Agenda Item No.9

WEST OXFORDSHIRE DISTRICT COUNCIL

FINANCE AND MANAGEMENT OVERVIEW AND SCRUTINY COMMITTEE WEDNESDAY, 3 JUNE 2015

TREASURY MANAGEMENT ACTIVITY AND PERFORMANCE – 2014/15

REPORT OF THE GO SHARED SERVICE - HEAD OF FINANCE

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1. PURPOSE

To advise members of treasury management activity and the performance of internal and external fund managers for 2014/15.

2. RECOMMENDATIONS

(a) That treasury management and the performance of in-house and external fund managers' activity for 2014/15 are noted.

(b) That the Council be recommended to approve that the Treasury Management activity and consequent Prudential Indicators are in compliance with the approved Treasury Management Strategy Statement and Investment Strategy.

3. BACKGROUND

3.1. The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year. This committee has received six reports between 30 April 2014 and 8 April 2015 regarding investment activities, performance, fundamental review of strategy and an annual treasury management report.

3.2. Treasury management is defined as: "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

3.3. The overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

4. ALTERNATIVES/OPTIONS

Not applicable.

5. FINANCIAL IMPLICATIONS

2014/15

5.1. The annual report for Treasury Management is a full review of the economic background and its impact on the financial markets, plus detail regarding the controls in place for the Council in its use of investment counterparties (credit risk). There is further detail of the investments and their performance the Council undertook during the year. Finally showing the Council has complied with the prudential indicators it set as part of its investment strategy, such as adhering to borrowing limits and how the capital programme was financed. All these factors are reported within Appendix A, B and C to this report.

2015/16

5.2. The performance of the pooled funds portfolio during 2014/15 is shown in Appendix A, paragraph 2.3. However, it should be noted that as part of the review and monitoring role of Treasury Management during the year, there was consultation with the Council's independent advisors (Arlingclose Ltd) and with this Committee to consider whether the overall balance of the Council's investment portfolio was correct. The main concern being the performance of Aberdeen (formerly SWIP).

5.3. It was proposed at the last Finance and Management Overview and Scrutiny Committee to reduce the level of investment within Aberdeen from £4m to £2m, and place that £2m within alternative Bond options. In addition there would be further consideration whether the remaining £2m should continue to be placed with Aberdeen.

5.4. It can be confirmed £2m has been withdrawn from the Aberdeen Fund with re-investment of £1m with UBS Multi Asset Income Fund, which the Council previously held £1m, and £1m with M&G Strategic Corporate Bond Fund.

5.5. Arlingclose will attend this Committee and provide a short presentation to give an overview of performance to date during 2015/16 of the Pooled Funds portfolio and discuss some alternative bond options for further consideration.

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Date: 22 May 2015

Appendix A

Annual Treasury Management Report

1. Economic Background

1.1 Political uncertainty had a large bearing on market confidence this year. The possibility of Scottish independence was of concern to the financial markets, however this dissipated following the outcome of September's referendum. The risk of upheaval (the pledge to devolve extensive new powers to the Scottish parliament; English MPs in turn demanding separate laws for England) lingers on. The highly politicised March Budget heralded the start of a closely contested general election campaign and markets braced for yet another hung parliament.

1.2 The Bank of England's MPC maintained interest rates at 0.5% and asset purchases (QE) at £375bn. Its members held a wide range of views on the response to zero CPI inflation, but just as the MPC was prepared to look past the temporary spikes in inflation to nearly 5% a few years ago, they felt it appropriate not to get panicked into response to the current low rate of inflation. The minutes of the MPC meetings reiterated the Committee's stance that the economic headwinds for the UK economy and the legacy of the financial crisis meant that increases in the Bank Rate would be gradual and limited, and below average historical levels.

1.3 The robust pace of GDP growth of 3% in 2014 was underpinned by a buoyant services sector, supplemented by positive contributions from the production and construction sectors. Resurgent house prices, improved consumer confidence and healthy retail sales added to the positive outlook for the UK economy given the important role of the consumer in economic activity. Annual CPI inflation fell to zero for the year to March 2015, down from 1.6% a year earlier. The key driver was the fall in the oil price (which fell to $44.35 a barrel a level not seen since March 2009) and a steep drop in wholesale energy prices with extra downward momentum coming from supermarket competition resulting in lower food prices. Bank of England Governor Mark Carney wrote an open letter to the Chancellor in February, explaining that the Bank expected CPI to temporarily turn negative but rebound around the end of 2015 as the lower prices dropped out of the annual rate calculation.

