

By: Peter Oakford, Deputy Leader and Cabinet Member for Finance, Traded and Corporate Services
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To: County Council – 19 March 2020

Subject: **TREASURY MANAGEMENT 6 MONTH REVIEW 2019-20**

Classification: Unrestricted

Summary: To present a review of Treasury Management Activity 2019-20 to date

FOR DECISION

INTRODUCTION

1. This report covers Treasury Management activity for the 6 months to 30 September 2019 and developments in the period since up to the date of this report.
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 therefore ensures this council is embracing Best Practice in accordance with CIPFA's recommendations.
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. This report covers treasury activity and the associated monitoring and control of risk.

GOVERNANCE

5. The Corporate Director Finance is responsible for the Council's treasury management operations and day to day responsibility is delegated to the Head of Finance (Policy, Planning & Strategy) / Head of Finance (Operations) and Treasury and Investments Manager. The detailed responsibilities are set out in the Council's Treasury Management Practices.
6. Council will agree the Treasury Management Strategy and receives annual and half yearly reports on treasury management activity. Governance and Audit Committee receives annual and half-yearly reports and makes recommendations to County Council. It also receives quarterly updates. The Treasury and Investments Manager produces a monthly report for members of the Treasury Management Advisory Group.

EXTERNAL CONTEXT

8. UK Consumer Price Inflation (CPIH) fell to 1.5% year/year in November 2019 from 2.0% in July, below the Bank of England's target. The most recent labour market data for the three months to October 2019 showed the unemployment rate at 3.8% unchanged from the previous quarter while the employment rate was 76.1%, slightly higher than the previous quarter. The 3-month average annual growth rate for pay excluding bonuses dipped to 3.2% while adjusting for inflation real wages were up 1.8%.
9. Quarterly GDP increased by 0.4% in Q3 2019 having contracted by 0.2% in Q2 2019, services and construction provided a positive contribution while agriculture contributed negatively.
10. Politics, both home and abroad, continued to be a big driver of financial markets over the period to end November. The issue of Brexit continued to dominate in the UK. After Boris Johnson became leader of the Conservative party he committed to the UK leaving the EU on 31 October however the date of leaving was then further delayed to 31 January 2020. The global economy is entering a period of slower growth in response to political issues, including the trade policy stance of the US. Some positivity on the trade negotiations between China and the US has however prompted worst case economic scenarios to be pared back.
11. The Bank of England maintained Bank Rate at 0.75% though gilt yields remained volatile over the period on the back of ongoing economic and political uncertainty. From a yield of 0.63% at the end of June, the 5-year benchmark gilt yield fell to 0.32% by the end of September. There were falls in the 10-year and 20-year gilts over the same period, with the former dropping from 0.83% to 0.55% and the latter falling from 1.35% to 0.88%. 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.65%, 0.75% and 1.00% respectively over the period.
12. KCC has previously raised the majority of its long-term borrowing from the PWLB but the government increased PWLB rates by 100 basis points in October 2019. The new margin above gilts is now 180 basis points for certainty rate loans. Early repayment rate margins were unchanged.
13. After rallying early in 2019, financial markets have been adopting a more risk-off approach in the following period as equities saw greater volatility and bonds rallied (prices up, yields down) in a flight to quality and anticipation of more monetary stimulus from central banks. The Dow Jones, FTSE 100 and FTSE 250 are broadly back at the same levels seen in March/April.

LOCAL CONTEXT

1. 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.

