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To: Governance and Audit Committee – 11 April 2017

Subject: **TREASURY MANAGEMENT UPDATE**

Classification: Unrestricted

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Summary: To report a summary of Treasury Management activity

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## **FOR ASSURANCE**

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### **INTRODUCTION**

1. This report covers Treasury Management activity for the 9 months to 31 December 2016 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 2016-17 was approved by full Council on 11 February 2016
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. 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 February 2017 report is attached in Appendix 1.

### **INVESTMENT ACTIVITY**

#### **External context**

6. The main external issue which has impacted on KCC's investment activity was the cut in the base rate to 0.25%. The cut led to reductions in the rates offered by banks for deposits and available from money market funds. Rates for very short-dated periods (overnight – 1 month) have fallen to between 0.1% and 0.2% while Debt Management Account Deposit Facility (DMADF) rates have fallen to 0.10%. Recently the yields on T-Bills have been slightly negative.

7. After recovering from an initial sharp drop in Quarter 2, equity markets appear to have continued their rally. The Council has had some exposure to equity markets, through its investment in the Pyrford Global Total Return Sterling Fund, which performed well in the 9 months.
8. Inflation has continued to rise and at the end of December the Consumer Price Index (CPI) had risen to 1.6%. The Bank of England forecasts a rise closer to the Bank's 2% target in the first half of 2017, as previous rises in commodity prices and the depreciation in sterling drive up imported material costs for companies.
9. Since the initial Brexit reaction UK Commercial Property values have continued the recovery trend. It is widely forecast however that UK Commercial Property returns in the next few years will be driven by income returns with consensus returns in the range 5-7% per annum over the next five years. KCC has exposure to this market through its investment in the CCLA LAMIT Property Fund.
10. The impact on KCC's counterparties and investments of the uncertain economic environment is being carefully monitored by officers and the Council's treasury advisors. Arlingclose's credit advice remains cautious however duration limits for major UK banks and building societies were unchanged with Standard Chartered remaining suspended from the list.

### **Investment activity 2016 - 17**

11. The Council's average investment balances to date have amounted to £330m, representing income received in advance of expenditure plus balances and reserves held.
12. 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.
13. 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, the Council's aim has been 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. In October KCC invested £10m in the Aberdeen cash plus fund and in late December made an investment of £25m in the Fidelity Multi Asset Income Fund which invests in a mix of asset classes including equities, fixed income, cash and property.
15. Internally managed investments have achieved an average return of 0.75% over the 9 month period.

### **Statement of investments**

16. A statement of investments as at 3 March 2017 is attached in Appendix 2. This statement is circulated to members of the Treasury Management Advisory Group every Friday.

## **BORROWING**

17. In June the Barclays LOBOs, totalling £281.8m were converted into fixed rate loans and is a highly welcome move by the bank.
18. Since the start of the current financial year the Council has received £7.5m of the funding agreed for the County's street lighting replacement project and expects to receive a total of £15.2m in 2016-17 (£1.3m still to be advanced by Salix and £6.4m from Green Investment Bank). KCC has repaid £32.2m of maturing loan principal in 2016/17.
19. As a result of the new borrowing and repayment of maturing loans, the average interest rate payable on the Council's debt portfolio reduced to 5.157%.
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 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 remain lower than long-term rates, the Council has determined it is more cost effective in the short-term to use internal resources instead.
21. 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, assists it with this 'cost of carry' and breakeven analysis.

