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To: Governance and Audit Committee – 6 October 2016

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 updates on any significant developments since then.

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 2016-17 was approved by full Council on 11 February 2016.
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 £334m, 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 referendum on the UK's future relationship with the EU and the slowdown in the Chinese economy were the dominant issues for financial markets in the 3 months to the end of June. Following the vote to leave the EU sterling exchange rates fell significantly, government bond yields also fell sharply while equity markets after an initial sharp fall recovered and finished the month on a high.
9. The repercussions of the vote were also particularly keenly felt in values of commercial and residential property. Commercial property fund managers including CCLA marked down their shares reflecting lower expected property valuations.
10. After the vote the Monetary Policy Committee (MPC) of the Bank of England sought to reassure markets and investors and on 4 August they decided to cut the base rate by 0.25% to 0.25%, to raise the stock of purchases of gilts to £435 billion from £375 billion, and to purchase £10 billion of corporate bonds.
11. The impact on UK banks and building societies of the uncertain economic environment is being carefully monitored by the offices and the Council's treasury advisors and Arlingclose's credit advice remains cautious. Duration limits for major UK banks and building societies were unchanged with Standard Chartered remaining suspended from the list.
12. In August returns on short-term unsecured bank investments fell as did interest rates on DMO term deposits (0.10% on 6 month deposits).
13. Security of capital has remained the Authority's main investment objective. Against a background of increasing uncertainty, the continuing risk of bail-in and continued low returns, 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 2016-17.
14. Details of the types of investments held at 30 June are shown in the table at paragraph 2.2 of appendix 1. At that date some 62% of KCC's cash was held in deposits with banks or money market funds and some 38% was invested in covered bonds, investment funds and equity which are not subject to bail-in risk.
15. From April through June the interest rate earned on the invested cash was 1.13% compared to the average 7 day LIBID rate of 0.36%.

STATEMENT OF INVESTMENTS

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

BORROWING

17. At 30 June 2016 the Authority held £980.84m of loans, an increase of £1.3m from the balance as at 31 March 2016, as part of its strategy for funding previous years' capital programmes.

18. 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.
19. In June Barclays Bank advised KCC of their decision to cancel all the embedded options within their standard Lender's Option Borrower's Option loans. This converts the Barclays LOBOs, totalling £281.8m, into fixed rate loans.
20. Since the start of the current financial year the Council has received £4.3m of the funding agreed for the County's street lighting and expects to receive a total of £11.56m in 2016-17. KCC also expects to repay £32m of maturing PWLB loans by 31 March 2017
21. As a result of new borrowing the average interest rate payable on the Council's debt portfolio reduced to 5.193%.
22. 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.
23. 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.

TREASURY ADVISOR

24. KCC agreed a new 3 year contract with Arlingclose for treasury advisory services with effect from 1 August 2016.

RECOMMENDATION

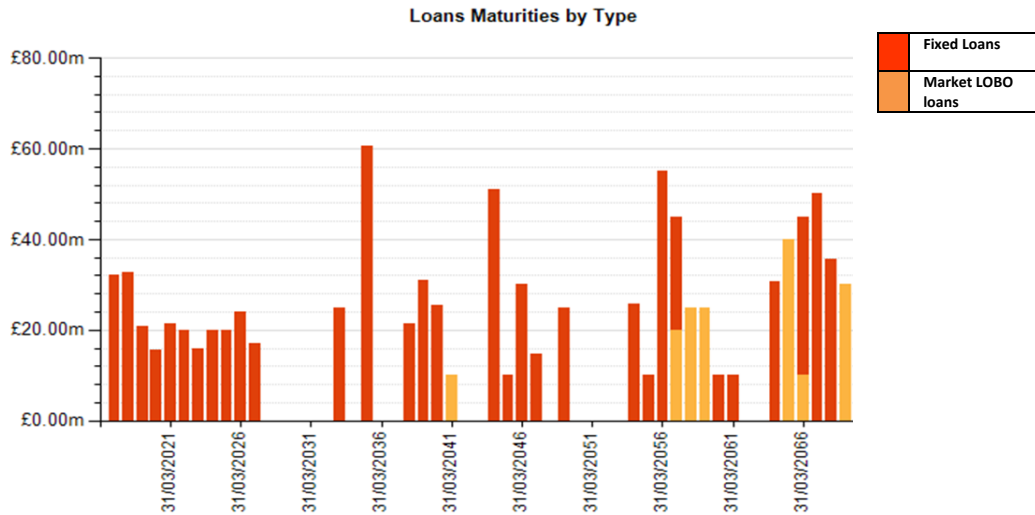
25. Members are asked to note this report for assurance.