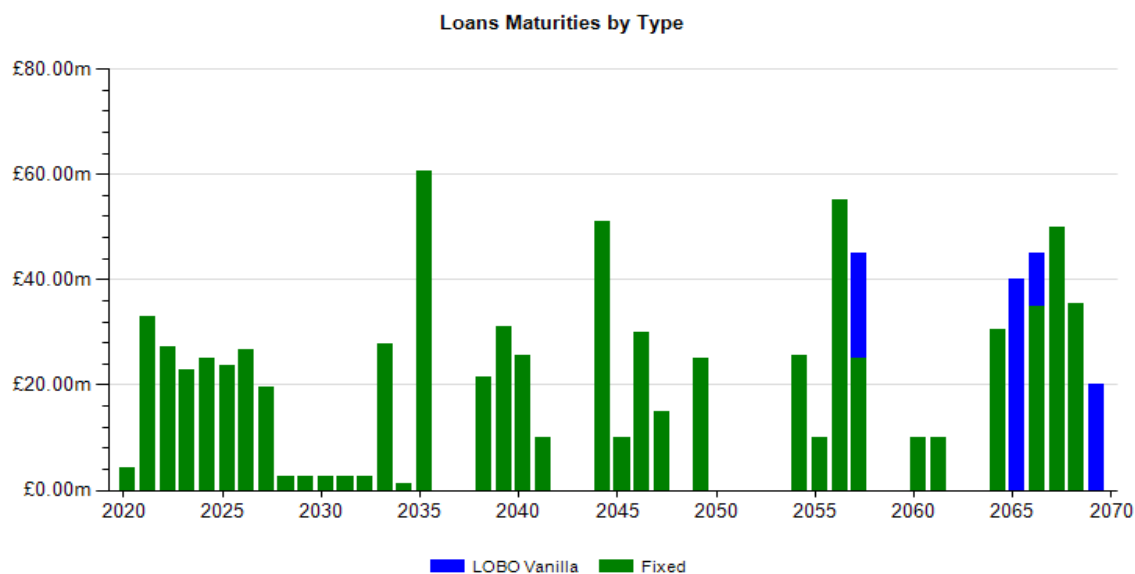
BORROWING ACTIVITY

2. At 30 November 2019 the Council had total debt outstanding of £888m, a reduction of £18.66m from the balance as at 31 March 2019. Outstanding loans at 30 November are summarised in the table below.

	31/03/2019 Balance £m	2019-20 Movement £m	30/11/2019		
			Balance £m	Average Rate %	Value weighted Average Life (yrs)
Public Works Loan Board	490.94	-15.33	475.61	4.96%	16.67
Banks (LOBO)	90.00	0.00	90.00	4.15%	44.38
Banks (Fixed Term)	325.26	-3.33	321.93	4.08%	35.61
Total borrowing	906.20	-18.66	887.54	4.56%	26.35

Borrowing Position

3. The maturity profile of KCC's outstanding debt is as follows:



4. The following table shows the maturity profile of KCC's debt in 5 year tranches.

Loan Principal Maturity Period	Total Loan Principal Maturing	Balance of Loan Principal Outstanding
Opening Balance 30/11/2019		£887,541,233
Maturity 0 - 5 years	£113,502,341	£774,038,892
Maturity 5 - 10 years	£77,060,833	£696,978,059

Maturity 10 - 15 years	£38,700,173	£658,277,886
Maturity 15 - 20 years	£114,668,374	£543,609,512
Maturity 20 - 25 years	£87,009,512	£456,600,000
Maturity 25 - 30 years	£79,800,000	£376,800,000
Maturity 30 - 35 years	£35,700,000	£341,100,000
Maturity 35 - 40 years	£100,000,000	£241,100,000
Maturity 40 - 45 years	£50,600,000	£190,500,000
Maturity 45 - 50 years	£190,500,000	£0
Total	£887,541,233	

5. 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.
6. In keeping with these objectives no new borrowing was undertaken and £15m of existing loans were allowed to mature without replacement.
7. With short-term interest rates remaining much lower than long-term rates, KCC has considered it to be more cost effective in the near term to use internal resources or borrowed short term loans instead. The Council's strategy has enabled it to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.
8. 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 at 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

9. The Council holds significant invested funds representing income received in advance of expenditure plus balances and reserves held. During the period the Council's investment balance ranged between £383m and £538m due to timing differences. The investment position is shown below.

	31/03/2019	2019-20	30/11/2019		
	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	-49.4	43.5	0.71	AA-
Local Authorities	65.0	10.0	75.0	0.89	AA-

Treasury Bills	52.4	-52.4	0		AA
Covered Bonds	90.4	-2.4	88.0	1.12	AAA
Icelandic Recoveries o/s	0.4	-	0.4		
Equity	2.1	-	2.1		
Internally managed cash	305.2	-96.2	209.0	0.95	AA
Strategic Pooled Funds	150.0	19.1	179.9	4.98	
Total	455.2	-66.3	388.9	2.83	

Investment Position

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. In furtherance of these objectives and given the increasing risk and low 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 2019-20.
12. A detailed schedule of KCC's investments as at 30 November 2019 is attached in Appendix 1. This schedule is circulated to members of the Treasury Management Advisory Group with the monthly TM report.

Benchmarking at 30 September 2019

13. The Council's treasury advisor, Arlingclose, monitors the risk and return of some 130 local authority investment portfolios. The metrics over the 6 months to 30 September 2019 extracted from their quarterly investment benchmarking, per the table below, show that we have marginally reduced the risk within the Kent internally managed funds while maintaining the return and that this risk is lower than that of other local authorities.

