

By: John Simmonds, Deputy Leader and Cabinet Member for
Finance and Business Support
Andy Wood, Corporate Director of Finance and
Procurement

To: Governance and Audit Committee – 2 October 2015

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 and developments in the period since up to the date of this report.

BACKGROUND

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 2015-16 was approved by full Council on 12 February 2015.
4. The Authority 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.

MONTHLY PERFORMANCE REPORT

5. The Treasury and Investments Manager produces a monthly report for members of the Treasury Management Advisory Group. The June report is attached in Appendix 1.

INVESTMENT ACTIVITY

6. The Council's average investment balances to date have amounted to £386m, representing income received in advance of expenditure plus balances and reserves held. These balances are forecast to remain relatively stable over the coming months.
7. The Guidance on Local Government Investments in England gives priority to security and liquidity and the Authority's aim is to achieve a yield commensurate with these principles.

8. The transposition of European Union directives into UK legislation now places the burden of rescuing failing EU banks disproportionately onto unsecured local authority investors such as Kent County Council through potential bail-in of unsecured bank deposits.
9. Security of capital has remained the Authority's main investment objective. Given the increasing risk and continued low returns from short-term unsecured bank investments, it is the Council's aim to further diversify into more secure and/or higher yielding asset classes as set out in its Treasury Management Strategy Statement for 2015/16.
10. During the 3 months to the end of June KCC made greater use of money market funds to support short term liquidity requirements and reduced the proportion of its surplus cash invested in unsecured bank deposits. By the end of the quarter some 32% of KCC's cash was invested in covered and corporate bonds as well as investments funds and equity which are not subject to bail in risk.
11. The UK Bank Rate has been maintained at 0.5% since March 2009. From April through June the interest rate earned on the invested cash was 0.74% compared to the average 7 day LIBID rate of 0.36%.

COUNTERPARTY UPDATE

12. With assistance from Arlingclose counterparty credit quality continues to be assessed and monitored.
13. All three credit ratings agencies (Moody's, S&P and Fitch) reviewed their ratings in the first quarter 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 on the KCC approved counterparty list have seen upgrades due to an improvement in their underlying strength and an assessment that the level of loss given default is low.
14. In August duration limits were increased for some UK and European banks, and building societies based on advice from Arlingclose. Those for Close Brothers, Coventry BS, Nationwide BS and Santander UK were increased to 6 months from 100 days and Bank of Scotland, HSBC Bank, Lloyds Bank and Svenska Handelsbanken increased to 13 months from 6 months. The limit for Barclays was unchanged while RBS / NatWest remained suspended from the list as their ratings continue to be below the Council's agreed threshold.

STATEMENT OF DEPOSITS

15. A statement of deposits as at 28 August is attached in Appendix 2. This statement is circulated to members of the Treasury Management Advisory Group every Friday.

BORROWING

16. At 30 June 2015 the Authority held £1,009.08m of loans, an increase of £25m from the balance as at 31 March 2015, as part of its strategy for funding previous years' capital programmes.

17. The Authority's chief objective when borrowing continues to be to consider borrowing at advantageous points in interest rate cycles as well as striking 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 Authority's long-term plans change being a secondary objective.
18. In April concerns rose regarding the likely outcome of the UK general election and possible impact on the UK financial market as well as uncertainty over the future for Greece in the EU. The decision was then made given the availability of advantageous rates from the PWLB for long term fixed rate maturity loans, to borrow £25m for 40 years from the PWLB at a fixed rate of 3.16%.
19. As a result the average interest rate payable on the Council's debt portfolio reduced slightly from 5.51% to 5.387%. KCC expects to repay £31m of maturing PWLB loans by 31 March 2016 and does not expect to undertake further borrowing during 2015–16.
20. Affordability and the "cost of carry" remain important influences on the Council's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing. As short-term interest rates remain lower than long-term rates it is more cost effective in the short-term for KCC to use internal resources instead.
21. The benefits of internal borrowing continue to be monitored regularly and the Council's treasury advisors, Arlingclose, assists the Council with the 'cost of carry' and breakeven analysis.

ICELAND DEPOSITS

22. On 26 August we received a further £741,000 from Heritable, bringing the Heritable recovery to 98%. The remaining dividend of 2p in the pound, circa £360,000, will be paid when a building defects issue is resolved. With regard to Landsbanki we have recovered 83% of the amount due with £3.2m remaining outstanding. The Landsbanki Winding Up Board is looking for ways of making this payment by the end of 2015. Total recoveries to date are £48.8m.

