

By: Peter Oakford, Deputy Leader and Cabinet Member for  
Finance and Trading Services  
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To: Governance and Audit Committee – 3 October 2019

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 and developments in 2019-20 up to the end of July.

### **INTRODUCTION**

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 2019-20 was approved by full Council on 14 February 2019.
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. The successful identification, monitoring and control of risk are therefore central to the council's treasury management strategy. This report covers treasury activity and the associated monitoring and control of risk.

### **MONTHLY ACTIVITY REPORT**

5. The Treasury and Investments Manager produces a monthly report for members of the Treasury Management Advisory Group and a copy of the July 2019 report is attached at appendix 1.

### **EXTERNAL CONTEXT**

6. Politics has been a big driver over the last few months with the Brexit deadline being extended to 31 October 2019 and Boris Johnson elected as the new prime minister. The terms on which the UK will leave the EU have still yet to be agreed.
7. The UK Consumer Price Inflation (CPI) for July 2019 was 2.1% year/year, coming in at consensus and meeting the Bank of England's inflation target. The most recent labour market data for the three months to May 2019 showed the unemployment rate remain at a low of 3.8% while the employment rate of 76.0% dipped by 0.1%, the first

quarterly decrease since June to August 2018. The 3-month average annual growth rate for pay excluding bonuses was 3.6% as wages continue to rise steadily and provide some upward pressure on general inflation. Once adjusted for inflation, real wages were up 1.7%.

8. There was a fall in quarterly GDP growth in the second calendar quarter for 2019 of 0.2% having grown by 0.5 in Q1 2019. Services provided a positive contribution, while agriculture, production and construction all contributed negatively.
9. With the deterioration in the wider economic environment, compounded by Brexit-related uncertainty and the risk of a no-deal Brexit, the Bank of England has hinted at the possibility of interest rate cuts, rather than gradual and limited rate hikes.
10. Since the beginning of 2019 markets have rallied, and the FTSE 100 moved up in Q1 2019/20 increasing by around 2%.
11. Gilt yields continued to display significant volatility over the period. The 5-year benchmark gilt yield falling to 0.63% at the end of June from 0.75% at the start of April. There were falls in the 10-year and 20-year gilts over the same period dropping from 1.00% to 0.83% and from 1.47% to 1.35% respectively. Money markets rates stabilised with 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.60%, 0.68% and 0.92% respectively over the period. Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth is also a global risk.
12. Credit Default Swap (CDS) spreads fell slightly across the board during the quarter, continuing to remain low in historical terms. S&P upgraded RBS Group and its subsidiaries, including National Westminster Bank PLC, NatWest Markets PLC, RBS and Ulster Bank Ltd. S&P believes the group and its subsidiaries have enhanced their capacity to manage the current UK political and economic uncertainties. There were minimal other credit rating changes during the period.

## **LOCAL CONTEXT**

13. At 31 March 2019 KCC had net investments of £455m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, known as internal borrowing, in order to reduce risk and keep interest costs low.

## **BORROWING STRATEGY**

14. At 31 July 2019 the Council held £898.98m of loans, a reduction of £7.22m from the balance as at 31 March 2019. Details of this debt is shown in the table at paragraph 1.1 of Appendix 1.
15. 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.

16. 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.
17. 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. No banks exercised their option during the period.

## **INVESTMENT ACTIVITY**

18. The Council's average investment balances to date have amounted to £458m, representing income received in advance of expenditure plus balances and reserves held. These balances are forecast to fluctuate over the coming months ending the year at a lower level reflecting the spend of grants received in advance in 2018-19. as shown the graph at paragraph 2.1 in appendix 1.
19. 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.
20. Security of capital has remained the Council's main investment objective. Against a background of uncertainty and low returns from short-term unsecured bank investments, the Council has continued to hold investments in strategic pooled funds and these represented 34% of total investments at 31 July.
21. Details of the Council's investment position during the 4 months to the end of July is summarised in the table at paragraph 3.2 in appendix 1. The average rate of return on the Council's portfolio for the 4 months to end July was 2.16% which is used to support services in year.

## **STATEMENT OF INVESTMENTS**

22. A statement of investments as at 31 July is attached in Appendix 2. This statement is circulated to members of the Treasury Management Advisory Group with the monthly TM report.