## **RECOMMENDATION**

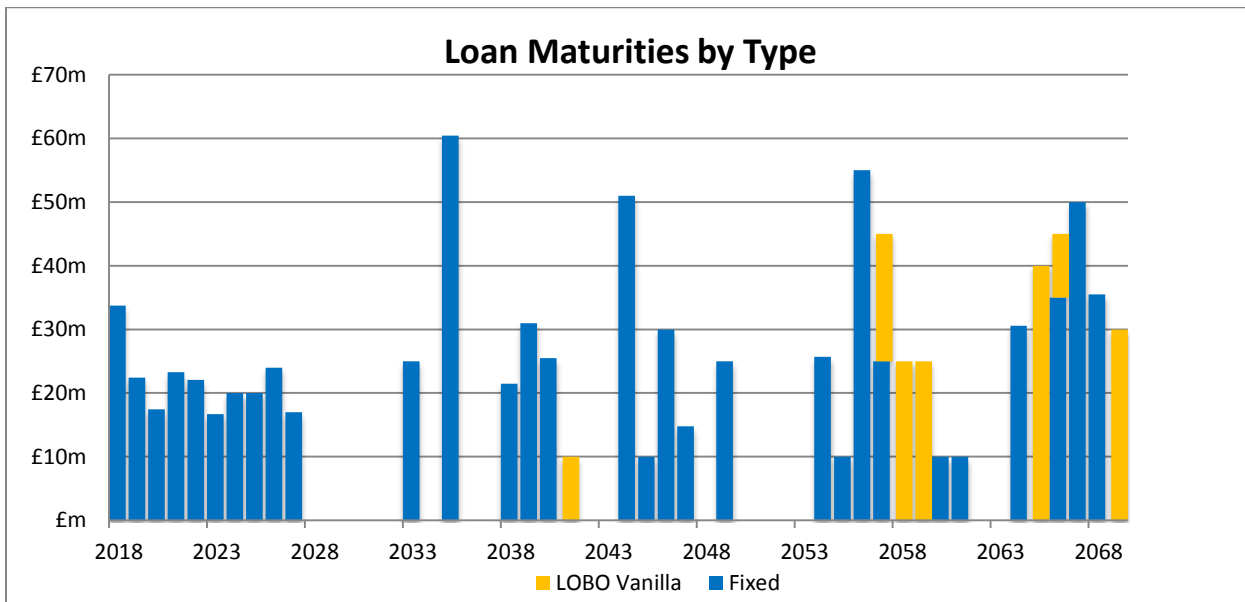
22. Members are asked to note this report for assurance.

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

# Treasury Management Report for the month of February 2017

## 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 February was £957.79m.

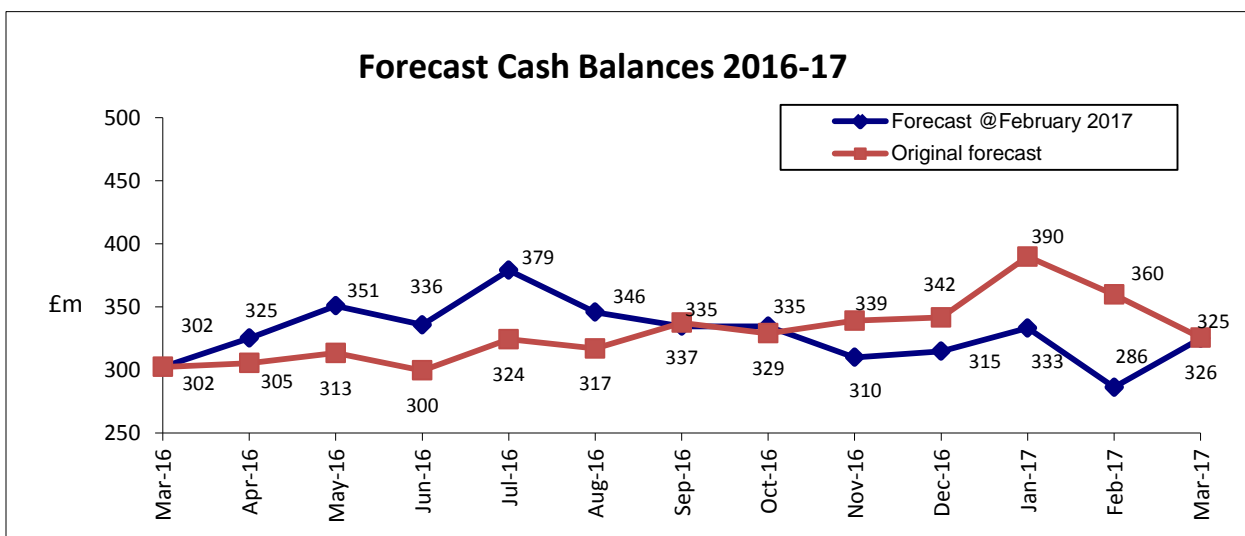


Total external debt managed by KCC includes £37.0m pre-LGR debt managed by KCC on behalf of Medway Council. Also included is pre-1990 debt managed on behalf of Further Education Funding Council (£0.54m), Magistrates Courts (£0.371m).

