

By: John Simmonds, Deputy Leader and Cabinet Member for Finance and Business Support  
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To: Governance and Audit Committee – 23 July 2015

Subject: **TREASURY MANAGEMENT ANNUAL REVIEW 2014-15**

Classification: Unrestricted

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Summary: To report a summary of Treasury Management activities in 2014-15

**FOR DECISION**

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## **INTRODUCTION**

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 yearly (mid-year and at year end).
2. At KCC half yearly reports are made to Council and quarterly updates are provided to the Governance and Audit Committee.
3. Treasury management is defined as: "The management of the local authority's investments and 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."
4. The Council's Treasury Management Strategy for 2014-15 was approved by full Council on 13 February 2014 and subsequently updated by Cabinet 2 June 2014.
5. 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. This report covers treasury activity and the associated monitoring and control of risk during 2014-15:
  - a) Reports on the implications of treasury decisions and transactions;
  - b) Gives details of the outturn position on treasury management transactions in 2014-15;
  - c) Confirms compliance with its Treasury Management Strategy, Treasury Management Practices and Prudential Indicators.
6. When this report is agreed by this Committee it will go forward to full Council.

## BORROWING STRATEGY

7. At 31 March 2015 KCC held £984m of loans, a decrease of £26m on 31 March 2014, as part of its strategy for funding previous years' capital programmes.
8. Affordability and the "cost of carry" remained important influences on the Council's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing. As short-term interest rates remained, and are likely to remain at least over the forthcoming two years, lower than long-term rates, the Council determined it to be more cost effective in the short-term to use internal resources rather than borrow from external lenders.
9. The benefits of internal borrowing are monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. The Council's Treasury Advisor, Arlingclose has assisted it with this 'cost of carry' and breakeven analysis.
10. This strategy has lowered overall treasury risk by reducing both external debt and temporary investments however the sustainability of this approach continues to be kept under review.

	Balance on 01/04/2014 £m	Debt Maturing £m	New Borrowing £m	Balance on 31/3/2015 £m	Average Rate % / Average Life (yrs)
Capital Financing Requirement (CFR)	1,435			1,383	
Long Term Borrowing	1,010	-26	0	984	5.51% / 32
Other Long Term Liabilities					
<b>TOTAL EXTERNAL DEBT</b>	1,010			984	
Decrease in Borrowing		-26			

11. The Council holds £441.8m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. £130.7m of these LOBOS had options during the year, none of which were exercised by the lender. These LOBO loans were primarily taken out between 2004 and 2007 at very low interest rates (average 4.2%) and were the most cost effective means of funding large scale capital spending at that time.

## INVESTMENT ACTIVITY

12. KCC holds significant invested funds, representing income received in advance of expenditure plus balances and reserves. During 2014-15 the Council's average investment balance was £391.5m.
13. The Guidance on Local Government Investments gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.
14. Investment Activity in 2014-15

Investment Counterparty	Balance on 01/04/2014 £m	Net Investments Made £m	Balance on 31/03/2015 £m	Avg Rate % / Avg Life (yrs)
UK Central Government	0.7	-0.7	0.0	0
Banks and building societies	292.4	-90.1	202.5	0.57% / 0.34
Marketable instruments (Covered Bonds)	5.3	84.4	89.7	1.03% / 3.05
Money Market Funds	0	4.0	4.0	0.38% / overnight
Icelandic recoveries outstanding	9.3	-5.1	4.2	
Icelandic deposits held in Escrow (incl interest)	3.1		3.3	
<b>Total Internally Managed Investments</b>	<b>310.8</b>		<b>303.7</b>	<b>0.62% / 1.8</b>
Pooled property fund	10.0	5.0	15.3	8.71% pa
Pooled investments fund	5.0		5.1	6.15% pa
Equity / Loan notes	2.1		2.1	7.20% pa
<b>Total Externally Managed Investments</b>	<b>17.1</b>	<b>5.0</b>	<b>22.5</b>	
<b>Total investments</b>	<b>327.9</b>		<b>326.2</b>	
Decrease in Investments (£m)			-1.7	

15. The UK Bank Rate was maintained at 0.5% through the year. Short term money market rates remained at very low levels and continued to have a significant impact on investment income. Internally managed deposits were made at an average of 0.67% compared to the average 7 day LIBID rate during 2014-15 of 0.35%. The Council's total investment income for the year, including dividends received on the externally managed investments, was £4.32m, 1.10% on funds held. The above benchmark return primarily reflects
- a) The additional return from the well diversified covered bond portfolio allowing us to achieve twice the LIBID return on internally managed investments. The bond portfolio earned £1.41m during 2014-15; and