## **READINESS FOR BREXIT**

23. The scheduled date for the UK to leave the EU is now 31 October 2019 and there remains little political clarity as to whether a deal will be agreed by this date, the potential of a no-deal Brexit has not been ruled out. Particularly as this new leave date approaches KCC will ensure there are enough accounts open at UK domiciled banks and Money Market Funds to hold sufficient liquidity and that its account with the Debt Management Account Deposit Facility (DMADF) remains available for use in an emergency.

## **RECOMMENDATION**

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

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

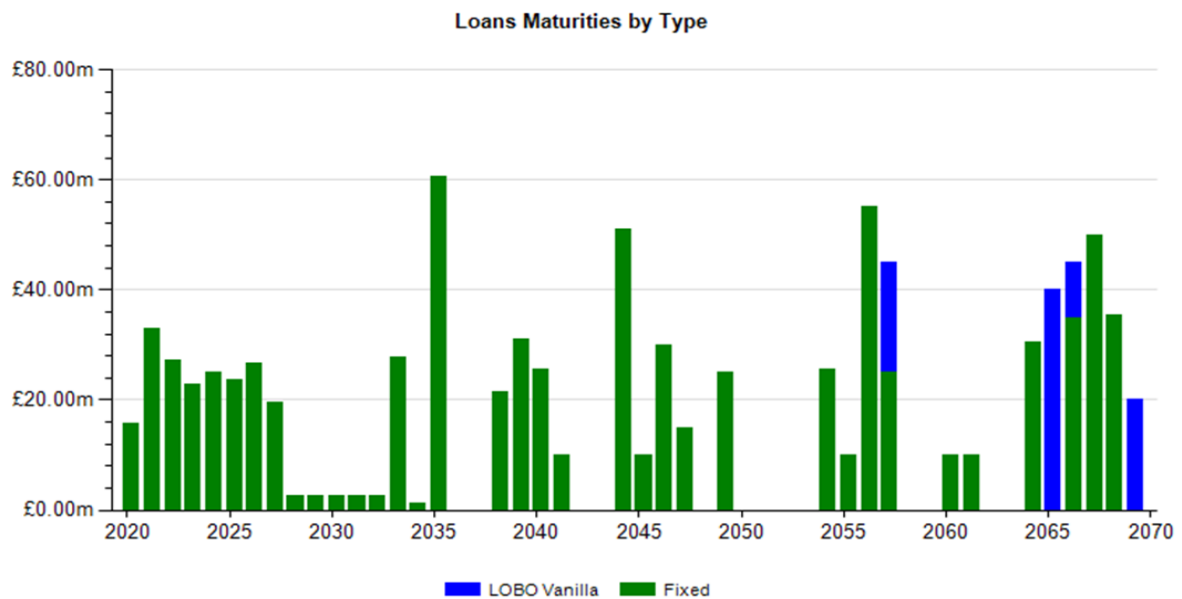
Treasury Management Report for the month of July 2019

1. Borrowing

1.1 The total amount of debt outstanding at the end of July was £899m. The following table shows the borrowing analysed by lender.

	31/03/2019 Balance £m	2019-20 Movement £m	31/07/2019 Balance £m	Average Rate %	Value waited Average Life (yrs)
Public Works Loan Board	490.94	-5.00	485.94	5.00%	16.53
Banks (LOBO)	90.00	0.00	90.00	4.15%	44.55
Banks (Fixed Term)	325.26	-2.22	323.04	4.06%	35.67
<b>Total borrowing</b>	<b>906.20</b>	<b>-7.22</b>	<b>898.98</b>	<b>4.58%</b>	<b>26.21</b>