## 2. Investments

### 2.1 Cash Balances

During February the total value of cash under management fell by approximately £47m to £286.2m, £73m below the original forecast due to timing of cashflows. At this time it is anticipated, based on information available, that the actual balance at 31 March will be in line with forecast.



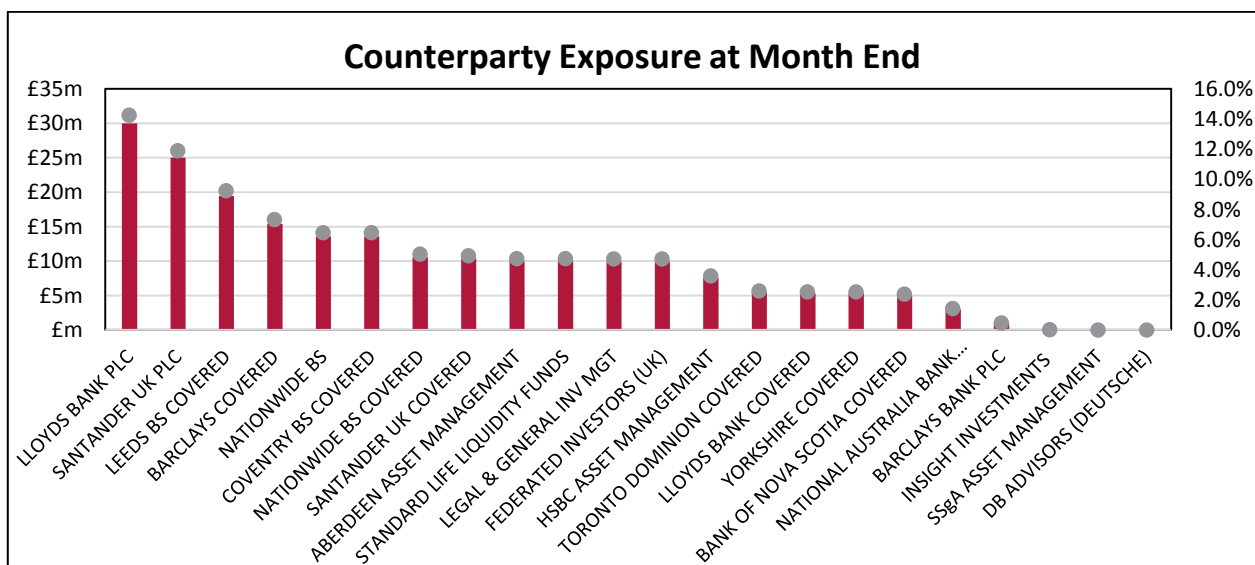
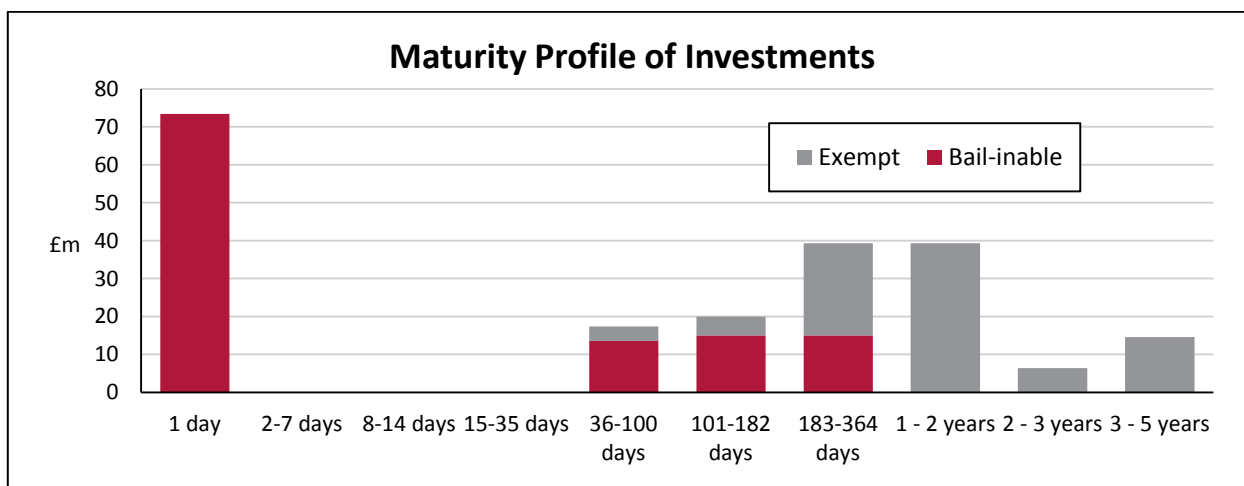
## 2.2 Type of investment at month end