RECOMMENDATION

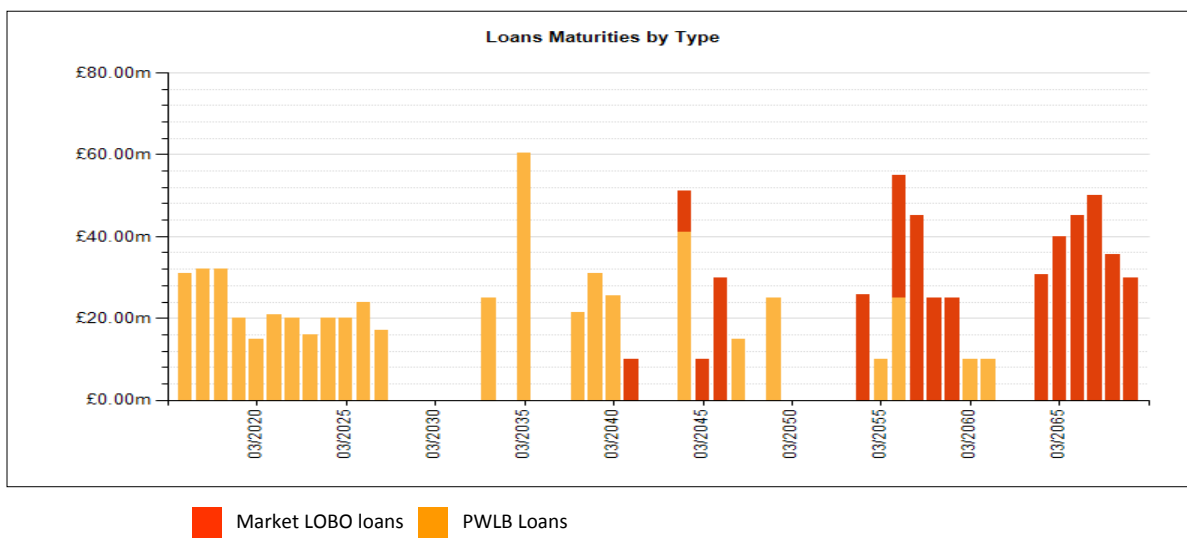
23. Members are asked to note this report for assurance.

Alison Mings
Treasury and Investments Manager
Ext: 03000 416488

Treasury Management Report for the month of June 2015

1. Long Term Borrowing

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. The total amount of debt outstanding at the end of June remained unchanged at £1,009m.

