

**WEST OXFORDSHIRE DISTRICT COUNCIL**  
**FINANCE AND MANAGEMENT OVERVIEW AND SCRUTINY COMMITTEE**  
**5 FEBRUARY 2014**

**TREASURY MANAGEMENT ACTIVITY AND PERFORMANCE 2013/14**

**REPORT OF GO SHARED SERVICE HEAD OF FINANCE**

**(Contact: Paul Stuart: - Tel (01993) 861171)**

**1. PURPOSE**

To advise members of treasury management activity, performance of internal and external fund managers for the period 1 April 2013 – 31 December 2013 and propose alternative investment models.

**2. RECOMMENDATION**

That treasury management and the performance of in-house and external fund managers' activity for the period 1 April 2013 – 31 December 2013 are noted.

**3. SUPPORTING INFORMATION**

**Investment Portfolio Background**

- 3.1. The value of the portfolio held by Investec Asset Management, at 1 April 2013, was £22,978,786. The fund was invested in the Pooled fund – Dynamic model, which is made up of 30% target fund, 65% short bond fund and 5% liquidity fund. The fund balance as at 31 December 2013 was £13,010,878 after a withdrawal of £10 million which was re-invested with Hanover Housing Association (£5m) and £4.7m in Corporate Bonds.
- 3.2. The In house investment balance amounted to zero at 1 April 2013. However, the average balance of investments for the period to 31 December 2013 was £10,060,491 excluding outstanding Icelandic deposits.
- 3.3. The performance of all funds is continually monitored and compared against the 7-day rate which is 0.40% as at 31 December 2013.

**Investment Activity**

- 3.4. The guidance on Local Government Investment in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.
- 3.5. The movement in the Council's cash balance between 1 April 2013 and 31 December 2013 is shown in the Table 1

**Table I - Movement of Cash Balances | April 2013 – 31 December 2013**

	<b>Fund Manager Investec</b>	<b>In-House</b>	<b>Icelandic</b>	<b>Housing Assoc</b>	<b>Corporate Bonds</b>	<b>Total Cash</b>
	£	£	£	£	£	£
Fund Value/Cash at 1 April 2013	22,978,786	0	2,222,547	0	0	25,201,333
Cash Invest / Withdraw from Fund	(10,000,000)	103,244,500	0	5,000,000	4,775,157	103,019,657
Increase/(Decrease) in Cash during the period	32,092	(89,383,500)	(228,249)	0	0	(89,579,657)
Fund Valuation /Cash At 31 December 2013	13,010,878	13,861,000	1,994,298	5,000,000	4,775,157	38,641,333

Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2013/14. New investments were made with the following institutions:

- AAA-rated Money Market Funds;
- Term Deposits with UK Banks and Building Societies systemically important to the UK banking system;
- Pooled funds (collective investment schemes) meeting the criteria in SI 2004 No 534 and subsequent amendments.
- Corporate Bonds
- Investments with Registered Providers of Social Housing (Housing Associations)

Counterparty credit quality was assessed and monitored with reference to Credit Ratings (the Council's minimum long-term counterparty rating of A (or equivalent) across rating agencies Fitch, S&P and Moody's); credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP; sovereign support mechanisms /potential support from a well-resourced parent institution; share price.

- 3.6. The cash investments outstanding at 31 December 2013 are detailed in Appendix A whilst Appendix B shows those investments outstanding with Investec at that date.

### **Counterparty Update**

- 3.7. In July Moody's had placed the A3 long term ratings of RBS and Nat West on review for possible downgrade. These ratings were affirmed in November 2013 following the announcement by the

government that RBS will not be split into a good bank/bad bank. Instead, non-performing assets will be ring-fenced in an internal bad bank to be created in 2014, with non-core assets being run down on a tighter timescale than previously planned. Despite the ratings being affirmed by Moody's, the RBS Group share price showed little signs of recovery on concerns over implementation risks. The markets were less convinced by the internal ring-fence and viewed the shares as still too expensive. Arlingclose continues to monitor these creditworthiness indicators. Until such time there is an improvement, the Council will invest on a call only basis with these banks.