- b) Well timed investments in the CCLA Property Fund, the Pырford Absolute Return Fund and Kent PFI (Holdings) Ltd. Total income received in the year from these investments was £1.256m.
16. Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2014-15 which defined "high credit quality" organisations 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.
17. The Council assessed and monitored counterparty credit quality with reference to credit ratings; credit default swap prices, financial statements, information on potential government support and reports in the quality financial press
18. There have been a number of developments during 2014 -15 as follows, which have impacted the banks and other financial institutions on the Council's approved counterparty list. KCC has therefore increasingly favoured diversified alternatives such as covered bonds, non-bank investments and pooled funds over unsecured bank and building society deposits.
- a) On April 15, 2014 the European Parliament approved the EU Bank Recovery and Resolution Directive (BRRD). Subsequently the rating agencies changed their outlook for UK, European and Canadian banks from stable to negative citing the reduction of government support for systemic banks and the potential bail in risk now faced by investors as the reason;
  - b) The combined effect of the BRRD and the UK's Deposit Guarantee Scheme Directive (DGSD) is to promote deposits of individuals and SMEs above those of public authorities, large corporates and financial institutions. Other EU countries, and eventually all other developed countries, are expected to adopt similar approaches in due course;
  - c) In October 2014 following sharp movements in market signals driven by deteriorating global growth prospects, especially in the Eurozone, the Council took advice from Arlingclose and reduced its investment duration limits for unsecured bank and building society investments. The duration for new unsecured investments with UK institutions other than HSBC was further reduced to 100 days in February 2015; and
  - d) The outlawing of bail-outs, the introduction of bail-ins, and the preference being given to large numbers of depositors other than local authorities also means that the risks of making unsecured deposits rose relative to other investment options.
19. In December 2014 a 5th dividend was received from Landsbanki of £5.3m which brought total recoveries to £48m. A full recovery of the Council's Icelandic deposits is still anticipated.

20. Investments as at 31 March 2015 are shown in Appendix 2.
21. In keeping with CLG's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of overnight deposits, call accounts and money market funds.

### **COMPLIANCE WITH PRUDENTIAL INDICATORS**

22. The Council confirms that it has complied with its Prudential Indicators for 2014-15, which were set as part of the Council's Treasury Management Strategy Statement. Details can be found in Appendix 1.
23. The Treasury Management activities were once again subject to review by Internal Audit whose assessment of the controls in place and the level of compliance with these controls was High assurance.

### **TREASURY ADVISOR**

24. KCC currently contracts with Arlingclose as Treasury Advisers.

### **RECOMMENDATION**

25. Members are asked to agree the report and recommend that it is submitted to County Council.

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

### 2014-15 Final Monitoring of Prudential Indicators

#### 1. Estimate of Capital Expenditure (excluding PFI)

	£m	
Actuals 2013-14	203.244	
Original estimate 2014-15	259.765	
Revised estimate 2014-15	260.520	(this includes the rolled forward re-phasing from 2013-14)
Actuals 2014-15	205.767	

#### 2. Estimate of capital financing requirement (underlying need to borrow for a capital purpose)

	2013-14 Actual £m	2014-15 Original Estimate £m	2014-15 Actual as at 31 March £m
CFR	1,435.263	1,437.960	1,382.856
Annual increase/(decrease) in underlying need to borrow	-29.698	-27.001	-52.407

In the light of current commitments and planned expenditure, forecast net borrowing by the Council will not exceed the Capital Financing Requirement.

#### 3. Estimate of ratio of financing costs to net revenue stream

Actual 2013-14	13.62%
Original estimate 2014-15	14.04%
Actual 2014-15	14.21%

#### 4. Operational Boundary for External Debt

The operational boundary for debt is determined having regard to actual levels of debt, borrowing anticipated in the capital plan, the requirements of treasury strategy and prudent requirements in relation to day to day cash flow management.

#### Operational boundary for debt relating to KCC assets and activities

	Prudential Indicator £m	Position as at 31 March 2015 Actual £m
Borrowing	993	944

Other Long Term Liabilities	261	248
<b>Total</b>	<b>1,254</b>	<b>1,192</b>

**Operational boundary for total debt managed by KCC including that relating to Medway Council etc (pre Local Government Reorganisation)**

	<b>Prudential Indicator £m</b>	<b>Position as at 31 March 2015 £m</b>
Borrowing	1,038	984
Other Long Term Liabilities	261	248
<b>Total</b>	<b>1,299</b>	<b>1,232</b>

**5. Authorised Limit for external debt**

The authorised limit includes additional allowance, over and above the operational boundary to provide for unusual cash movements. It is a statutory limit set and revised by the County Council.