Alison Mings
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Treasury Management Report for the month of June 2016

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 was £980.84m.



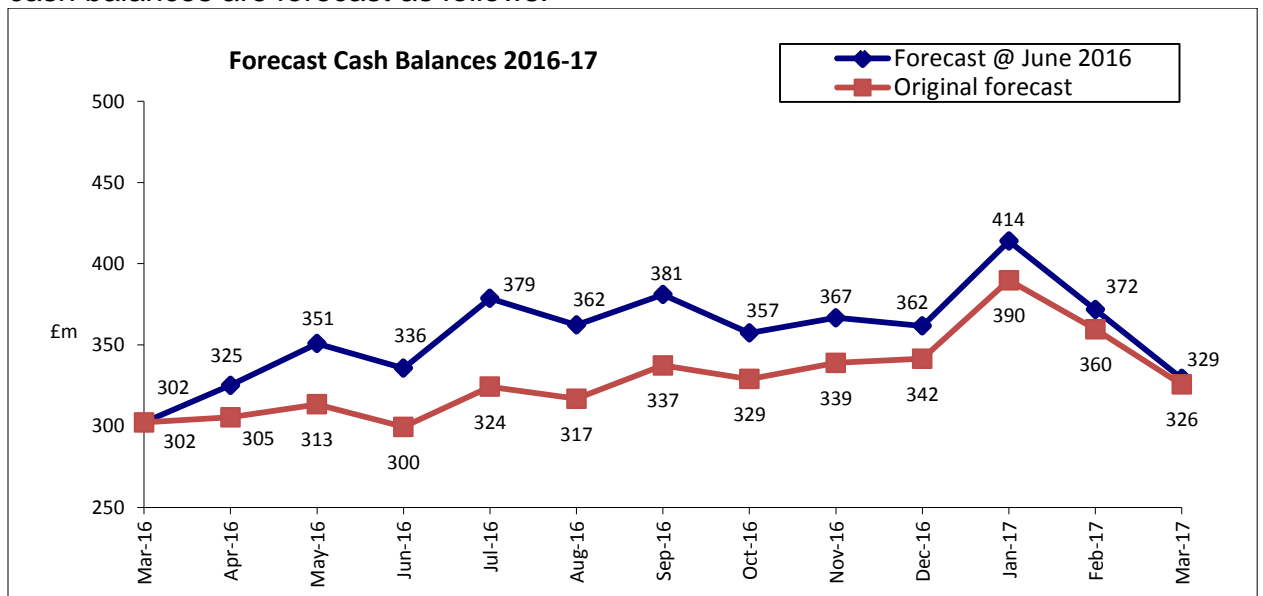
Total external debt managed by KCC includes £38.04m pre-LGR debt managed by KCC on behalf of Medway Council. Also included is pre-1990 debt managed on behalf of Further Education Funding Council (£0.54m), Magistrates Courts (£0.371m).

In June Barclays Bank informed KCC that they have cancelled all the embedded options within the £281.8m of LOBOs held by the Council. This effectively converts the Barclays LOBOs into fixed rate loans.

2. Investments

2.1 Cash Balances

During June the total value of cash under management decreased by £15m to £336m, £36m above the original forecast mainly due to higher than anticipated receipts. Future cash balances are forecast as follows:



2.2 Type of investment at month end

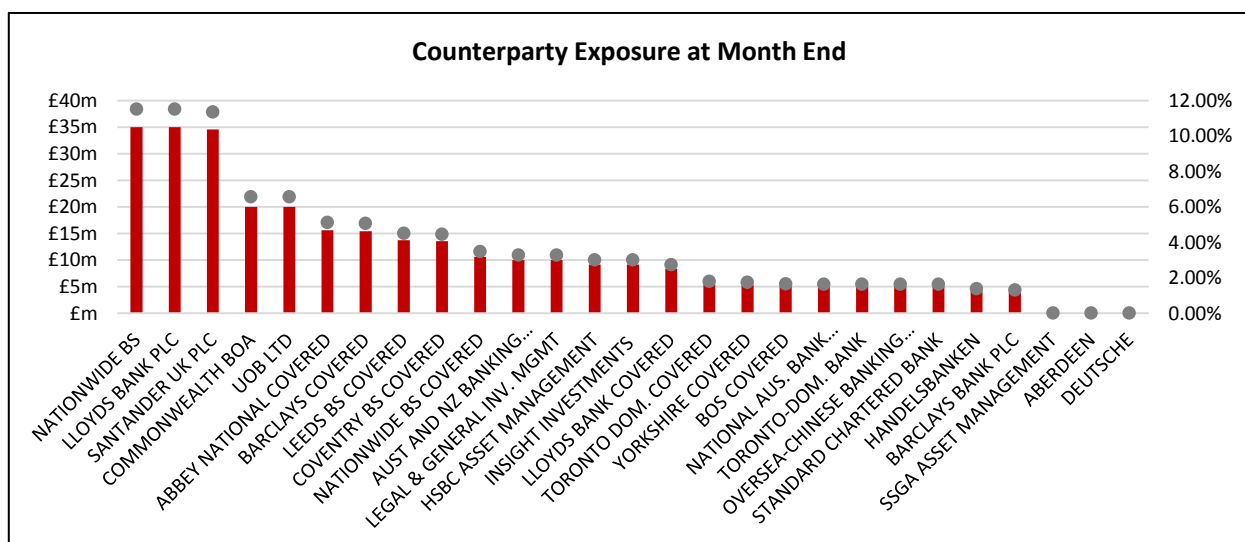
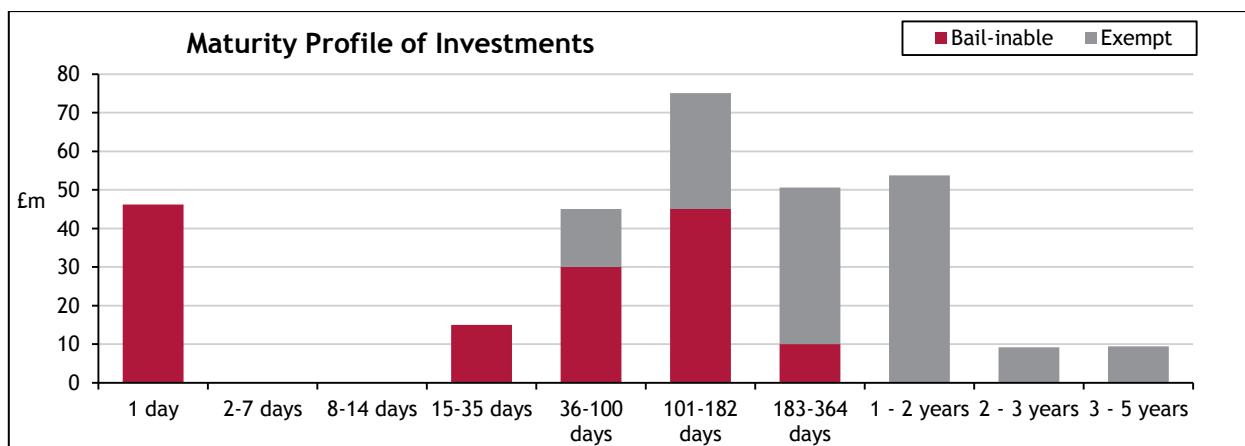
Type of Investment	Total	
	£m	%
Call Account	17.75	5.20
Money Market Fund	28.48	8.35
Notice Account	25.00	7.33
Certificate of Deposit	10.00	2.93
Fixed Deposit	125.00	36.64
Covered Bond	97.97	28.71
ISK held in Escrow	3.28	0.96
Icelandic Recoveries outstanding	0.51	0.15
Internally managed cash	307.99	90.27
External Investments	31.07	9.11
Equity	2.14	0.63
Total	341.19	100.00

2.3 Internally managed cash

2.3.1 Average return on new investments

The rate of return on investments held at month end is 0.79% vs the target return 7 day LIBID of 0.36%.