1.2 The maturity profile of KCC's outstanding debt at 31 July is shown in graphical and tabular format as follows:

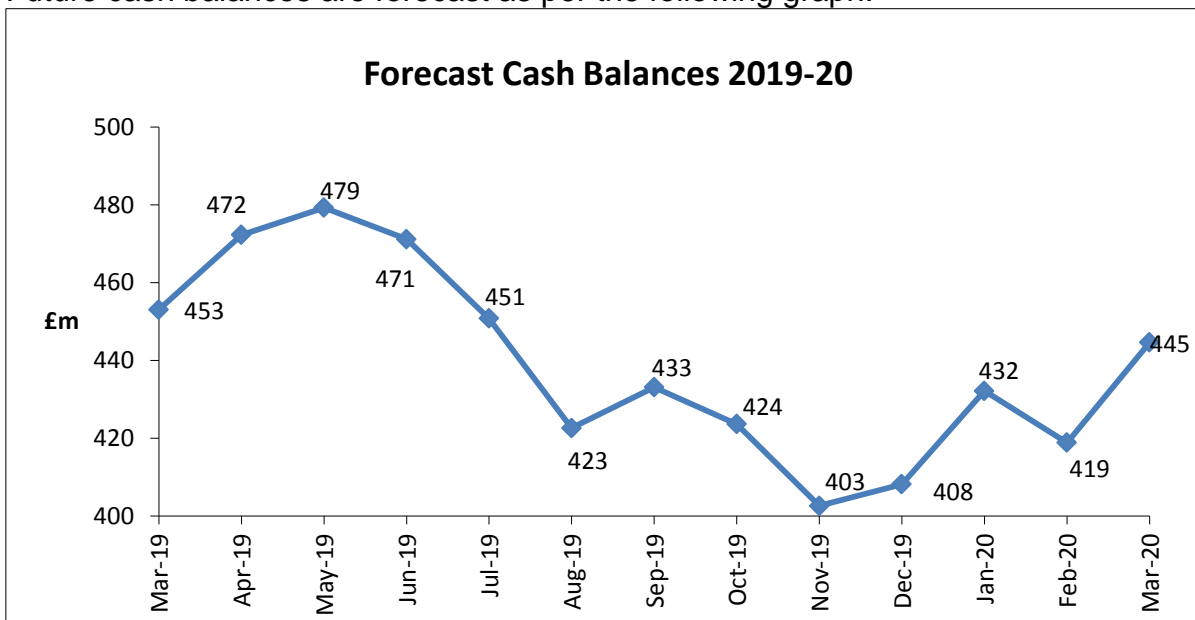


	Principial Maturing £m	Balance Outstanding £m	Percentage of Opening Balance Maturing
Opening Balance 31/07/2019		898.980	
Maturity 0 -5 years	130.546	768.434	14.5%
Maturity 5 -10 years	75.362	693.072	8.4%
Maturity 10-15 years	37.002	656.070	4.1%
Maturity 15 -20 years	112.970	543.100	12.6%
Maturity 20 -25 years	86.500	456.600	9.6%
Maturity 25 -30 years	79.800	376.800	8.9%
Maturity 30 -35 years	25.700	351.100	2.9%
Maturity 35 - 40 years	110.000	241.100	12.2%
Maturity 40 -45 years	50.600	190.500	5.6%
Maturity 45 -50 years	190.500	0.000	21.2%
Total	898.980		

- 1.3 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.
- 1.4 Total long-term debt managed by KCC includes £33.52m pre-LGR debt managed by KCC on behalf of Medway Council.

## 2. Cash Balances

- 2.1 During the month of July, the value of cash under management fell by £20m to £451m reflecting higher than anticipated outflows in respect of normal creditor clearances. Future cash balances are forecast as per the following graph.



## 3. Investments

- 3.1 At the end of July the value of KCC's investments was £451m of which £154m, 34%, was invested in strategic pooled funds.