| Type of Investment               | Total         |               |
|----------------------------------|---------------|---------------|
|                                  | £m            | %             |
| Call Account                     | 1.00          | 0.35          |
| Money Market Fund                | 47.39         | 16.78         |
| Notice Account                   | 25.00         | 8.85          |
| Fixed Deposit                    | 43.6          | 15.44         |
| Covered Bond                     | 93.39         | 33.07         |
| ISK held in Escrow               | 3.28          | 1.16          |
| Icelandic Recoveries Outstanding | 0.51          | 0.18          |
| <b>Internally managed cash</b>   | <b>214.17</b> | <b>75.84</b>  |
| External Investments             | 56.07         | 19.85         |
| Cashplus Fund                    | 10.03         | 3.55          |
| Equity                           | 2.14          | 0.76          |
| <b>Total</b>                     | <b>282.41</b> | <b>100.00</b> |

## 2.3 Internally managed cash

2.3.1 The rate of return on investments held at month end is 0.77% vs the target return 7 day LIBID of 0.1147%.

2.3.2 Investment maturity profile and counterparty exposure.



### 2.3.3 Credit Score matrix

|                        | Credit Rating | Credit Risk Score |
|------------------------|---------------|-------------------|
| Value Weighted Average | AA            | 3.24              |
| Time Weighted Average  | AAA           | 1.47              |

### 3. External Investments

|  | Book cost<br>£000 | Market Value at<br>28 Feb 2017<br>£000 | 12 months return to<br>28 Feb 2017 |       |
|--|-------------------|--|------------------------------------|-------|
|  |                   |  | Income                             | Total |
| CCLA Property Fund                           | 25,000            | 25,256                                 | 4.56%                              | 2.36% |
| Pyrford Global Total<br>Return Sterling Fund | 5,000             | 5,077                                  | 9.18%                              | 8.80% |
| Fidelity Multi Asset<br>Income Fund          | 25,000            | 25,739                                 | 0.27%                              | 3.23% |

### 4. Financing Items

The forecast underspend has increased to -£1.1m on the net debt charges budget, mainly due to lower than budgeted interest costs and higher interest receipts and dividends, a reduction in bank charges following the recent retendering for banking services and savings on brokerage fees, as we are not looking to take out any new borrowing this financial year.