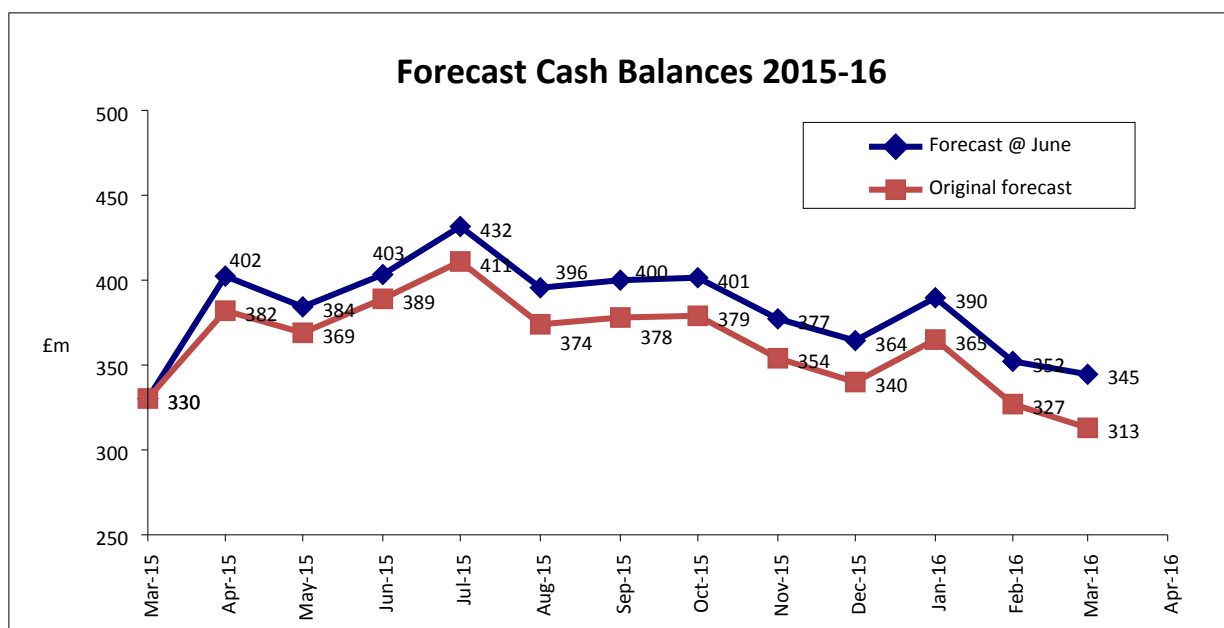


Total external debt managed by KCC includes £39.62m pre-LGR debt managed by KCC on behalf of Medway Council. Also included is pre-1990 debt managed on behalf of the Further Education Funding Council (£1.76m) and Magistrates Courts (£0.556m).

2. Investments

2.1 Cash Balances

During June the total value of cash under management rose by some £19m to £403m, £14m above the original forecast. Future cash balances are forecast as follows:



2.2 Type of investment at month end

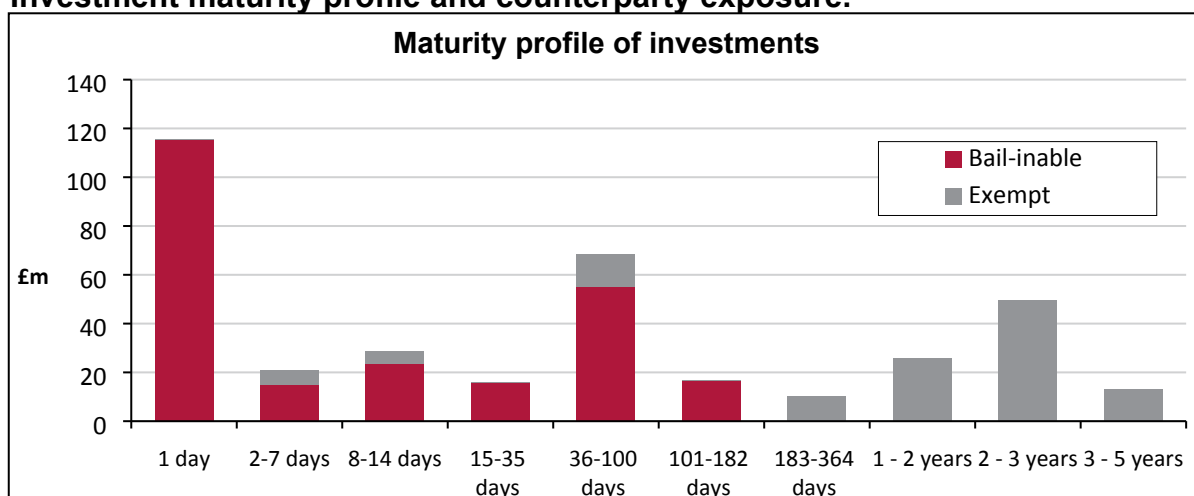
Type of Investment	Total	
	£m	%
Call Account	75.00	19
Money Market Fund	40.42	10
Certificate of Deposit	45.00	11
Fixed Deposit	103.70	26
Covered Bond	98.88	25
Corporate Bond	1.75	0
ISK held in Escrow	3.30	1
Icelandic Recoveries outstanding	4.00	1
Internally managed cash	372.05	93
External Investments	25.21	6
Equity	2.70	1
Total	397.26	100