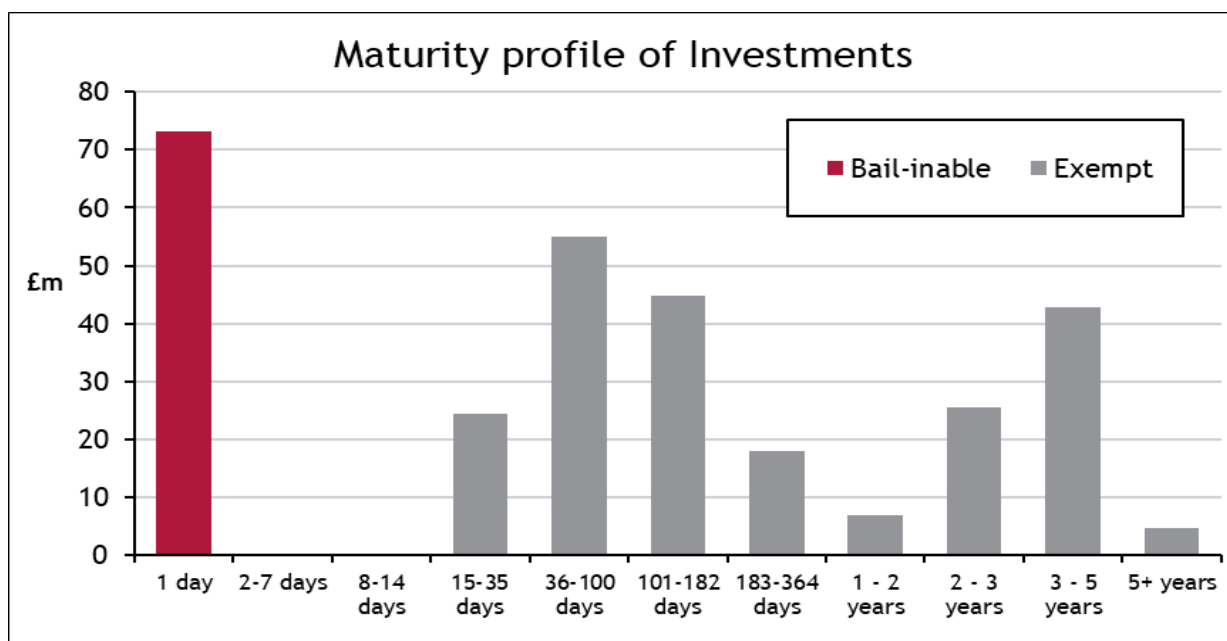
3.2 Details of the investments at the month end as well as the movement in 2019-20 are shown in the following table. A detailed listing of investments at 31 July is at appendix 2.

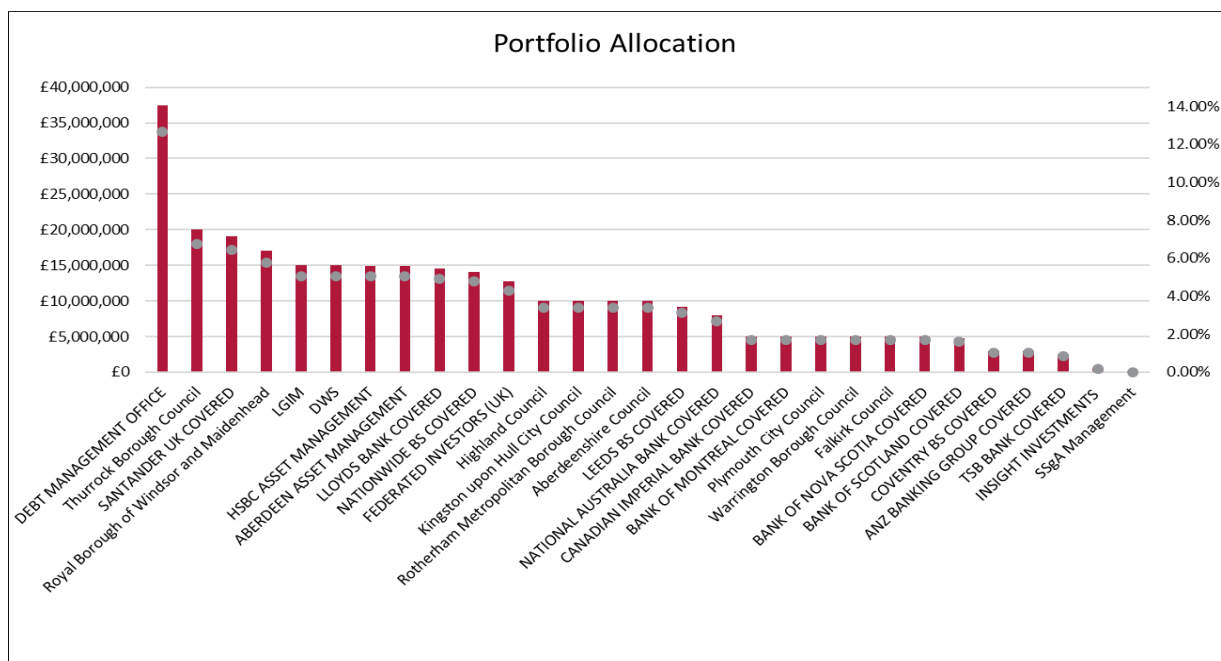
	31-Mar-19	2019-20	31-Jul-19		
	Balance	Movement	Balance	Rate of Return	Average Credit Rating
	£m	£m	£m	%	
Bank Call Accounts	2.0	-2.0	0		
Money Market Funds	92.9	-19.7	73.2	0.73	AA-
Local Authorities	65.0	27.0	92.0	0.92	AA-
Treasury Bills	52.4	-15.0	37.4	0.72	AA
Covered Bonds	90.4	2.6	93.0	1.12	AAA
Icelandic Recoveries o/s	0.4	-	0.4		
Equity	2.1	-	2.1		
<b>Internally managed cash</b>	<b>305.2</b>	<b>-7.1</b>	<b>298.1</b>	<b>0.91</b>	<b>AA</b>
<b>Strategic Pooled Funds</b>	<b>150.0</b>	<b>3.7</b>	<b>153.7</b>	<b>4.57</b>	
<b>Total</b>	<b>455.2</b>	<b>-3.4</b>	<b>451.8</b>	<b>2.16</b>	