3.8. December 2013 was a busy month for the bank reform agenda:

- Co-operative Bank successfully completed a voluntary bail-in of junior bondholders, which goes par way to fill its capital shortfall.
- RBS exited the Contingent Capital Facility, under which it was previously eligible for a further £8bn government bail-out if the need had arisen.
- The Financial Services (Banking Reform) Act 2013 gained Royal Assent, legislating for the separation of retail and investment banks, and for the introduction of mandatory bail-in in the UK.
- EU finance ministers agreed further steps towards banking union, including introduction of bail-in from January 2016.

### Investment Performance

3.9. Performance Achieved for the period (excluding outstanding Icelandic investments) is shown below

<b>Performance of Fund   April 2013 to 31 December 2013</b>	<b>Investec</b>	<b>In-House</b>	<b>Housing Assoc</b>	<b>Total</b>
Gross Return	0.24%	0.62%	2.33%	0.44%
Net Return	-0.03%	0.62%	2.33%	0.33%

<b>Performance of Corporate Bonds</b>	<b>A2D Funding</b>	<b>Places for People Homes Ltd</b>	<b>Total</b>
Invested Amount	£2,606,250	£2,168,907	£4,775,157
Coupon Rate	4.75%	5%	

3.10. In – house investment achieved a gross return of 0.62% which is 0.22% above the 7 day rate of 0.40%. The outperformance is due to a number of fixed term deposits with Lloyds TSB at beginning of year with an average rate of 0.79%. However it should be noted in-house investments are largely constrained by cash flow commitments such as precept payments, benefit payout as well as the capital programme requirements.

## Investec – Pooled Fund

- 3.11. Investec did manage a £22.9m portfolio for the Council at the start of the financial year. A decision to withdraw £5m to re-invest with a housing association was taken in July 2013 and a further £5m was withdrawn from the fund in October 2013 to re-invest in corporate bonds, leaving Investec just over £13m to manage. This consists of 65% Short dated Bonds, 30% Target fund and 5% of Liquidity Fund. The gross return of the fund for the reporting period is a very disappointing - 0.24%. The returns of the three funds that make up the overall performance were as follows:

Net of fees	Investec Funds			
Monthly %	Liquidity	Short Bond	Target Return	Average weighted
	<b>5%</b>	<b>65%</b>	<b>30%</b>	<b>100%</b>
<b>Apr-13</b>	0.03	-0.17	0.03	
<b>May-13</b>	0.03	0.20	0.51	
<b>Jun-13</b>	0.03	-0.22	-0.40	
<b>Jul-13</b>	0.03	0.06	0.11	
<b>Aug-13</b>	0.03	-0.10	-0.57	
<b>Sep-13</b>	0.04	0.28	0.17	
<b>Oct-13</b>	0.02	0.20	0.37	
<b>Nov-13</b>	0.03	0.07	-0.15	
<b>Dec-13</b>	0.01	-0.13	0.29	
<b>9 months</b>	0.25	0.19	0.36	0.24

- 3.12. The Target Return Fund has had a modest return over the year to date. Performance was helped by interest rate positioning, benefiting from short duration exposure in both the US and Japan. Corporate bond exposure also made a positive contribution with credit spreads continuing to narrow versus government bonds. Emerging market exposure was a modest drag to returns, as was currency positioning.
- 3.13. The Short Dated Fund took profits on Australian and Swedish government bonds in December, when yield targets were met however the fund still had a negative return for the month as holdings were impacted by the shift to higher yields in the aftermath of US Federal Reserve's announcement that it would begin to slow its bond buying programme
- 3.14. The Liquidity Fund continued its small yet positive return, which is below performance against the 7 date rate. The strategy of the Fund is purchasing high quality tradable securities, liquid in nature. On average, the fund holds 65% securities rated A-I+, the highest short-term rating attributed by Standard & Poor's with the remaining holding being rated A-I.