**Alison Mings**  
14 March 2017

## Investments as at 10 March 2017

## 1. Internally Managed Investments

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

| Instrument Type               | Counterparty                              | Principal Amount   | End Date   | Interest Rate    |
|-------------------------------|---|--------------------|------------|------------------|
| Same Day Call Deposit         | Barclays Bank                             | £1,000,000         | n/a        | 0.35%            |
|                               | <b>Total Barclays</b>                     | <b>£1,000,000</b>  |            |                  |
| Fixed Deposit                 | Lloyds Bank                               | £5,000,000         | 21/08/2017 | 1.00%            |
| Fixed Deposit                 | Lloyds Bank                               | £5,000,000         | 29/09/2017 | 1.00%            |
| 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         | 08/02/2018 | 0.90%            |
| Fixed Deposit                 | Lloyds Bank                               | £5,000,000         | 05/09/2017 | 1.00%            |
|                               | <b>Total Lloyds Group</b>                 | <b>£30,000,000</b> |            |                  |
| 180 Day Call Notice Account   | Santander UK                              | £25,000,000        | n/a        | 0.90%            |
|                               | <b>Total Santander</b>                    | <b>£25,000,000</b> |            |                  |
| <b>Total UK Bank Deposits</b> |   | <b>£56,000,000</b> |            |                  |
| Fixed Deposit                 | Nationwide Building Society               | £3,600,000         | 19/04/2017 | 0.42%            |
| Fixed Deposit                 | Nationwide Building Society               | £10,000,000        | 24/04/2017 | 0.43%            |
|                               | <b>Total UK Building Society Deposits</b> | <b>£13,600,000</b> |            |                  |
| Money Market Fund             | Aberdeen Sterling Liquidity Fund          | £9,971,290         | n/a        | 0.23% (variable) |
| Money Market Fund             | Deutsche Managed Sterling Fund            | £4,727             | n/a        | 0.21% (variable) |
| Money Market Fund             | Federated (PR) Short-term GBP Prime Fund  | £9,928,939         | n/a        | 0.22% (variable) |
| Money Market Fund             | HSBC Global Liquidity Fund                | £7,549,048         | n/a        | 0.22% (variable) |
| Money Market Fund             | Insight Sterling Liquidity Fund           | £29,251            | n/a        | 0.21% (variable) |
| Money Market Fund             | LGIM Liquidity Fund                       | £9,931,938         | n/a        | 0.33% (variable) |
| Money Market Fund             | SSgA GBP Liquidity Fund                   | £6,138             | n/a        | 0.23% (variable) |
| Money Market Fund             | SSgA GBP Liquidity Fund                   | £9,967,400         | n/a        | 0.26% (variable) |
|                               | <b>Total Money Market Funds</b>           | <b>£47,388,731</b> |            |                  |

| Instrument Type                             | Principal Amount  |
|---|-------------------|
| Total Icelandic Recoveries outstanding      | £506,554          |
| Total ISK held in Escrow (est GBP)          | £3,278,427        |
| <b>Net Icelandic Recoveries outstanding</b> | <b>£3,784,981</b> |