### 3.3 Internally managed investments

3.3.1 The rate of return on investments held at month end was 0.91% vs the target return 7-day LIBID of 0.564%.

3.3.2 The maturity profile of KCC's investments and counterparty exposure are shown in the following charts.





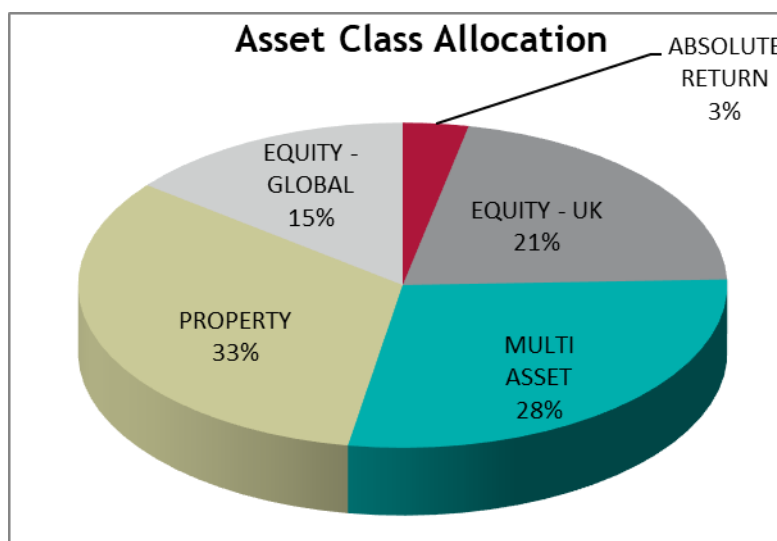
### 3.3.3 Credit Score matrix

The Council's overall credit scores for its internally managed cash are detailed in the following table.

	Credit Rating	Credit Risk Score
Value Weighted Average	AA	3.0
Time Weighted Average	AAA	1.3