### Update on Icelandic Banks Investment

- 3.15. There are no significant changes since previously reported, the Council remains as secured priority creditors to Icelandic Banks. The latest estimate is that the Council is expecting 100% recovery rate from both Glitnir and Landsbanki.

3.16. The repayments from Icelandic banks as at the 31 December are summarised in the table below:-

	Principal (£)	Cash Repaid (£)	% repayment
Landsbanki Island Group	2,500,000	1,455,305	0.55
GLITNIR	5,000,000	4,225,794	0.85
Kaupthing Singer Friedlander	1,500,000	1,324,603	0.82
Total	9,000,000	7,005,702	0.78

- 3.17. Glitnir (£5m) - the Council received a total of £4.225m cash on 15/16 March 2012. The distribution currencies were; Kroner, Euros, US dollars, pounds sterling and Norwegian krona. The outstanding claim is to be repaid in ISK currency and is held in the Glitnir winding - up board escrow account. It cannot be released until the Icelandic currency restrictions are lifted. Bevan Brittan – the Council’s legal representative continue to liaise with the Central Bank of Iceland and the Bank of England in relation to the ISK distribution element. In the meantime, these distributions must remain in Iceland, held in an escrow account accruing interest at the rate of 4.20% p.a.
- 3.18. Landsbanki (£2.5m) – the Council has received further repayments of the claim in September 2013, which amounted to £138,859 (5.5%), and the total amount received is approximately £1.46m to date or 55p. Officers will give a verbal update at committee on the current position of outstanding Landsbanki investments.
- 3.19. Kaupthing Singer and Friedlander (£1.5m) – the Council received its eleventh repayment in December 2013 amounting to 2.5p in £ taking the amount received to 81.5p in the £. The Administrator has estimated the recovery rate to be 86.5p. Further repayments will be made at regular intervals, subject to the agreement of the Creditors’ Committee. It is the Administrators’ current intention to pay a further repayment in six months time.
- 3.20. The recovered amount to the Council is approximately £7.006 million to date. The Council will continue to work with the Local Government Association to expedite remaining payments.

### **Interest rate forecast**

- 3.21. There was no change to UK monetary policy with official interest rates and asset purchases maintained at 0.50% and 375bn respectively. On the probability of unemployment reaching the 7% threshold under the MPC’s Forward Guidance, the November Inflation Report stated only a two-in-five chance to the rate having reached the 7% level by the end of 2014. The corresponding figures for the end of 2015 and 2016 were around three-in-five and two-in-three respectively. These forecasts brought forward market expectations of a bank rate rise, although the MPC repeatedly emphasised that the 7% threshold was not an automatic trigger for a rate rise.
- 3.22. A fragile economic recovery, subdued inflation and depressed bank lending resulted in the European Central Bank cutting the repo rate from 0.50% to 0.25%. The ECB pledge to keep interest rates low for as long as necessary and warned that it was too soon to say the euro region is out of danger. In the US, following the clear momentum witnessed in its economy –

despite the political impasse which resulted in a partial government shutdown during the quarter – the ‘tapering’ of asset purchases was announced by the Federal reserve in December. Tapering will commence in January 2014 reducing its monthly purchases from \$85bn to \$75bn a month. Financial markets reacted in a predictably enthusiastic manner with risk assets such as equities rallying towards higher levels whilst government bond prices reversed, leading to higher yields.

3.23. Arlingclose’s projected interest rates are tabled below. Short term interest rates remain flat and investment income returns to date have reflected this.

