

By: John Simmonds, Cabinet Member for Finance
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To: Governance and Audit Committee – 1 November 2017

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 2017-18 was approved by full Council on 9 February 2017.
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.

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 August report is attached at appendix 1.

EXTERNAL CONTEXT

6. The dominant issues for financial markets in the 3 months to the end of June were the election of a minority Conservative government in June as well as rising inflation. In the face of this uncertainty, Arlingclose expects that the Bank of England will look through this period of higher inflation and maintain its low-for-longer stance on policy interest rates for an extended period.
7. Equity markets rose but dropped off towards the end of the quarter. Money markets rates have remained low: 1-month, 3-month and 12-month LIBID rates have averaged 0.25%, 0.33% and 0.66% in the quarter respectively.

8. Ring-fencing, which requires the larger UK banks to separate their core retail banking activity from the rest of their business, is expected to be implemented within the next year. In May, following Arlingclose's advice, KCC reduced the maximum duration of its deposits at Bank of Scotland, HSBC and Lloyds Bank from 13 months to 6 months reflecting the uncertainty surrounding which banking entities the Council will be dealing with once ring-fencing is implemented.

INVESTMENT ACTIVITY

9. The Council's average investment balances to date have amounted to £300m, representing income received in advance of expenditure plus balances and reserves held. These balances are forecast to remain relatively stable over the coming months.
10. 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.
11. 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 2017-18.
12. Details of the types of investments held at 30 June are shown below. At that date 57% was invested in covered bonds, pooled funds and equity which are not subject to bail-in risk.

Type of Investment	Total	
	£m	%
Money Market Fund	55.93	18.77
Call Account	5.00	1.68
Notice Account	25.00	8.39
Fixed Deposit	35.00	11.74
Covered Bond	89.11	29.90
Proceeds of sale of ISK held in Escrow	4.54	1.52
Icelandic Recoveries Outstanding	0.37	0.12
Internally managed cash	214.95	72.12
External Investments	60.92	20.44
Cashplus / Short term Bond Funds	20.04	6.72
Equity	2.14	0.72
Total	298.04	100.00

13. At its meeting in July TMAG agreed a further £5m investment in the CCLA LAMIT property fund and £50m in equity funds. These investments were made between July and September as cashflow allowed.

ICELANDIC DEPOSITS

14. In June the Icelandic authorities lifted exchange controls and KCC took the opportunity to sell 706.2m ISK held in escrow accounts in Iceland being funds received as a result of the repayment of deposits originally made with Glitnir and Landsbanki banks. KCC received EUR5.1m from the sale and in July sold the Euros realising £4.6m. These funds were used for the investment in the CCLA fund.
15. As at October 2008 KCC had deposits (principal and interest) totalling £51.99m outstanding with Icelandic Banks. The total amount recovered by KCC now totals £52.6m, some £600k higher than the original claim. £372k remains outstanding from Heritable bank and settlement of this claim is subject to the resolution of a dispute concerning a property portfolio.

STATEMENT OF INVESTMENTS

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

BORROWING

17. At 30 June 2017 the Council held £965.5m of loans, unchanged from the balance as at 31 March 2017, as part of its strategy for funding previous years' capital programmes. The following table shows the borrowing analysed by lender.

	30/6/2017 Balance £m	Average Rate %	Average Life (yrs)
Public Works Loan Board	504.3	5.7	16.8
Banks (LOBO)	160.0	4.0	43.6
Banks and other lenders (Fixed Term)	301.2	4.2	39.5
Total borrowing	965.5	5.0	28.3

18. 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.
19. 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.
20. 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. The total value of these loans fell to £150m at the end of August as the result of RBS' decision to waive its options on a £10m loan agreed

in December 2009, converting it into a fixed rate loan and assigning it to Phoenix Life Assurance Ltd.