1.4 The UK labour market continued to improve and remains resilient across a broad base of measures including real rates of wage growth. January 2015 showed a headline employment rate of 73.3%, while the rate of unemployment fell to 5.7% from 7.2% a year earlier. Comparing the three months to January 2015 with a year earlier, employee pay increased by 1.8% including bonuses and by 1.6% excluding bonuses

1.5 On the continent, the European Central Bank lowered its official benchmark interest rate from 0.15% to 0.05% in September and the rate paid on commercial bank balances held with it was from -0.10% to 0.20%. The much-anticipated quantitative easing, which will expand the ECB's balance sheet by €1.1 trillion was finally announced by the central bank at its January meeting in an effort to steer the euro area away from deflation and invigorate its mori und economies. The size was at the high end of market expectations and it will involve buying €60bn of sovereign bonds, asset-backed securities and covered bonds a month commencing March 2015 through to September 2016. The possibility of a Greek exit from the Eurozone refused to subside given the clear frustrations that remained between its new government and its creditors.

1.6 The US economy rebounded strongly in 2014, employment growth was robust and there were early signs of wage pressures building, albeit from a low level. The Federal Reserve made no change to US policy rates. The central bank however continued with 'tapering', i.e. a reduction in asset purchases by $10 billion per month, and ended them altogether in October 2014. With the US economy resilient enough the weather the weakness of key trading partners and a strong US dollar, in March 2015 the Fed removed the word "patient" from its statement accompanying its rates decisions, effectively leaving the door open for a rise in rates later in the year.

2. **Investment Activities**

2.1 Both the CIPFA and the CLG's Investment Guidance require the Authority to invest prudently and have regard to the security and liquidity of investments before seeking the optimum yield. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2013/14. Investments during the year included:

- Investments in AAA-rated Stable Net Asset Value Money Market Funds
- Call accounts and deposits with Banks and Building Societies systemically important to UK banking system
- Pooled funds (collective investment schemes) meeting the criteria in SI 2004 No 534 and subsequent amendments
- Housing Associations
- Corporate Bonds

2.2 **Investment Background**

- The In house investment balance was £14.610m at 1 April 2014 and the average balance of investments for the period to 31 March 2015 was £14.796 million excluding outstanding Icelandic deposits.
- The performance of all funds was continually monitored and compared against the 3 month LIBID rate.
- The criteria and lending list limits the Council adopted within its Treasury Management Strategy includes specified and non specified investments (i.e. investments up to one year and more than one year). The full counterparty list is maintained and updated by Arlingclose on a monthly basis in according to the Council's investment strategy; although amendments are informed to officers immediately they occur.

The investment income budget for 2014/15 was set at £550k assuming an average investment balance of £32.9m achieving an overall return of 1.67%. This was achieved with levels of return for the in- house investments at 0.62%, Housing Association Loan at 3.35%, jointly achieving a return of £259k at an average rate of 1.31% when compared to a budgeted return of £243k.

2.3 **Externally Managed Funds**

At the end of 2013/14 financial year the authority changed its strategy regarding the use of Pooled Funds and decided to invest £12m over seven pooled funds in consultation with Arlingclose Ltd, the Council's independent advisors. The spread of the funds was balanced between short term / cash equities, longer term equities and bonds. The logic of this spread of funds was to act as a counterbalance that should one aspect of the portfolio perform poorly it would be compensated elsewhere within the funds, fundamentally between equities and bonds. This has proven to be the case and the performance of each of the Pooled Funds can be seen in the table below.