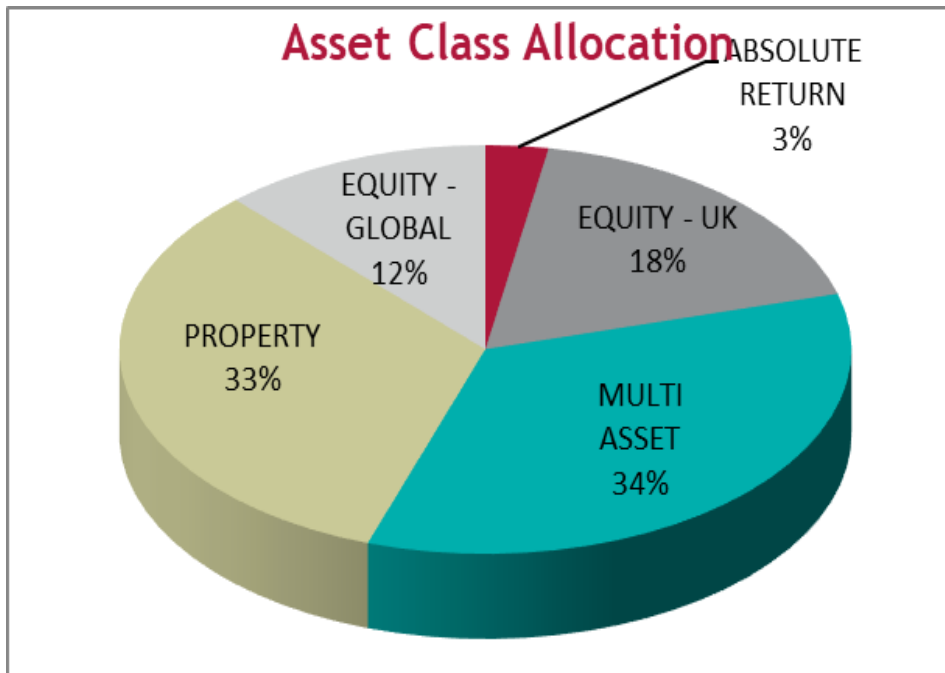
Internally managed investments	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
Kent - 31.03.2019	3.02	AA	31%	381	0.92
Kent - 30.09.2019	2.81	AA	22%	375	0.90
Similar LAs	3.97	AA-	54%	751	0.97
All LAs	4.28	AA-	62%	28	0.83

14. The following table shows that overall KCC's investments are achieving a strong return compared with that of other local authorities.

Strategic Funds at 30.09.2019	Rate of Return %	
	Income only	Total
Kent	4.53	4.23
Similar LAs	3.92	3.50
All LAs	3.68	3.32
Total Investments at 30.09.2019	Income Only	Total
Kent	2.19	2.09
Similar LAs	1.44	1.30
All LAs	1.34	1.22

Strategic Pooled Funds

15. The strategic investment funds have no defined maturity date, rather they are available for withdrawal after a notice period. Their performance and continued suitability in meeting the Council's investment objectives is regularly reviewed. Investment in these funds has been increased in 2019-20 in light of their performance and the Council's latest cash flow forecasts.
16. A breakdown of the pooled funds by asset class is as follows:



READINESS FOR BREXIT

17. The scheduled date for the UK to leave the EU is now 31 January 2020 and as this 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.

ACTUAL AND FORECAST OUTTURN

18. Over the 8 months to end November the Council's investments generated an average total return of 2.83%, comprising a 2.55% income return which is used to support services in year, and 0.28% of capital gains.
19. It is anticipated that there will be an underspend against the net debt costs budget for the year of £2.4m as a result of higher dividends and interest receipts. Average cash balances during the year are forecast to be £426m earning an average income return of 2.4%.
20. The forecast average rate of debt interest payable in 2019-20 is 4.58%, based on an average debt portfolio of £875.2m.

