	12.57%
Pyrford Global Total Return Sterling Fund	£4,947,000	3.63%	0.67%
Schroder Income Maximiser Fund	£25,665,000	5.95%	10.77%
Threadneedle Global Equity Institutional Income Fund	£10,139,000	3.61%	5.00%
Threadneedle UK Equity Income Fund	£10,299,000	3.89%	6.89%
<b>Total Strategic Pooled Funds</b>	<b>£137,803,000</b>	<b>4.67%</b>	<b>6.31%</b>
Cashplus / Short Term Bond Funds	£9,992,000	0.42%	0.42%
<b>Total Bond, Equity and Property Funds</b>	<b>£147,795,000</b>	<b>4.38%</b>	<b>5.91%</b>

## 3. Total Investments

<b>Total Investments</b>	<b>£366,134,826</b>
--------------------------	---------------------