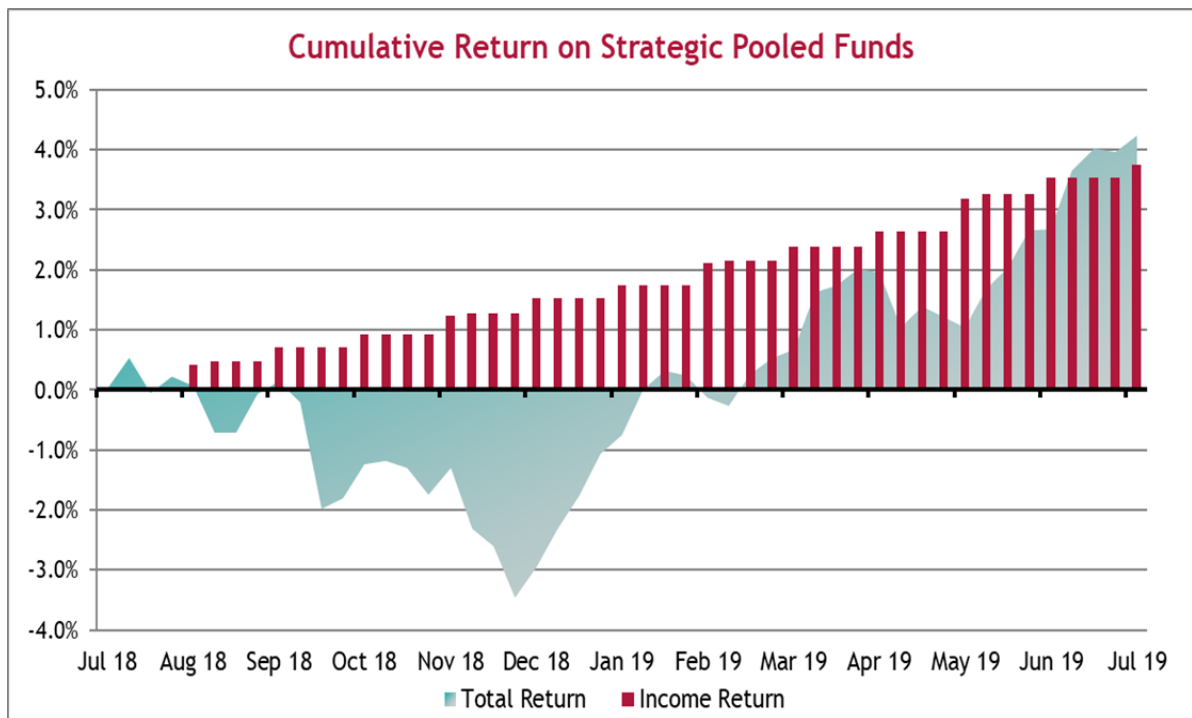
## 4 Strategic Pooled Funds

4.1 A breakdown of the strategic pooled funds by asset class is shown in the following chart.





4.2 The following chart tracks the returns earned on the pooled funds over the 12 months to end July 2019.



## 5. Revenue outturn

5.1 An underspend is forecast against the net debt costs budget (£2.1m) mainly as a result of higher forecast dividends from the externally managed funds.

**Alison Mings**  
**Treasury and Investments Manager**  
**14 August 2019**

## Investments as at 31 July 2019

## 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	Kingston Upon Hull City Council	5,000,000	0.85%	20/12/19
Fixed Deposit	Plymouth City Council	5,000,000	0.80%	10/09/19
Fixed Deposit	Warrington Borough Council	5,000,000	0.82%	18/12/19
Fixed Deposit	Rotherham Metropolitan Borough Council	10,000,000	0.85%	20/08/19
Fixed Deposit	Thurrock Borough Council	10,000,000	0.95%	31/08/19
Fixed Deposit	Falkirk Council	5,000,000	1.00%	05/09/19
Fixed Deposit	Highland Council	5,000,000	1.05%	23/10/19
Fixed Deposit	Highland Council	5,000,000	1.05%	06/01/20
Fixed Deposit	Aberdeenshire Council	10,000,000	0.88%	29/10/19
Fixed Deposit	Royal Borough of Windsor and Maidenhead	5,000,000	0.90%	31/10/19
Fixed Deposit	Royal Borough of Windsor and Maidenhead	10,000,000	0.92%	08/11/19
Fixed Deposit	Royal Borough of Windsor and Maidenhead	2,000,000	0.79%	22/08/19
Fixed Deposit	Kingston Upon Hull City Council	5,000,000	0.85%	20/01/20
Fixed Deposit	Thurrock Borough Council	10,000,000	1.07%	29/05/20
<b>Total Local Authority Deposits</b>		<b>92,000,000</b>		
Treasury Bill	DMO	4,982,699	0.72%	25/11/19
Treasury Bill	DMO	9,964,227	0.72%	09/12/19
Treasury Bill	DMO	9,964,176	0.73%	25/11/19
Treasury Bill	DMO	9,982,578	0.70%	28/10/19
Treasury Bill	DMO	2,528,429	0.76%	27/08/19
<b>Total Govt Deposits</b>		<b>37,422,109</b>		
Money Market Fund	Aberdeen Sterling Liquidity Fund	14,946,631	0.75%	n/a
Money Market Fund	Deutsche Managed Sterling Fund	14,984,355	0.75%	n/a
Money Market Fund	Federated (PR) Short-term GBP Prime Fund	12,737,537	0.75%	n/a
Money Market Fund	HSBC Global Liquidity Fund	14,954,991	0.68%	n/a
Money Market Fund	Insight Liquidity Funds PLC	543,663	0.67%	n/a
Money Market Fund	LGIM Sterling Liquidity Fund	14,994,973	0.72%	n/a
Money Market Fund	SSgA GBP Liquidity Fund	10,885	0.67%	n/a
<b>Total Money Market Funds</b>		<b>73,173,035</b>		
<b>Equity and Loan Notes</b>	Kent PFI (Holdings) Ltd	<b>£2,135,741</b>		n/a