2.3.2 Investment maturity profile and counterparty exposure.



2.3.3 Credit Score matrix

	Credit Rating	Credit Risk Score
Value Weighted Average	AA	3.45
Time Weighted Average	AA+	1.94

3. External Investments

	Book cost £000	Market Value at 31 May 2016 £000	12 months return to 31 May 2016
CCLA	25,000	25,948	5.40%
Pyrford	5,000	5,119	1.65%

Appendix 2 – Investments as at 2 September 2016

Internally Managed Investments

Instrument Type	Counterparty	Principal Amount	Maturity Date	Interest Rate
Same Day Call Deposit	Barclays Bank	£1,000,000	n/a	0.35%
Same Day Call Deposit	Barclays FIBCA	£0	n/a	0.50%
Fixed Deposit	Lloyds Bank	£5,000,000	21/08/2017	1.00%
Fixed Deposit	Lloyds Bank	£5,000,000	30/09/2016	1.05%
Fixed Deposit	Lloyds Bank	£5,000,000	24/02/2001	0.80%
Fixed Deposit	Lloyds Bank	£5,000,000	24/07/2017	1.05%
Fixed Deposit	Lloyds Bank	£5,000,000	08/08/2017	1.00%
Fixed Deposit	Lloyds Bank	£5,000,000	09/02/2017	0.90%
Fixed Deposit	Lloyds Bank	£5,000,000	05/09/2016	1.00%
Call Deposits	Natwest SIBA	£0	n/a	0.25%
Call Deposits	Santander UK	£10,000,000	n/a	0.15%
31 Day Call Notice Account	Santander UK	£5,000,000	n/a	0.40%
60 Day Call Notice Account	Santander UK	£5,000,000	n/a	0.50%
95 Day Call Notice Account	Santander UK	£5,000,000	n/a	0.65%
120 Day Call Notice Account	Santander UK	£5,000,000	n/a	0.80%
180 Day Call Notice Account	Santander UK	£5,000,000	n/a	0.90%
Total UK Bank Deposits		£71,000,000		

Fixed Deposit	Nationwide Building Society	£3,600,000	19/10/2016	0.71%
Fixed Deposit	Nationwide Building Society	£10,000,000	24/10/2016	0.68%
Fixed Deposit	Nationwide Building Society	£10,000,000	03/11/2016	0.71%
Fixed Deposit	Nationwide Building Society	£7,700,000	18/11/2016	0.71%
Fixed Deposit	Nationwide Building Society	£3,700,000	23/11/2016	0.71%
Total UK Building Society Deposits		£35,000,000		

Certificate of Deposit	Toronto-Dominion Bank Bonds	£5,000,000	10/02/2017	0.80%
Total Canadian Bank Deposits		£5,000,000		

Fixed Deposit	United Overseas Bank	£5,000,000	24/10/2016	0.62%
Fixed Deposit	United Overseas Bank	£10,000,000	10/02/2017	0.73%
Fixed Deposit	United Overseas Bank	£5,000,000	10/02/2017	0.70%
Fixed Deposit	Overeseas Chinese Banking Corp	£5,000,000	10/02/2017	0.65%
Total Singapore Bank Deposits		£25,000,000		

Fixed Deposit	Common Wealth Bank Of Australia	£10,000,000	19/10/2016	0.65%
Fixed Deposit	Common Wealth Bank Of Australia	£10,000,000	10/11/2006	0.65%
Total Australian Bank Deposits		£20,000,000		

Money Market Fund	Deutsche Managed Sterling Fund	£30,713	n/a	0.44 (variable)
Money Market Fund	HSBC Global Liquidity Fund	£9,961,068	n/a	0.46 (variable)
Money Market Fund	Insight Sterling Liquidity Fund	£2,847,203	n/a	0.47 (variable)
Money Market Fund	LGIM Liquidity Fund	£9,993,160	n/a	0.49 (variable)
Money Market Fund	SSgA GBP Liquidity Fund	£21,633	n/a	0.42 (variable)
Money Market Fund	Aberdeen Sterling Liquidity Fund	£9,968,896	n/a	0.43 (variable)
Total Money Market Funds		£32,822,674		