Pooled Funds

Fund Manager	Original Investment	Fund Values for April-March 2015 August	December	March	Unrealised Gain/(Loss)	% Return Annualised
	£	£	£	£	£	%
Insight LPF	2,000,000	2,006,916	2,012,130	2,016,036	16,036	0.80%
Payden & Rygel	2,000,000	2,008,961	2,018,844	2,025,667	25,667	1.28%
UBS	1,000,000	1,036,947	1,044,970	1,065,124	65,124	6.51%
Aberdeen	4,000,000	3,952,206	3,860,294	3,830,882	(169,118)	-4.23%
Schroders	1,000,000	1,043,314	1,060,972	1,105,041	105,041	10.50%
Threadneedle	1,000,000	1,033,009	1,029,990	1,121,811	121,811	12.18%
M&G	1,000,000	1,039,277	1,030,457	1,075,050	75,050	7.53%
	12,000,000	12,120,630	12,057,659	**12,239,611**	**239,611**	**2.00%**

2.4 The performances of having several Pooled Funds compared with the previous use of having just one External Fund Manager, has seen a positive return in all but one of the Pooled Funds. The Aberdeen Absolute Return Bond Fund (formerly known as SWIP Absolute Return Bond Fund) has performed poorly throughout 2014/15. Members, after taking advice from Arlingclose and Senior Finance Officers agreed to pull back £2m from this fund in April 2015 and open a new £1m Pooled Fund with M&G Strategic Corporate Bond Fund and a further £1m in the UBS Multi Asset Income Fund. As shown in the table above an annualised return of 2% has shown a strong return backed up from data analysed and sent by Arlingclose showing the authorities investment returns being at the top compared with all their clients for 2014/15.

2.5 The In-house team were budgeted to achieve £72.5k for the year. Their actual was £91,582, averaging a return of 0.73% from fixed term deposits and 0.39% from Money Market Funds (MMFs) an overall return of 0.62%. The In-house team are constrained by having to meet cash flow requirements to conduct the Council's business and consequently is investing for short time periods especially with Money Market Funds.

2.6 A summary of investment return compared to budget is as follows:

Performance of Fund 1 April 2014 to 31 March 2015	**Pooled Funds**	**In-House**	**Hous Assoc / Bonds**	**Total**
Budget (£)	£120,000	£72,500	£357,500	£550,000
Budget (%)	1.00%	0.60%	3.75%	1.67%
Gross interest (£)	£239,612	£91,582	£356,125	£687,319
Gross rate of Return (%)	2.00%	0.62%	3.56%	1.87%

2.7 The movement in cash between all the types of investments are shown in the table below:

Movement of Cash Balances 1 April 2014 – 31 March 2015

	Pooled Funds	**In-House**	**Bonds**	**Housing Assoc**	**Total Cash**
	£	£	£	£	£
Fund Value/Cash at 1 April 2014	10,000,000	9,610,000	5,116,215	5,00,000	29,726,215
Cash Invest / Withdraw from Fund	2,000,000	-3,575,000	0	0	-1,575,000
Increase/(Decrease) in Cash/Value during the period	239,612	0	87,397	0	327,009
Fund Valuation /Cash At 31 March 2015	12,239,612	6,035,000	5,203,612	5,000,000	28,478,224

The cash investments for all funds as at 31 March 2015 are shown in Appendix B

<u>Icelandic Investments</u>

2.8 The Council held Icelandic investments of £1.184mk at 1 April 2014 but did not budget for the return of these funds in terms of capital or interest. The outstanding liability now stands at £1.137mk. The interest accruing for 2014/15 from the Glitnir and KSF investments totalled £46,485. However, due to the exchange rates at 31 March 15, there would technically have been a loss of £87k if a transaction had occurred on that day. Consequently, as part of the closedown of the Council's accounts, provision will be made for this potential charge to the investment interest account. It should be noted the impact of exchange rates can be both positive and negative, but it is prudent to make provision for such an occurrence.

3. Credit Risk / Liquidity and Yield

3.1 Counterparty credit quality was assessed and monitored with reference to credit ratings (the Authority's minimum long-term counterparty rating is [A-] across rating agencies Fitch, S&P and Moody's); credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

Counterparty credit quality as measured by credit ratings is summarised below:

Credit Score Analysis

Date	Value Weighted Average Credit Risk Score	Value Weighted Average Credit Rating	Time Weighted Average Credit Risk Score	Time Weighted Average Credit Rating	Average Life (days)
31/03/2014	5.12	A+	5.17	A+	573
30/06/2014	5.08	A+	5.08	A+	699
30/09/2014	5.23	A+	5.23	A+	692
31/12/2014	5.21	A+	5.21	A+	648
31/03/2015	4.73	A+	4.73	A+	908

The value weighted average reflects the credit quality of investments according to the size of the deposit. The time weighted average reflects the credit quality of investment according to the maturity of the deposit.