<b>Icelandic Recoveries outstanding</b>	Heritable Bank Ltd	<b>£366,905</b>		n/a
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## 1.2 Bond Portfolio

<b>Bond Type</b>	<b>Issuer</b>	<b>Adjusted Principal £</b>	<b>Coupon Rate</b>	<b>Maturity Date</b>
Floating Rate Covered Bond	Australia and New Zealand Banking group	3,000,000	1.39%	24/01/22
Floating Rate Covered Bond	Bank of Montreal	5,005,028	1.02%	17/04/23
Fixed Rate Covered Bond	Bank of Nova Scotia	4,990,619	0.88%	14/09/21
Fixed Rate Covered Bond	Bank of Scotland	4,703,496	1.71%	20/12/24
Floating Rate Covered Bond	Canadian Imperial Bank of Commerce	5,030,580	0.96%	10/01/22
Floating Rate Covered Bond	Coventry Building Society	3,001,558	1.02%	17/03/20
Floating Rate Covered Bond	Leeds Building Society	5,000,000	1.18%	01/10/19
Fixed Rate Covered Bond	Leeds Building Society	4,206,223	1.29%	17/04/23
Floating Rate Covered Bond	Lloyds	4,500,000	1.31%	14/01/22
Floating Rate Covered Bond	Lloyds	2,502,747	0.99%	27/03/23
Floating Rate Covered Bond	Lloyds	2,503,666	0.98%	27/03/23
Floating Rate Covered Bond	Lloyds	5,006,474	0.98%	27/03/23
Fixed Rate Covered Bond	National Australia Bank	4,971,050	1.35%	10/11/21
Fixed Rate Covered Bond	National Australia Bank	3,001,889	1.10%	10/11/21
Floating Rate Covered Bond	Nationwide Building Society	4,504,528	1.00%	12/04/23
Floating Rate Covered Bond	Nationwide Building Society	5,587,041	0.98%	12/04/23
Floating Rate Covered Bond	Nationwide Building Society	3,999,236	1.42%	10/01/24
Fixed Rate Covered Bond	Santander UK	5,006,977	0.94%	05/05/20
Floating Rate Covered Bond	Santander UK	3,751,775	0.96%	13/04/21
Floating Rate Covered Bond	Santander UK	3,265,748	0.65%	14/04/21
Floating Rate Covered Bond	Santander UK	5,003,042	1.02%	16/11/22
Floating Rate Covered Bond	Santander UK	2,003,206	1.40%	12/02/24
Floating Rate Covered Bond	TSB	2,503,995	1.54%	15/02/24
<b>Total Bonds</b>		<b>93,048,878</b>		

<b>Total Internally managed investments</b>	<b>£ 298,146,670</b>
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## 2. Externally Managed Investments

Investment Fund	Book Cost £	Market Value at 31 July 2019 £	12 months return to 31 July 2019	
			Income	Total
CCLA - Diversified Income Fund	5,000,000	5,204,801	3.32%	6.92%
CCLA – LAMIT Property Fund	50,000,000	50,490,581	4.19%	4.00%
Fidelity Global Multi Asset Income Fund (purchased 20 March 2019)	25,038,637	27,547,469	1.88%	11.90%
Fidelity Multi Asset Income Fund (sold 20 March 2019)		0	2.49%	1.89%
Kames Diversified Monthly Income Fund	10,000,000	10,662,144	3.19%	9.82%
M&G Global Dividend Fund	10,000,000	11,433,461	3.04%	7.32%
Pyrford Global Total Return Sterling Fund	5,000,000	5,014,126	1.83%	3.13%
Schroder Income Maximiser Fund	25,000,000	22,796,118	7.03%	-4.15%
Threadneedle Global Equity Income Fund	10,000,000	10,780,538	3.30%	9.62%
Threadneedle UK Equity Income Fund	10,000,000	9,767,931	3.83%	-1.33%
<b>Total External Investments</b>	<b>150,038,637</b>	<b>153,697,169</b>	<b>4.57%</b>	<b>5.06%</b>

## 3. Total Investments

<b>Total Investments</b>	<b>£451,843,839</b>
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