Covered Bond Portfolio

Bond Type	Issuer	Adjusted Principal	Maturity Date	Net Yield
Fixed Rate Covered Bond	Bank of Scotland	£2,070,756	08/11/2016	1.291%
Fixed Rate Covered Bond	Bank of Scotland	£2,980,464	08/11/2016	1.340%
Fixed Rate Covered Bond	Coventry Building Society	£3,157,053	19/04/2018	1.931%
Fixed Rate Covered Bond	Coventry Building Society	£5,282,513	19/04/2018	1.726%
Fixed Rate Covered Bond	Coventry Building Society	£2,121,260	19/04/2018	1.524%
Fixed Rate Covered Bond	Leeds Building Society	£2,128,008	17/12/2018	2.029%
Fixed Rate Covered Bond	Leeds Building Society	£1,601,727	17/12/2018	1.192%
Fixed Rate Covered Bond	Yorkshire Building Society	£2,107,752	12/04/2018	1.976%
Fixed Rate Covered Bond	Yorkshire Building Society	£3,187,918	12/04/2018	1.545%
Floating Rate Covered Bond	Abbey National Treasury	£5,754,319	20/01/2017	0.820%
Floating Rate Covered Bond	Abbey National Treasury	£3,002,213	20/01/2017	0.714%
Floating Rate Covered Bond	Abbey National Treasury	£2,425,843	05/04/2017	0.776%
Floating Rate Covered Bond	Abbey National Treasury	£1,370,213	05/04/2017	0.716%
Floating Rate Covered Bond	Abbey National Treasury	£3,002,844	29/05/2018	0.787%
Floating Rate Covered Bond	Barclays Bank	£5,003,830	15/09/2017	0.693%
Floating Rate Covered Bond	Barclays Bank	£3,002,447	15/09/2017	0.685%
Floating Rate Covered Bond	Barclays Bank	£5,002,292	12/02/2018	0.721%
Floating Rate Covered Bond	Barclays Bank	£2,394,877	12/02/2018	0.781%
Floating Rate Covered Bond	Coventry Building Society	£3,007,783	17/03/2020	0.877%
Floating Rate Covered Bond	Leeds Building Society	£2,501,859	09/02/2018	0.784%
Floating Rate Covered Bond	Leeds Building Society	£2,501,888	09/02/2018	0.784%
Floating Rate Covered Bond	Leeds Building Society	£5,000,000	01/10/2019	0.967%
Floating Rate Covered Bond	Lloyds	£3,002,100	14/01/2017	0.806%
Floating Rate Covered Bond	Lloyds	£3,901,786	19/01/2018	0.721%
Floating Rate Covered Bond	Lloyds	£1,404,128	18/07/2019	0.758%
Floating Rate Covered Bond	Nationwide Building Society	£1,899,997	17/07/2017	0.769%
Floating Rate Covered Bond	Nationwide Building Society	£1,000,492	17/07/2017	0.719%
Floating Rate Covered Bond	Nationwide Building Society	£2,101,240	17/07/2017	0.709%
Floating Rate Covered Bond	Nationwide Building Society	£3,429,778	27/04/2018	0.740%
Floating Rate Covered Bond	Nationwide Building Society	£2,146,826	27/04/2018	0.771%
Floating Rate Covered Bond	Toronto Dominion	£5,457,077	01/02/2019	1.016%
Fixed Rate Covered Bond	Leeds Building Society	£5,851,747	17/12/2018	0.623%
Fixed Rate Covered Bond	Santander UK PLC	£3,615,957	14/04/2021	0.649%
Total Bonds		£102,418,987		

Iceland

ISK held in Escrow at Islandsbanki	Glitnir	£3,148,798
ISK held in Escrow at Islandsbanki	Landsbanki Islands	£129,629
Total ISK held in Escrow		£3,278,427

Icelandic Recoveries outstanding	Heritable Bank Ltd	£366,905
Icelandic Recoveries outstanding	Landsbanki Islands	£139,649
Total Icelandic Recoveries outstanding		£506,554

Total Internally Managed Funds	£295,026,642
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Externally Managed Funds

CCLA LAMIT Property Fund	£25,000,000
Pyrford Global Total Return (Sterling) Fund	£5,000,000
Total Externally Managed Investments	£30,000,000

Kent PFI (Holdings) Ltd	£2,135,741
Total UK Private Equity Holding	£2,135,741

Total Externally Managed Funds	£32,135,741
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GRAND TOTAL OF ALL DEPOSITS	£327,162,382
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