**Authorised limit for debt relating to KCC assets and activities**

	<b>Prudential Indicator £m</b>	<b>Position as at 31 March 2015 £m</b>
Borrowing	1,033	944
Other long term liabilities	261	248
<b>Total</b>	<b>1,294</b>	<b>1,192</b>

**Authorised limit for total debt managed by KCC including that relating to Medway Council etc (pre Local Government Reorganisation)**

	<b>Prudential Indicator £m</b>	<b>Position as at 31 March 2015 £m</b>
Borrowing	1,078	984
Other long term liabilities	261	248
<b>Total</b>	<b>1,339</b>	<b>1,232</b>

The additional allowance over and above the operational boundary has not needed to be utilised and external debt, has and will be maintained well within the authorised limit.

**6. Compliance with CIPFA Code of Practice for Treasury Management in the Public Services**

The Council has adopted the Code of Practice on Treasury Management and has adopted a Treasury Management Policy Statement. Compliance has been tested and validated by our independent professional treasury advisers

## 7. Upper limits of fixed interest rate and variable rate exposures

The Council has determined the following upper limits for 2014-15

Fixed interest rate exposure	100%
Variable rate exposure	40%

These limits have been complied with in 2014-15.

## 8. Upper limits for maturity structure of borrowings

	Upper limit	Lower limit	As at 31 March 2015
	%	%	%
Under 12 months	10	0	0.00
12 months and within 24 months	10	0	3.20
24 months and within 5 years	15	0	8.50
5 years and within 10 years	15	0	9.30
10 years and within 20 years	20	5	8.70
20 years and within 30 years	20	5	20.30
30 years and within 40 years	25	10	10.70
40 years and within 50 years	25	10	18.90
50 years and within 60 years	30	10	20.40

## 9. Upper limit for principal sums invested for periods longer than 364 days

Prudential Indicator	Actual
£m	£m
175.0	116.6



## Appendix 2

### Investments as at 31 March 2015

#### 1. Internally Managed Investments

Instrument Type	Counterparty	Principal Amount (£)	Maturity Date	Interest Rate
Fixed Deposit	Bank of Scotland plc	5,000,000.00	07/05/15	0.70%
Call Deposit	Barclays Bank plc	30,000,000.00	01/04/15	0.50%
Call Deposit	Barclays Bank plc	5,000,000.00	01/04/15	0.35%
Certificate of Deposit	Barclays Bank plc	5,000,000.00	14/08/15	0.99%
Fixed Deposit	Lloyds Bank plc	5,000,000.00	22/04/15	0.70%
Fixed Deposit	Lloyds Bank plc	5,000,000.00	06/05/15	0.70%
Fixed Deposit	Lloyds Bank plc	5,000,000.00	19/05/15	0.70%
Fixed Deposit	Lloyds Bank plc	5,000,000.00	19/05/15	0.57%
Fixed Deposit	Lloyds Bank plc	5,000,000.00	26/05/15	0.57%
Fixed Deposit	Lloyds Bank plc	5,000,000.00	30/06/15	0.70%
Fixed Deposit	Lloyds Bank plc	5,000,000.00	22/07/15	0.70%
Call Deposit	Santander UK plc	22,110,000.00	01/04/15	0.40%
<b>Total UK Bank Deposits</b>		<b>102,110,000.00</b>		
Fixed Deposit	Nationwide Building Society	5,000,000.00	02/04/15	0.66%
Fixed Deposit	Nationwide Building Society	3,700,000.00	11/05/15	0.58%
Fixed Deposit	Nationwide Building Society	1,000,000.00	05/06/15	0.50%
Fixed Deposit	Nationwide Building Society	5,700,000.00	21/07/15	0.66%
<b>Total UK Building Society Deposits</b>		<b>15,400,000.00</b>		
Fixed Deposit	Australia and New Zealand Banking Group Limited	10,000,000.00	07/04/15	0.50%
Fixed Deposit	Australia and New Zealand Banking Group Limited	10,000,000.00	11/05/15	0.51%
<b>Total Australian Bank Deposits</b>		<b>20,000,000.00</b>		
Certificate of Deposit	Bank of Montreal	10,000,000.00	07/04/15	0.59%
Certificate of Deposit	Bank of Montreal	10,000,000.00	22/04/15	0.53%
Certificate of Deposit	The Toronto-Dominion Bank	5,000,000.00	14/07/15	0.56%
<b>Total Canadian Bank Deposits</b>		<b>25,000,000.00</b>		
Call Deposit	Handelsbanken	40,000,000.00	01/04/2015	0.40%
<b>Total Swedish Bank Deposits</b>		<b>40,000,000.00</b>		

#### Money Market Funds

Fund Name	Principal Balance	Effective Interest Rate at 31/03/15
Deutsche Managed Sterling Advisory	3,950,000.00	0.38%
<b>Total Money Market Fund Deposits</b>	<b>3,950,000.00</b>	