COMPLIANCE

21. The Corporate Director of Finance reports that all treasury management activities undertaken during the quarter complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

Treasury Management Indicators

22. The Council measures and manages its exposures to treasury management risks using the following indicators.
23. **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its internally managed investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Credit risk indicator	Actual 30/09/2019	Target
Portfolio average credit rating	AA	AA

24. **Liquidity:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

Liquidity risk indicator	Actual 30/09/2019	Target
Total cash available within 3 months	£140m	£110m

25. **Interest rate exposures:** This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	Actual 30/09/2019	Upper Limit
One-year revenue impact of a 1% <u>rise</u> in interest rates	-£200k	£10m
One-year revenue impact of a 1% <u>fall</u> in interest rates	-£900k	-£10m

26. **Maturity structure of borrowing:** This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

	Actual 30/09/2019	Upper limit	Lower limit
Under 12 months	0.49%	100%	0%
12 months and within 5 years	12.31%	50%	0%
5 years and within 10 years	8.68%	50%	0%
10 years and within 20 years	17.28%	50%	0%
20 years and within 40 years	34.08%	50%	0%
40 years and longer	27.16%	50%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

27. **Principal sums invested for periods longer than a year:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price risk indicator	Actual	Limit		
	30/09/2019	2019/20	2020/21	2021/22
Principal invested beyond year end	£256m	£300m	£300m	£300m

RECOMMENDATION

28. Members are asked to consider and comment on the report.

Alison Mings
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22 January 2020

Investments as at 30 November 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	Warrington Borough Council	5,000,000	0.82%	18/12/19
Fixed Deposit	Highland Council	5,000,000	1.05%	06/01/20
Fixed Deposit	Royal Borough of Windsor and Maidenhead	5,000,000	0.95%	30/04/20
Fixed Deposit	Royal Borough of Windsor and Maidenhead	10,000,000	0.95%	07/05/20
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
Fixed Deposit	Thurrock Borough Council	10,000,000	0.81%	30/04/20
Fixed Deposit	Blackburn with Darwen Borough Council	5,000,000	0.87%	27/02/20
Fixed Deposit	Conwy County Borough Council	5,000,000	0.75%	31/03/20
Fixed Deposit	Rotherham Metropolitan Borough Council	£10,000,000	0.78%	23/04/20
Total Local Authority Deposits		75,000,000		
Money Market Fund	Aberdeen Sterling Liquidity Fund	12,601,055	0.73%	n/a
Money Market Fund	Deutsche Managed Sterling Fund	10,622,467	0.71%	n/a
Money Market Fund	Federated (PR) Short-term GBP Prime Fund	16,716,362	0.73%	n/a
Money Market Fund	HSBC Global Liquidity Fund	552	0.66%	n/a
Money Market Fund	Insight Liquidity Funds PLC	13,615	0.67%	n/a
Money Market Fund	LGIM Sterling Liquidity Fund	3,493,128	0.70%	n/a
Money Market Fund	SSgA GBP Liquidity Fund	8,915	0.66%	n/a
Total Money Market Funds		43,456,095		
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 £	Coupon Rate	Maturity Date
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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	5,004,690	1.04%	17/04/23
Fixed Rate Covered Bond	Bank of Nova Scotia	4,993,773	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	5,027,505	0.95%	10/01/22
Floating Rate Covered Bond	Coventry Building Society	3,001,035	1.01%	17/03/20
Fixed Rate Covered Bond	Leeds Building Society	4,205,814	1.29%	17/04/23
Floating Rate Covered Bond	Lloyds	4,500,000	1.31%	14/01/22
Floating Rate Covered Bond	Lloyds	2,503,420	0.97%	27/03/23
Floating Rate Covered Bond	Lloyds	2,502,563	0.98%	27/03/23
Floating Rate Covered Bond	Lloyds	5,006,040	0.98%	27/03/23
Fixed Rate Covered Bond	National Australia Bank	4,978,564	1.35%	10/11/21
Fixed Rate Covered Bond	National Australia Bank	3,001,266	1.10%	10/11/21
Floating Rate Covered Bond	Nationwide Building Society	4,504,217	1.02%	12/04/23
Floating Rate Covered Bond	Nationwide Building Society	5,586,421	1.00%	12/04/23
Floating Rate Covered Bond	Nationwide Building Society	3,998,847	1.42%	10/01/24
Floating Rate Covered Bond	Santander UK	5,003,488	0.93%	05/05/20
Floating Rate Covered Bond	Santander UK	3,751,521	0.98%	13/04/21
Fixed Rate Covered Bond	Santander UK	3,265,748	0.65%	14/04/21
Floating Rate Covered Bond	Santander UK	5,002,600	1.00%	16/11/22
Floating Rate Covered Bond	Santander UK	2,002,868	1.40%	12/02/24
Floating Rate Covered Bond	TSB	2,503,572	1.54%	15/02/24
Total Bonds		88,047,449		

Total Internally managed investments	209,006,190
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2. Externally Managed Investments

Investment Fund	Book Cost £	Market Value at 30 November 2019 £	12 months return to 30 November 2019	
			Income	Total
CCLA - Diversified Income Fund	5,000,000	5,231,571	3.33%	8.39%