RECOMMENDATION

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

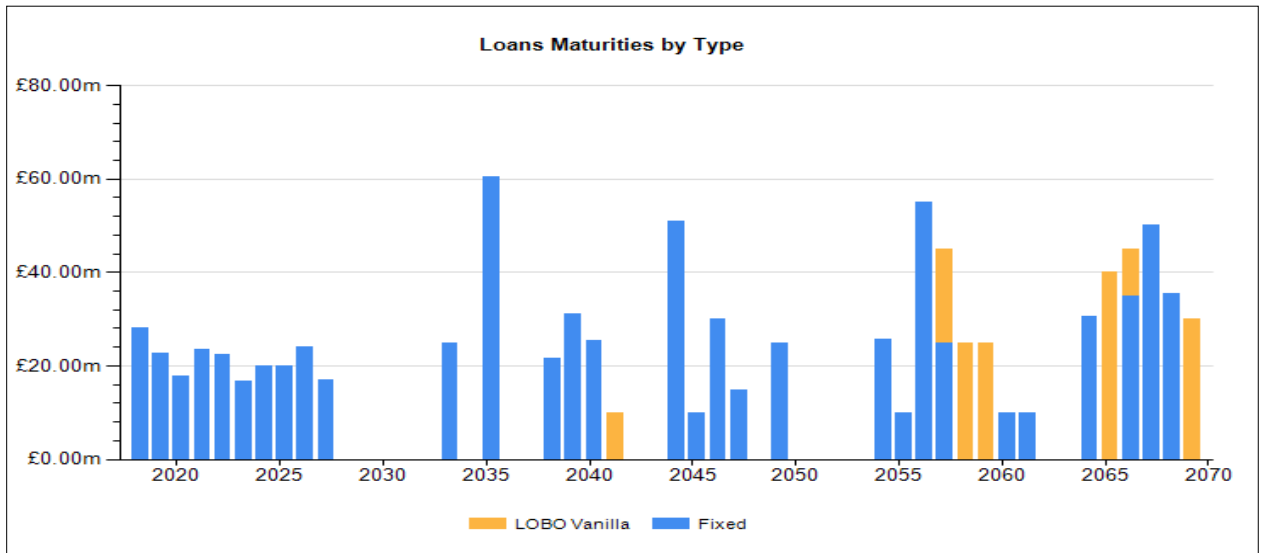
Alison Mings
Treasury and Investments Manager
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Treasury Management Report for the month of August 2017

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 August was £959.7m which includes the Green Investors.

At the end of August the value of outstanding LOBO loans fell to £150m as RBS waived its rights to exercise the Option on a £10m loan agreed in December 2009 and assigned the loan to Phoenix Life Assurance.

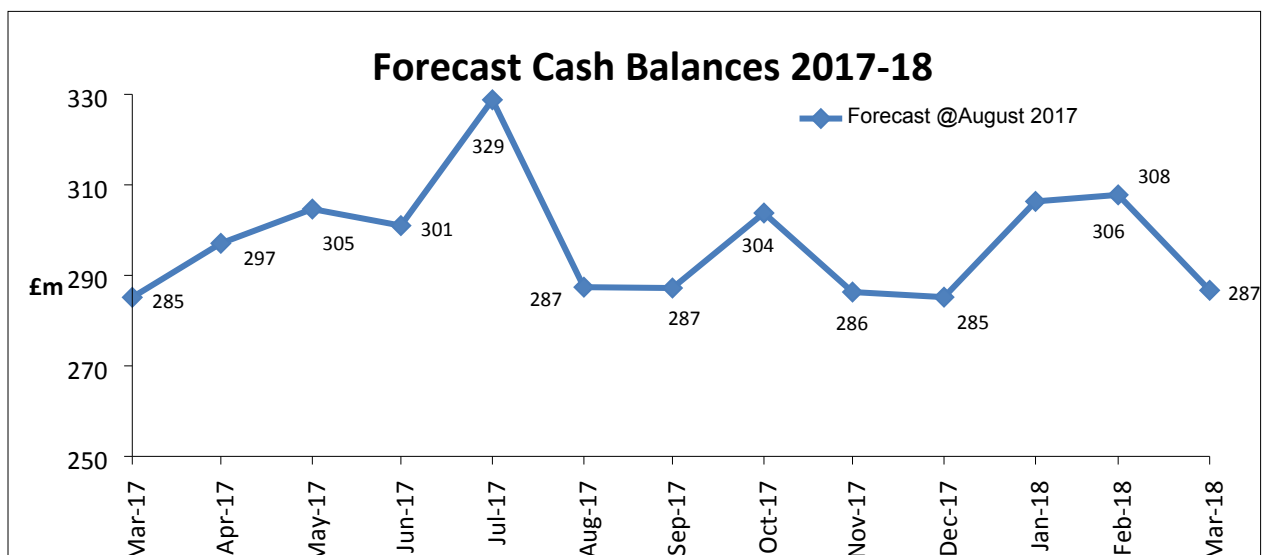


Total external debt managed by KCC includes £36.28m pre-LGR debt managed by KCC on behalf of Medway Council. Also included is pre-1990 debt managed on behalf of Further Education Funding Council (£0.29m), Magistrates Courts (£0.28m).