### Covered Bond Portfolio

Instrument Type	Counterparty	Principal Outstanding (£)	Maturity Date	Effective Interest Rate
Fixed Rate Covered Bond	Bank of Scotland	2,140,610.33	08/11/16	1.29%
Fixed Rate Covered Bond	Bank of Scotland	3,079,599.22	08/11/16	1.34%
Fixed Rate Covered Bond	Yorkshire Building Society	3,320,841.00	12/04/18	1.55%
Fixed Rate Covered Bond	Yorkshire Building Society	2,192,862.66	12/04/18	1.98%
Fixed Rate Covered Bond	Coventry Building Society	3,308,210.84	19/04/18	1.93%
Fixed Rate Covered Bond	Coventry Building Society	5,495,025.00	19/04/18	1.73%
Fixed Rate Covered Bond	Coventry Building Society	2,208,806.00	19/04/18	1.52%
Fixed Rate Covered Bond	Leeds Building Society	2,168,990.70	17/12/18	2.03%
Fixed Rate Covered Bond	Leeds Building Society	1,640,009.76	17/12/18	1.19%
Floating Rate Note Covered Bond	Yorkshire Building Society	3,039,615.31	23/03/16	0.98%
Floating Rate Note Covered Bond	Yorkshire Building Society	2,029,963.09	23/03/16	0.81%
Floating Rate Note Covered Bond	Yorkshire Building Society	5,072,307.07	23/03/16	0.86%
Floating Rate Note Covered Bond	National Australia Bank	5,013,464.26	12/08/16	0.68%
Floating Rate Note Covered Bond	Lloyds	3,008,342.02	16/01/17	0.67%
Floating Rate Note Covered Bond	Santander UK	3,008,793.81	20/01/17	0.72%
Floating Rate Note Covered Bond	Santander UK	5,767,160.57	20/01/17	0.71%
Floating Rate Note Covered Bond	Santander UK	2,477,433.65	05/04/17	0.81%
Floating Rate Note Covered Bond	Santander UK	1,400,584.17	05/04/17	0.75%
Floating Rate Note Covered Bond	Nationwide Building Society	2,103,099.80	17/07/17	0.70%
Floating Rate Note Covered Bond	Nationwide Building Society	1,001,229.28	17/07/17	0.71%
Floating Rate Note Covered Bond	Nationwide Building Society	1,899,993.18	17/07/17	0.76%
Floating Rate Note Covered Bond	Barclays	5,007,659.04	15/09/17	0.69%
Floating Rate Note Covered Bond	Lloyds	1,406,187.26	18/07/19	0.76%
Floating Rate Note Covered Bond	Leeds Building Society	5,000,000.00	01/10/19	0.96%
Floating Rate Note Covered Bond	Barclays	3,004,933.20	15/09/17	0.69%
Floating Rate Note Covered Bond	Barclays	5,004,575.35	12/02/18	0.72%
Floating Rate Note Covered Bond	Lloyds	3,903,470.57	19/01/18	0.72%
Floating Rate Note Covered Bond	Leeds Building Society	2,503,710.75	09/02/18	0.83%
Floating Rate Note Covered Bond	Leeds Building Society	2,503,731.08	09/02/18	0.78%
<b>Total Covered Bonds</b>		<b>89,711,208.97</b>		

Icelandic Recoveries outstanding	Heritable Bank Ltd	£1,097,722.47
Icelandic Recoveries outstanding	Landsbanki Islands	£3,106,469.94
<b>Total Icelandic Recoveries outstanding</b>		<b>£4,204,192.41</b>
<b>Total Icelandic Deposits held in ESCROW (est GBP)</b>		<b>£3,278,426.78</b>

<b>Grand Total of Internally Managed Funds</b>		<b>£303,653,828.16</b>
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## 2. Externally Managed Funds

<b>Investment Fund Name</b>	<b>Purchase Book Cost</b>	<b>Market Value at 31/03/15</b>	<b>Total Annualised Return (%)</b>
CCLA LAMIT Property Fund	15,000,000.00	15,335,560.68	8.71%
Pyrford Global Total Return Fund	5,000,000.00	5,101,066.44	6.15%
		<b>20,436,627.12</b>	

### Equity

<b>Investment Fund Name</b>	<b>Purchase Book Cost</b>	<b>Market Value at 31/03/15</b>	<b>Total Annualised Return (%)</b>
Kent PFI (Holdings) Ltd	2,135,740.59	2,135,740.59	7.20%
		<b>2,135,740.59</b>	

<b>Total Externally Managed Funds</b>	<b>22,572,367.71</b>
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<b>Grand Total of All Investments</b>	<b>£326,226,195.87</b>
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