	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Official Bank Rate													
Upside risk			0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.75	0.75	1.00
Central case	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk													

### **Alternative Investment Model**

3.24 Committee supported a review of the on-going viability of the Pooled Funds investment model. The Council’s independent advisors have provided a cross section of alternative investors. However, work is still ongoing analysing this data in consultation with Arlingclose to determine a revised strategy. The investment funds currently under scrutiny include:

- Insight Liquidity Plus Fund (enhanced cash)
- Payden Sterling Reserve Fund (short bond)
- SWIP Absolute Return Bond Fund
- M&G Global Dividend Fund (equity income)
- Schroder Income Maximiser Fund (equity income)
- Threadneedle Global Equity Income Fund (equity income)

3.25 Officers will update committee on the current position of this review at the meeting.

## **4. FINANCIAL IMPLICATIONS**

4.1. The original investment interest budget for 2013/14 was set at £550,000 which was based on an average balance of £32.9 million with an average return of 1.67%. Investment income of £194,000 from Fund Manager – Investec and £75k interest from the in-house investments plus £281k from new Housing Association Loans has been budgeted for 2013/14. To date £5m was withdrawn in July 2013 and again a further £5m in October 2013 from the Investec Fund managers and re-invested with Hanover Housing Association at a rate of 3.35% and the purchase of A2D corporate bonds at a rate of 4.75%. The current forecast for 2013/14 is to achieve £370,000 a shortfall of £180,000

4.2. The investment interest budget for 2014/15 has been maintained at £550,000 which has incorporated the new longer term investments in Housing Associations and corporate bonds.

Plus a return of 1% for the current £13 million with Investec has been anticipated. However, as identified in paragraphs 3.24 and 3.25 above, over the coming weeks it is planned to re-invest £10m of that sum over five or six funds. This strategy is to reduce overall volatility that has been experienced in recent years by spreading the risk over a number of funds and consequently increasing the level of return.

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Background Papers

Valuation 31 December 2013 – Investec Investment Management

In – House investment as at 31 December 2013

## SCHEDULE OF CASH INVESTMENTS OUTSTANDING AT 31 DECEMBER 2013

NAME OF COUNTERPARTY	VALUE DATE	NOMINAL AMOUNT (£)	MATURITY DATE	RATE OF INTEREST	Fitch Credit Rating			
					Long Term	Short Term	Viability	Support
<b>IN HOUSE MANAGEMENT</b>								
NatWest (call account)	31.12.13	2,751,000	31.03.14	0.40%	A	FI		I
Goldman Sachs MMF	31.12.13	2,010,000	31.03.14	0.37%			AAA	
Nationwide Building Society	01.07.13	1,600,000	02.01.14	0.50%	A	FI	a+	I
Lloyds Bank	11.07.13	1,000,000	07.01.14	1.05%	A	FI	bbb	I
Barclays Bank	01.08.13	1,500,000	31.01.14	0.52%	A	FI	a	I
Nationwide Building Society	03.10.13	1,000,000	03.02.14	0.47%	A	FI	a+	I
Lloyds Bank	02.12.13	2,000,000	03.03.14	0.70%	A	FI	bbb	I
Lloyds Bank	13.12.13	1,000,000	13.03.14	0.70%	A	FI	bbb	I
Barclays Bank	13.12.13	1,000,000	13.03.14	0.46%	A	FI	A	I
<b>TOTAL IN-HOUSE INVESTMENTS</b>		<b>13,861,000</b>						
<b>ICELANDIC BANK DEPOSITS</b>								
Landsbanki Island Group	01.06.07	416,700	01.06.09	6.440%				
GLITNIR	27.06.07	236,166	29.06.09	6.520%				
Kaupthing Singer Friedlander	02.07.07	175,397	02.07.09	6.590%				
Landsbanki Island Group	01.08.07	627,995	03.08.09	6.690%				
GLITNIR ( Tradition )	31.08.07	538,041	28.08.09	6.350%				
<b>TOTAL ICELANDIC DEPOSITS</b>		<b>1,994,299</b>						



**INVESTEC ASSET MANAGEMENT PORTFOLIO VALUATION AT 31 DECEMBER 2013**

<b>MONEY MARKET FUNDS</b>	<b>MARKET VALUE (£)</b>
Liquidity Fund STG S Shares	646,152
Short Dated Bond Fund S ACC	8,509,618
Invested Series IV Target Return S ACC	3,845,759
Cash – Settled Balance	9,349
<b>TOTAL VALUE OF FUND</b>	<b>13,010,878</b>