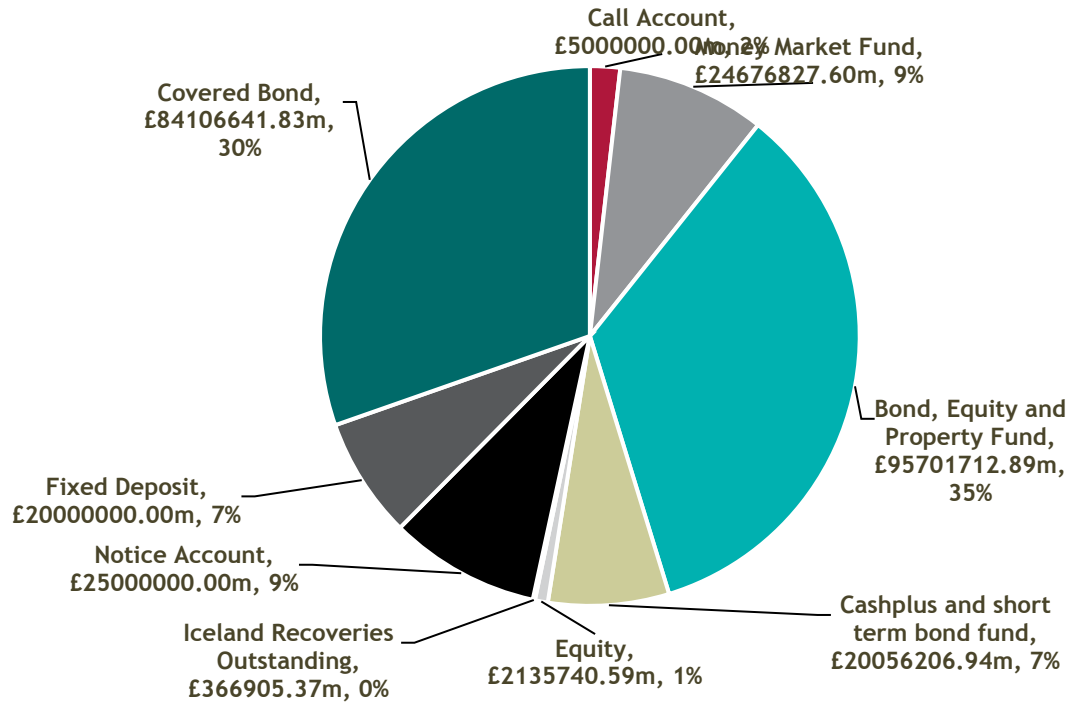
2. Investments

2.1 Cash Balances

During August the value of cash under management decreased by £42m to £287m. Future cashflows are forecast as follows:



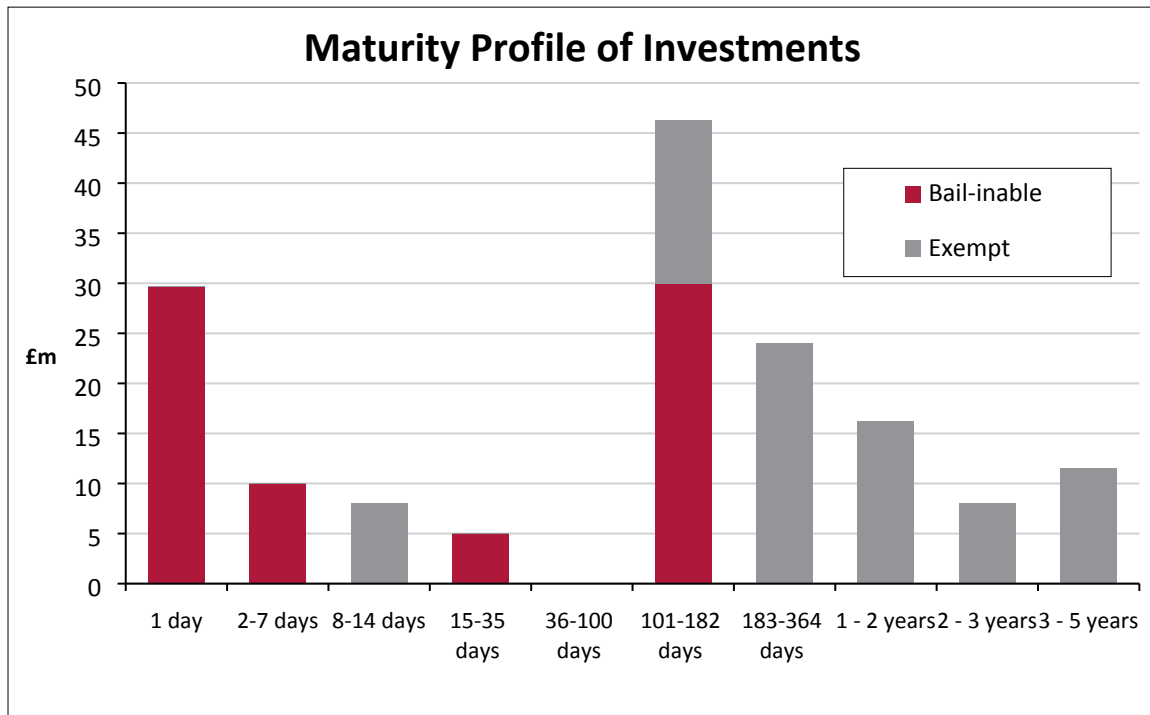
2.2 Type of investment at month end

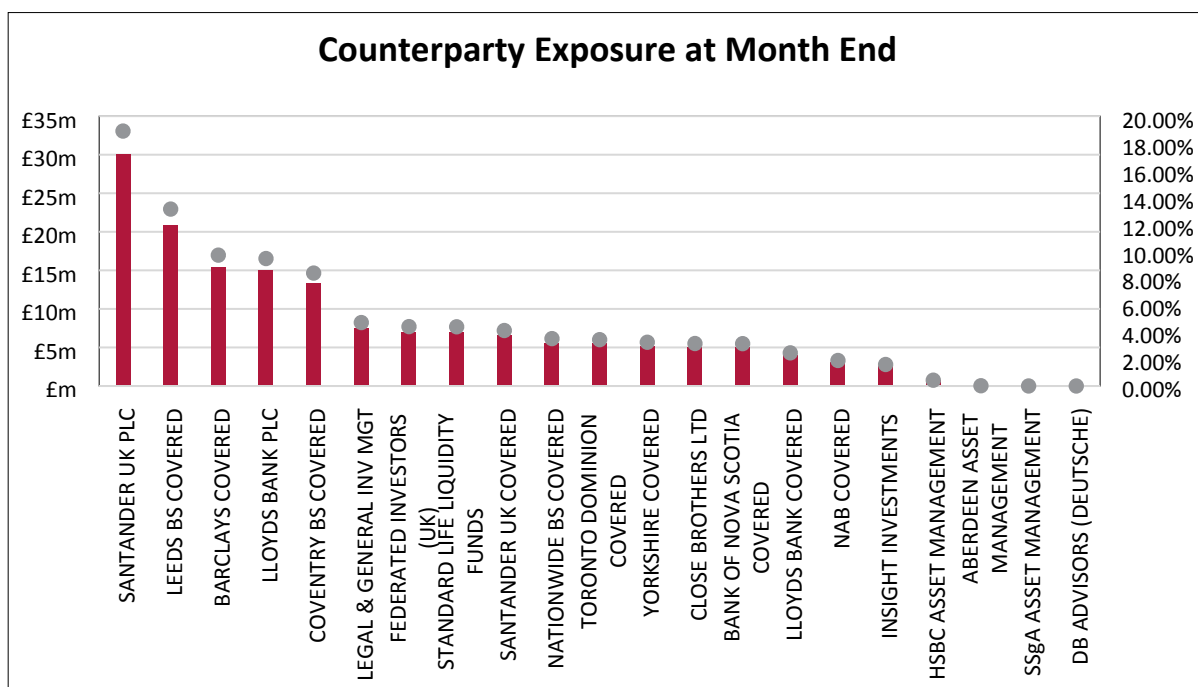


2.3 Internally managed cash

2.3.1 The rate of return on investments held at month end is 0.80% vs the target return 7 day LIBID of 0.1125%.

2.3.2 Investment maturity profile and counterparty exposure





2.3.3 Credit Score matrix

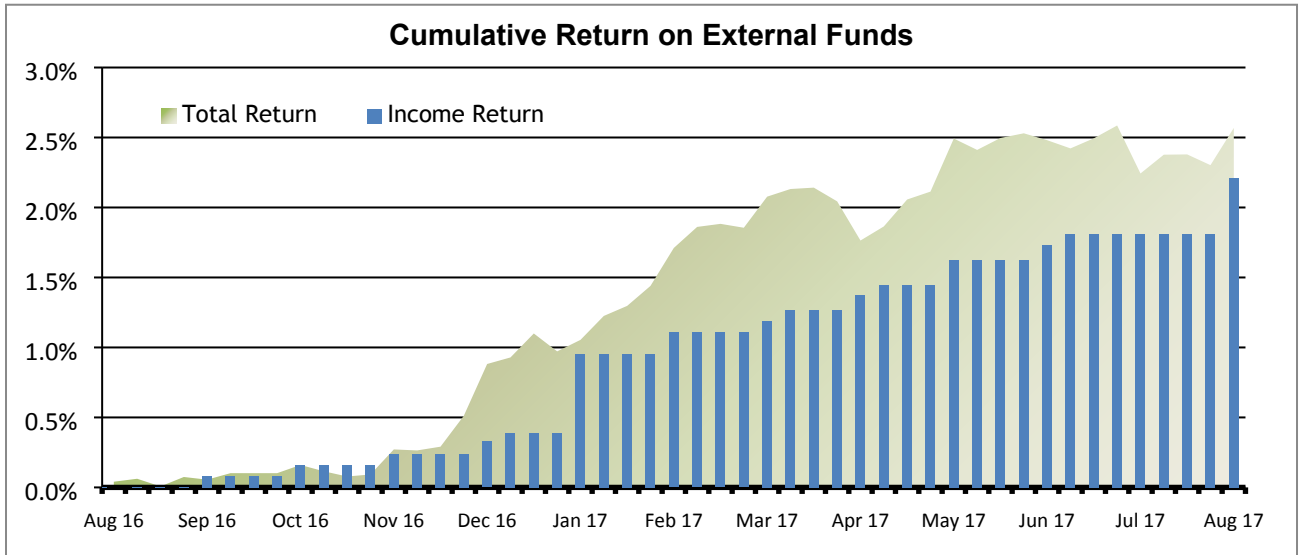
	Credit Rating	Credit Risk Score
Value Weighted Average	AA	2.92
Time Weighted Average	AA+	1.53

3. Externally managed Investments

3.1 At the end of August 42% of total investments were held in externally managed funds following the investment in M&G and Schroder funds. The £20m investment agreed by TMAG in the Columbia Threadneedle funds has been made in September.

	Book cost (£000)	Market Value at 31 August 2017 (£000)	12 months return to 31 August 2017	
			Income	Total
CCLA Property Fund	35,000	35,081	2.92%	3.38%
Pyrford Global Total Return Sterling Fund	5,000	5,123	8.58%	3.05%
Fidelity Multi Asset Income Fund	25,000	25,940	2.74%	6.50%
Schroder Income Maximiser Fund	20,000	19,409	1.80%	-1.16%
M&G Global Dividend Fund	10,000	10,148	0.00%	1.48%
Cashplus / Short Term Bond Funds	20,000	20,056	0.09%	0.37%
Bond, Equity and Property Funds	115,000	115,757	2.21%	2.57%