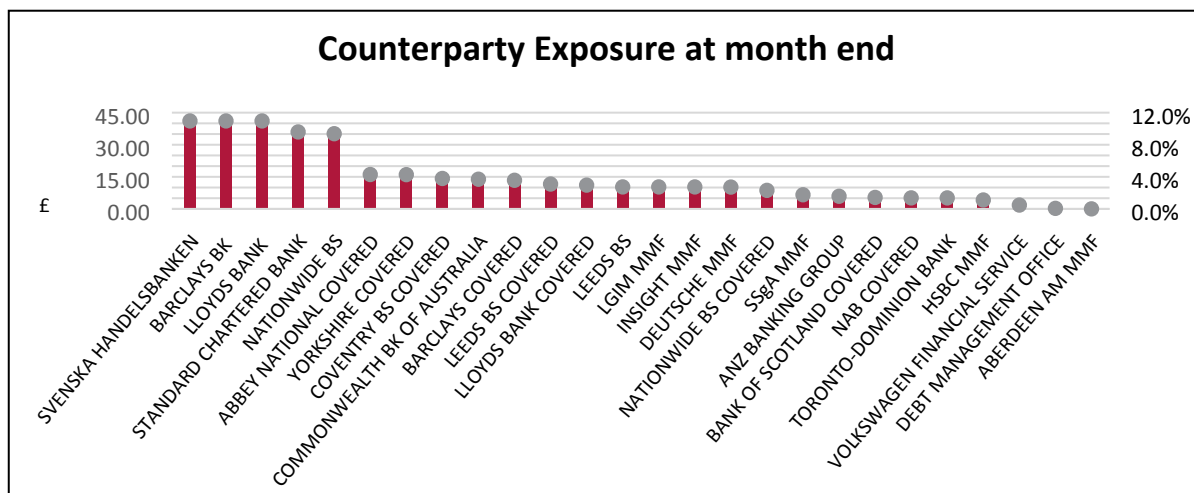
2.3 Internally managed cash

2.3.1 Average return on new investments

The average rate of interest on new investments made during the month was 0.6628% vs 7 day LIBID of 0.3637%. The rate of return on outstanding investments is 0.65%.

2.3.2 Investment maturity profile and counterparty exposure.





2.3.3 Credit Score matrix

	Credit Rating	Credit Risk Score
Value Weighted Average	AA-	3.81
Time Weighted Average	AAA	1.28

3. External Investments

	Book cost £000	Market Value at 30 June 2015 £000	Total annualised return to 30 June 2015
CCLA (note)	20,000	20,235	5.69%
Pyrford	5,000	4,974	3.49%

Note: includes £5m investment made 29 June

Alison Mings, 21 July 2015

Investments as at 28 August 2015

1. Internally Managed Investments

1.1 Term deposits, Call accounts and Money Market Funds

Instrument Type	Counterparty	Principal Amount	End Date	Interest Rate
Call Account	Barclays Bank	£5,000,000	n/a	0.35%
Call Account	Barclays FIBCA	£30,000,000	n/a	0.50%
	Total Barclays	£35,000,000		
Fixed Deposit	Lloyds Bank	£5,000,000	19/08/2016	1.00%
Fixed Deposit	Lloyds Bank	£5,000,000	26/02/2016	0.70%
Fixed Deposit	Lloyds Bank	£5,000,000	30/09/2015	0.57%
Fixed Deposit	Lloyds Bank	£5,000,000	24/05/2016	0.80%
Fixed Deposit	Lloyds Bank	£5,000,000	22/10/2015	0.57%
Fixed Deposit	Lloyds Bank	£5,000,000	08/08/2016	1.00%
Fixed Deposit	Lloyds Bank	£5,000,000	09/05/2016	0.80%
Fixed Deposit	Lloyds Bank	£5,000,000	03/09/2015	0.57%
	Total Lloyds Group	£40,000,000		
Certificate of Deposit	Standard Chartered Bank	£10,000,000	02/10/2015	0.68%
Certificate of Deposit	Standard Chartered Bank	£10,000,000	07/10/2015	0.72%
Certificate of Deposit	Standard Chartered Bank	£10,000,000	22/10/2015	0.72%
Certificate of Deposit	Standard Chartered Bank	£5,000,000	15/01/2016	0.72%
Certificate of Deposit	Standard Chartered Bank	£5,000,000	06/11/2015	0.72%
	Total Standard Chartered	£40,000,000		
Total UK Bank Deposits		£115,000,000		
Fixed Deposit	Nationwide Building Society	£5,800,000	05/10/2015	0.50%
Fixed Deposit	Nationwide Building Society	£18,000,000	18/12/2015	0.59%
	Total Nationwide BS	£23,800,000		
Total UK Building Society Deposits		£23,800,000		
Fixed Deposit	Commonwealth Bank of Australia	£6,500,000	07/10/2015	0.52%
Fixed Deposit	Australia and New Zealand Banking Group	£15,750,000	26/11/2015	0.55%
Total Australian Bank Deposits		£22,250,000		
Certificate of Deposit	Bank of Montreal	£5,000,000	22/01/2016	0.63%
Total Canadian Bank Deposits		£5,000,000		
Call Account	Handelsbanken	£40,000,000	n/a	0.40%
Total Swedish Bank Deposits		£40,000,000		
Money Market Fund	Deutsche Managed Sterling Fund	£9,988,654	n/a	0.38 (variable)
Money Market Fund	HSBC Global Liquidity Fund	£3,290,526	n/a	0.36 (variable)
Money Market Fund	Insight Sterling Liquidity Fund	£9,990,649	n/a	0.40 (variable)
Money Market Fund	LGIM Liquidity Fund	£9,992,782	n/a	0.44 (variable)
Money Market Fund	SSgA GBP Liquidity Fund	£9,989,325	n/a	0.38 (variable)
Money Market Fund	Aberdeen Sterling Liquidity Fund	£8,879,666	n/a	0.35 (variable)
Total Money Market Funds		£52,131,602		