Long-Term Credit Rating	Score
AAA	1
AA+	2
AA	3
AA-	4
A+	5
A	6
A-	7
BBB+	8
BBB	9
BBB-	10

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 26
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

The Council aimed to achieve a score of 7 or lower, to reflect the Council's overriding priority of security of monies invested and the minimum credit rating of threshold of A- for investment counterparties. The average life in days is much higher than previous analysis but reflects the £5m investment with Hanover Housing Association fixed to July 2018.

Counterparty Update

3.2 The European Parliament approved the EU Bank Recovery and Resolution Directive (BRRD) on April 15, 2014. Taking the view that potential extraordinary government support available to banks' senior unsecured bondholders will likely diminish, over 2014-15 Moody's revised the Outlook of several UK and EU banks from Stable to Negative (note, this is not the same as a rating review negative) and S&P placed the ratings of UK and German banks on Credit Watch with negative implications, following these countries' early adoption of the bail-in regime in the BRRD. S&P also revised the Outlook for major Canadian banks to negative following the government's announcement of a potential bail-in policy framework.

3.3 The Bank of England published its approach to bank resolution which gave an indication of how the reduction of a failing bank's liabilities might work in practice. The Bank of England will act if, in its opinion, a bank is failing, or is likely to fail, and there is not likely to be a successful private sector solution such as a takeover or share issue; a bank does not need to be technically insolvent (with liabilities exceeding assets) before regulatory intervention such as a bail-in takes place.

3.4 The combined effect of the BRRD and the UK's Deposit Guarantee Scheme Directive (DGSD) is to promote deposits of individuals and SMEs above those of public authorities, large corporate and financial institutions. Other EU countries, and eventually all other developed countries, are expected to adopt similar approaches in due course.

3.5 In December the Bank's Prudential Regulation Authority (PRA) stress tested eight UK financial institutions to assess their resilience to a very severe housing market shock and to a sharp rise in interest rates and address the risks to the UK's financial stability. Institutions which 'passed' the tests but would be at risk in the event of a 'severe economic downturn' were Lloyds Banking Group and Royal Bank of Scotland. Lloyds Banking Group, [whose constituent banks are on the Authority's lending list], is taking measures to augment capital and the PRA does not require the group to submit a revised capital plan. RBS, which is not on the Authority's lending list for investments, has updated plans to issue additional Tier 1 capital. The Co-operative Bank failed the test.

3.6 The European Central Bank also published the results of the Asset Quality Review (AQR) and stress tests, based on December 2013 data. 25 European banks failed the test, falling short of the required threshold capital by approximately €25bn (£20bn) in total – none of the failed banks featured on the Authority's lending list.

3.7 In October following sharp movements in market signals driven by deteriorating global growth prospects, especially in the Eurozone, Arlingclose advised a reduction in investment duration limits for unsecured bank and building society investments to counter the risk of another full-blown Eurozone crisis. Durations for new unsecured investments with banks and building societies which were previously reduced. Duration for new unsecured investments with some UK institutions was further reduced to 100 days in February 2015.

4. Update on Iceland Investment

4.1 As of the 31 March 2015 the Council had received £8.110m of principal from Icelandic Banks. The table below shows the detailed repayments in respect of the specific investments:

	Principal (£)	Cash Received (£)	Repayment %
Landsbanki Island Group	2,500,000	2,543,707	100
Glitnir	5,000,000	4,225,794	85
Kaupthing Singer Friedlander	1,500,000	1,340,856	83
Total	9,000,000	8,110,357	90

4.2 KSF the Council received its twelve repayment in December 2014 amounting to 1p in the £, taking the amount received to 82.5p in the £. The Administrator has estimated a recovery rate of to be 86.5p. It is estimated the next repayment will be in December 2015.