3.2 The following chart tracks the returns earned over the 12 months to end August.



Alison Mings
Treasury and Investments Manager
20 September 2017

Investments as at 31st August 2017

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	Lloyds Bank	£5,000,000	1.00%	29/02/2017
Fixed Deposit	Lloyds Bank	£5,000,000	0.90%	08/02/2018
Fixed Deposit	Lloyds Bank	£5,000,000	1.00%	05/09/2017
Fixed Deposit	Close Brothers	£5,000,000	0.40%	04/09/2017
Same Day Call	Santander UK	£5,000,000	0.15%	n/a
180 Day Call Notice Account	Santander UK	£25,000,000	0.90%	n/a
Total UK Bank Deposits		£50,000,000		
Money Market Fund	Aberdeen Sterling Liquidity Fund	£31,761	0.14% (variable)	n/a
Money Market Fund	Deutsche Managed Sterling Fund	£1,377	0.13% (variable)	n/a
Money Market Fund	Federated (PR) Short-term GBP Prime Fund	£6,988,415	0.22% (variable)	n/a
Money Market Fund	HSBC Global Liquidity Fund	£684,759	0.16% (variable)	n/a
Money Market Fund	Insight Sterling Liquidity Fund	£2,532,194	0.14% (variable)	n/a
Money Market Fund	LGIM Liquidity Fund	£7,465,903	0.22% (variable)	n/a
Money Market Fund	SSgA GBP Liquidity Fund	£4,745	0.15% (variable)	n/a
Money Market Fund	Standard Life Liquidity Fund	£6,967,673	0.24% (variable)	n/a
Total Money Market Funds		£24,676,828		
Equity and Loan Notes	Kent PFI (Holdings) Ltd	£2,135,741		n/a
Icelandic Recoveries outstanding	Heritable Bank Ltd	£366,905		n/a

1.2 Bond Portfolio

Bond Type	Issuer	Adjusted Principal	Net Yield	Maturity Date
Floating Rate Covered Bond	Abbey National Treasury	£3,001,219	0.462%	29/05/2018
Fixed Rate Covered Bond	Bank Of Nova Scotia	£4,984,225	0.880%	14/09/2021
Floating Rate Covered Bond	Barclays Bank	£5,000,771	0.491%	15/09/2017
Floating Rate Covered Bond	Barclays Bank	£3,000,493	0.491%	15/09/2017
Floating Rate Covered Bond	Barclays Bank	£5,000,760	0.491%	12/02/2018
Floating Rate Covered Bond	Barclays Bank	£2,398,302	0.491%	12/02/2018
Fixed Rate Covered Bond	Coventry Building Society	£2,061,088	1.931%	19/04/2018
Fixed Rate Covered Bond	Coventry Building Society	£3,079,278	1.726%	19/04/2018
Fixed Rate Covered Bond	Coventry Building Society	£5,142,465	1.524%	19/04/2018
Floating Rate Covered Bond	Coventry Building Society	£3,005,696	0.527%	17/03/2020

Floating Rate Covered Bond	Leeds Building Society	£2,500,623	0.539%	09/02/2018
Floating Rate Covered Bond	Leeds Building Society	£2,500,633	0.538%	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	0.626%	17/12/2018
Floating Rate Covered Bond	Leeds Building Society	£5,000,000	0.704%	01/10/2019
Floating Rate Covered Bond	Lloyds	£3,900,583	0.491%	19/01/2018
Floating Rate Covered Bond	Lloyds	£1,402,752	0.601%	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	£3,428,762	0.501%	27/04/2018
Floating Rate Covered Bond	Nationwide Building Society	£2,148,639	0.501%	27/04/2018
Fixed Rate Covered Bond	Santander UK PLC	£3,528,063	0.652%	14/04/2021
Floating Rate Covered Bond	Toronto Dominion	£5,454,397	0.781%	01/02/2019
Fixed Rate Covered Bond	Yorkshire Building Society	£2,054,403	1.976%	12/04/2018
Fixed Rate Covered Bond	Yorkshire Building Society	£3,094,680	1.545%	12/04/2018
Total Bonds		£84,106,642		

Total Internally managed investments	£ 161,286,116
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2. Externally Managed Investments

Investment Fund / Equity	Market Value at 31 August	12 months return to 31 August 2017	
		Income	Total
CCLA LAMIT Property Fund	£35,081,000	2.92%	3.38%
Pyrford Global Total Return Fund	£5,123,000	8.58%	3.05%
Fidelity Multi Asset Income Fund	£25,940,000	2.74%	6.50%
Schroders Income Maximiser Fund	£19,409,000	1.80%	-1.16%
M&G Global Dividend Fund	£10,148,000	0.00%	1.48%
Cashplus / Short Term Bond Funds	£20,056,000	0.09%	0.37%
Total External Investments	£115,757,000		

3. Total Investments

Total Investments	£277,043,116
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