Instrument Type	Principal Amount
Total Icelandic Recoveries outstanding	£7,352,991
Total ISK held in Escrow (est GBP)	-£3,278,427
Net Icelandic Recoveries outstanding	£4,074,564

1.2 Bond Portfolio

Bond Type	Issuer	Adjusted Principal	Net Yield	Maturity Date
Corporate FRN Bond	Volkswagen Financial Services	£1,750,589	0.863%	12/10/2015
Floating Rate Covered Bond	Yorkshire Building Society	£3,029,657	0.911%	23/03/2016
Floating Rate Covered Bond	Yorkshire Building Society	£5,054,132	0.911%	23/03/2016
Floating Rate Covered Bond	Yorkshire Building Society	£2,022,431	0.911%	23/03/2016
Floating Rate Covered Bond	National Australia Bank	£5,009,009	0.647%	12/08/2016
Fixed Rate Covered Bond	Bank of Scotland	£2,140,610	1.293%	08/11/2016
Fixed Rate Covered Bond	Bank of Scotland	£3,079,599	1.309%	08/11/2016
Floating Rate Covered Bond	Lloyds	£3,006,276	0.806%	14/01/2017
Floating Rate Covered Bond	Abbey National Treasury	£5,762,912	0.820%	20/01/2017
Floating Rate Covered Bond	Abbey National Treasury	£3,006,616	0.714%	20/01/2017
Floating Rate Covered Bond	Abbey National Treasury	£2,460,268	0.776%	05/04/2017
Floating Rate Covered Bond	Abbey National Treasury	£1,390,479	0.716%	05/04/2017
Floating Rate Covered Bond	Abbey National Treasury	£3,004,487	0.787%	29/05/2018
Floating Rate Covered Bond	Nationwide Building Society	£1,899,751	0.769%	17/07/2017
Floating Rate Covered Bond	Nationwide Building Society	£1,001,231	0.719%	17/07/2017
Floating Rate Covered Bond	Nationwide Building Society	£2,102,490	0.709%	17/07/2017
Floating Rate Covered Bond	Barclays Bank	£5,006,896	0.693%	15/09/2017
Floating Rate Covered Bond	Barclays Bank	£3,004,442	0.685%	15/09/2017
Floating Rate Covered Bond	Lloyds	£3,902,910	0.721%	19/01/2018
Floating Rate Covered Bond	Leeds Building Society	£2,503,095	0.784%	09/02/2018
Floating Rate Covered Bond	Barclays Bank	£5,003,820	0.721%	12/02/2018
Fixed Rate Covered Bond	Yorkshire Building Society	£2,160,067	1.981%	12/04/2018
Fixed Rate Covered	Yorkshire Building Society	£3,279,738	1.550%	12/04/2018

Bond				
Fixed Rate Covered Bond	Coventry Building Society	£3,233,355	1.933%	19/04/2018
Fixed Rate Covered Bond	Coventry Building Society	£5,420,183	1.703%	19/04/2018
Fixed Rate Covered Bond	Coventry Building Society	£2,180,528	1.520%	19/04/2018
Floating Rate Covered Bond	Coventry Building Society	£3,009,789	0.877%	17/03/2020
Floating Rate Covered Bond	Leeds Building Society	£2,503,143	0.784%	09/02/2018
Floating Rate Covered Bond	Nationwide Building Society	£3,431,050	0.740%	27/04/2018
Fixed Rate Covered Bond	Leeds Building Society	£2,168,991	2.016%	17/12/2018
Fixed Rate Covered Bond	Leeds Building Society	£1,640,010	1.187%	17/12/2018
Floating Rate Covered Bond	Lloyds	£1,405,501	0.758%	01/07/2019
Floating Rate Covered Bond	Leeds Building Society	£5,000,000	0.967%	01/10/2019
Total Bonds		£100,574,056		

Total Internally managed investments	£370,183,213
---	---------------------

2. Externally Managed Investments

Investment Fund / Equity	Book cost
CCLA	£20,000,000
Pyrford	£5,000,000
Kent PFI (Holdings) Ltd	£2,135,741

Total External Investments	£27,135,741
-----------------------------------	--------------------

3. Total Investments

Total Investments	£397,318,954
--------------------------	---------------------