## 1.2 Bond Portfolio

| Bond Type                  | Issuer                      | Adjusted Principal | Net Yield | Maturity Date |
|----------------------------|-----------------------------|--------------------|-----------|---------------|
| Floating Rate Covered Bond | Abbey National Treasury     | £2,408,488         | 0.776%    | 05/04/2017    |
| Floating Rate Covered Bond | Abbey National Treasury     | £1,359,997         | 0.716%    | 05/04/2017    |
| Floating Rate Covered Bond | Abbey National Treasury     | £3,002,032         | 0.787%    | 29/05/2018    |
| Fixed Rate Covered Bond    | Bank Of Nova Scotia         | £4,984,225         | 0.813%    | 14/09/2021    |
| Floating Rate Covered Bond | Barclays Bank               | £5,002,296         | 0.693%    | 15/09/2017    |
| Floating Rate Covered Bond | Barclays Bank               | £3,001,467         | 0.685%    | 15/09/2017    |
| Floating Rate Covered Bond | Barclays Bank               | £5,001,520         | 0.721%    | 12/02/2018    |
| Floating Rate Covered Bond | Barclays Bank               | £2,396,603         | 0.781%    | 12/02/2018    |
| Fixed Rate Covered Bond    | Coventry Building Society   | £3,157,053         | 1.931%    | 19/04/2018    |
| Fixed Rate Covered Bond    | Coventry Building Society   | £5,282,513         | 1.726%    | 19/04/2018    |
| Fixed Rate Covered Bond    | Coventry Building Society   | £2,121,260         | 1.524%    | 19/04/2018    |
| Floating Rate Covered Bond | Coventry Building Society   | £3,006,731         | 0.877%    | 17/03/2020    |
| Floating Rate Covered Bond | Leeds Building Society      | £2,501,236         | 0.784%    | 09/02/2018    |
| Floating Rate Covered Bond | Leeds Building Society      | £2,501,255         | 0.784%    | 09/02/2018    |
| Fixed Rate Covered Bond    | Leeds Building Society      | £2,085,960         | 2.029%    | 17/12/2018    |
| Fixed Rate Covered Bond    | Leeds Building Society      | £1,558,096         | 1.192%    | 17/12/2018    |
| Fixed Rate Covered Bond    | Leeds Building Society      | £5,771,641         | 0.623%    | 17/12/2018    |
| Floating Rate Covered Bond | Leeds Building Society      | £5,000,000         | 0.967%    | 01/10/2019    |
| Floating Rate Covered Bond | Lloyds                      | £3,901,156         | 0.721%    | 19/01/2018    |
| Floating Rate Covered Bond | Lloyds                      | £1,403,435         | 0.758%    | 18/07/2019    |
| Fixed Rate Covered Bond    | National Australia Bank     | £3,003,113         | 1.104%    | 10/11/2021    |
| Floating Rate Covered Bond | Nationwide Building Society | £1,899,999         | 0.769%    | 17/07/2017    |



|                            |                             |                    |        |            |
|----------------------------|-----------------------------|--------------------|--------|------------|
| Floating Rate Covered Bond | Nationwide Building Society | £1,000,245         | 0.719% | 17/07/2017 |
| Floating Rate Covered Bond | Nationwide Building Society | £2,100,617         | 0.709% | 17/07/2017 |
| Floating Rate Covered Bond | Nationwide Building Society | £3,429,266         | 0.740% | 27/04/2018 |
| Floating Rate Covered Bond | Nationwide Building Society | £2,147,740         | 0.771% | 27/04/2018 |
| Fixed Rate Covered Bond    | Santander UK PLC            | £3,615,957         | 0.649% | 14/04/2021 |
| Floating Rate Covered Bond | Toronto Dominion            | £5,455,852         | 1.016% | 01/02/2019 |
| Fixed Rate Covered Bond    | Yorkshire Building Society  | £2,107,752         | 1.976% | 12/04/2018 |
| Fixed Rate Covered Bond    | Yorkshire Building Society  | £3,187,918         | 1.545% | 12/04/2018 |
|                            | <b>Total Bonds</b>          | <b>£93,395,422</b> |        |            |

|   |                     |
|---|---------------------|
| <b>Total Internally managed investments</b> | <b>£214,169,134</b> |
|---|---------------------|

## 2. Externally Managed Investments

| Investment Fund / Equity                    | Market Value at 28 February 2017 | 12 months return to 28 February 2017 |       |
|---|----------------------------------|--------------------------------------|-------|
|   |                                  | Income                               | Total |
| CCLA LAMIT Property Fund                    | £25,256,038                      | 4.56%                                | 2.36% |
| Pyrford Global Total Return Fund            | £5,077,303                       | 9.18%                                | 8.80% |
| Fidelity Multi Asset Income Fund            | 25,739,175                       | 0.27%                                | 3.23% |
| Aberdeen Ultra Short Duration Sterling Fund | £10,027,103                      | -                                    | 0.27% |
| Kent PFI (Holdings) Ltd                     | £2,135,741                       |                                      |       |

|                                   |                    |
|-----------------------------------|--------------------|
| <b>Total External Investments</b> | <b>£68,235,360</b> |
|-----------------------------------|--------------------|

## 3. Total Investments

|                          |                     |
|--------------------------|---------------------|
| <b>Total Investments</b> | <b>£282,404,495</b> |
|--------------------------|---------------------|