CCLA – LAMIT Property Fund	60,000,000	59,094,964	3.56%	0.54%
Fidelity Global Multi Asset Income Fund (purchased 20 March 2019)	25,038,637	25,990,006	3.36%	7.16%
Fidelity Multi Asset Income Fund (sold 20 March 2019)		0	1.12%	2.92%
Investec Diversified Income	10,000,000	9,999,852	0.30%	0.30%
Kames Diversified Monthly Income Fund	20,000,000	20,982,227	2.51%	7.42%
M&G Global Dividend Fund	10,000,000	11,156,139	3.23%	8.65%
Pyrford Global Total Return Sterling Fund	5,000,000	4,974,449	2.29%	3.68%
Schroder Income Maximiser Fund	25,000,000	22,173,683	7.57%	1.49%
Threadneedle Global Equity Income Fund	10,000,000	10,352,353	3.46%	9.28%
Threadneedle UK Equity Income Fund	10,000,000	9,951,822	4.23%	10.10%
Total External Investments	180,038,637	179,907,065	4.39%	4.98%

3. Total Investments

Total Investments	£388,913,256
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GLOSSARY

Local Authority Treasury Management Terms

Bond	A certificate of long-term debt issued by a company, government, or other institution, which is tradable on financial markets
CET 1	Core equity tier 1 - the purest form of capital for a financial institution, which is available to absorb losses while it remains a going concern, usually expressed as a ratio to risk weighted assets.
CFR	Capital Financing Requirement. A local authority's underlying need to hold debt for capital purposes, representing the cumulative capital expenditure that has been incurred but not yet financed. The CFR increases with capital expenditure and decreases with capital finance and MRP.
Covered bond	Bond issued by a financial institution that is secured on that institution's assets, usually residential mortgages, and is therefore lower risk than unsecured bonds. Covered bonds are exempt from bail-in.
CPI	Consumer Price Index - the measure of inflation targeted by the Monetary Policy Committee, measured on a harmonised basis across the European Union
FTSE	Financial Times stock exchange – a series of indices on the London Stock Exchange. The FTSE 100 is the index of the largest 100 companies on the exchange, the FTSE 250 is the next largest 250 and the FTSE 350 combines the two
GDP	Gross domestic product – the value of the national aggregate production of goods and services in the economy. Increasing GDP is known as economic growth.
IFRS	International Financial Reporting Standards, the set of accounting rules in use by UK local authorities since 2010
IMF	International Monetary Fund
LOBO	Lender's Option Borrower's option
MMF	Money Market Funds. A collective investment scheme which invests in a range of short-term assets providing high credit quality and high liquidity. Usually refers to CNAV and LVNAV funds with a WAM under 60 days which offer instant access, but the European Union definition extends to include cash plus funds
Monetary Policy	Measures taken by central banks to boost or slow the economy, usually via changes in interest rates. Monetary easing refers to cuts in interest rates, making it cheaper for households and businesses to borrow and hence spend more, boosting the economy, while monetary tightening refers to the opposite. See also fiscal policy and quantitative easing.
MPC	Monetary Policy Committee. Committee of the Bank of England responsible for implementing monetary policy in the UK by changing Bank Rate and quantitative easing with the aim of keeping CPI inflation at around 2%.
MRP	Minimum Revenue Provision – an annual amount that local authorities are required to set aside and charge to revenue for the repayment of debt associated with capital expenditure. Local authorities are required by law to have regard to government guidance on MRP. Not applicable in Scotland, but see Loans Fund
Municipal	Bond issued or guaranteed by local authorities.

bond	
Municipal bond Agency	Company that issues bonds in the capital market and lends the proceeds back to local authorities. The bonds are guaranteed by the local authorities
Pooled Fund	Scheme in which multiple investors hold units or shares. The investment assets in the fund are not held directly by each investor, but as part of a pool (hence these funds are also referred to as 'pooled funds').
Prudential Code	Developed by CIPFA and introduced in April 2004 as a professional code of practice to support local authority capital investment planning within a clear, affordable, prudent and sustainable framework and in accordance with good professional practice. Local authorities are required by law to have regard to the Prudential Code
PWLB	Public Works Loan Board – a statutory body operating within the DMO that lends money from the National Loans Fund to local authorities and other prescribed bodies and collects the repayments. Not available in Northern Ireland.
REIT	Real estate investment trust – a company whose main activity is owning investment property and is therefore similar to a property fund in many ways
Share	An equity investment, which usually also confers ownership and voting rights
Short-term	Usually means less than one year