4.3 Glitnir – The Council received £4.225m cash on 15/16 March 2012, the distribution currencies were; Kroner, Euros, US $, £ 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 Icelandic currency restrictions are lifted. Bevan Brittan continue to liaise with the Central Bank of Iceland on behalf of a number of local authorities but in the meantime these funds remain in Iceland held in an escrow account accruing interest at the rate of just under 4% p.a.

4.4 Landsbanki – The account was repaid at the end of January 2014.

5 Compliance with Prudential Indicators

The Council can confirm that it has complied with its Prudential Indicators for 2014/15, which were set in February 2014 as part of the Council's Treasury Management Strategy. In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during 2014/15. None of the Prudential Indicators have been breached and a prudent approach has been taking in relation to investment activity with priority being given to security and liquidity over yield.

The Prudential Indicators include:

- Authorised and Operational Boundary for External Debt

- Upper limits for fixed interest rate exposure and variable interest rate exposure
- Upper limit for total principal sums invested over 364 days

Appendix C reports the approved capital expenditure for 2014/15, the actual year end figures and how the capital programme has been funded, and the impact it has on the Ratio of Financing Costs to the Net Revenue Stream. The accounts for 2014/15 are still in the process of being closed down and may be subject to some minor change. However, even should the final figures show any change it is not anticipated this will impact on full compliance with Prudential Indicators.

Appendix B

SCHEDULE OF CASH INVESTMENTS OUTSTANDING AT 31 MARCH 2015

NAME OF COUNTERPARTY	VALUE DATE	NOMINAL AMOUNT (£)	MATURITY DATE	RATE OF INTEREST
IN HOUSE MANAGEMENT				
Invesco MMFs	31.03.15	2,025,000	01.04.15	0.39%
Goldman Sachs MMF	31.03.15	4,010,000	01.04.15	0.41%
Hanover Housing Association	24.07.13	5.000.000	24.07.18	3.35%
TOTAL IN-HOUSE INVESTMENTS		**11,035,000**		

ICELANDIC BANK DEPOSITS				Original Investment Rate
GLITNIR	27.06.07	236,166	29.06.09	6.520%
Kaupthing Singer Friedlander	02.07.07	159,144	02.07.09	6.590%
GLITNIR (Tradition)	31.08.07	538,041	28.08.09	6.350%
TOTAL ICELANDIC DEPOSITS		**933,351**		

BONDS	BOOK COST(£)	MARKET VALUE (£)
A2D Bond (4.75%)	2,500,000	2,748,100
Place for People Bond (5%)	2,445,276	2,420,497
TOTAL VALUE OF BONDS	**4,945,276**	**5,168,597**

MANAGED FUNDS		NOMINAL VALUE (£)	MARKET VALUE (£)
Aberdeen Absolute Return Bond Fund	31.03.15	4,000,000	3,830,882
Payden Sterling Reserve Fund	31.03.15	2,000,000	2,025,667
M&G Global Dividend Fund	31.03.15	1,000,000	1,075,050
Threadneedle Global Equity Fund	31.03.15	1,000,000	1,121,811
Insight Liquidity Plus Fund	31.03.15	2,000,000	2,016,036
UBS Multi-Asset Income Fund	31.03.15	1,000,000	1,065,124
Schroders Income Maximiser Fund	31.03.15	1,000,000	1,105,041
TOTAL VALUE OF FUND		**12,000,000**	**12,239,611**

<u>Appendix C</u>

<u>Capital Expenditure 2014/15</u>

1. Capital Expenditure – this indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits, and, in particular, to consider the impact on council tax.

Capital Expenditure	2014/15 Approved £000	2014/15 Actual £000	2015/16 Estimate £000	2016/17 Estimate £000
General Fund	4,314	2,863	4,142	1,146

2. Capital expenditure has been and will be financed as follows:

Capital Financing	2014/15 Approved £000	2014/15 Actual £000	31/03/2016 Estimate £000	31/03/2017 Estimate £000
Capital receipts	2,456	1,584	1,441	95
Government Grants /Contributions	1,458	1,050	301	251
Revenue contributions	400	229	2,400	800
Total Financing	4,314	2,863	4,142	1,146

3. Ratio of Financing Costs to Net Revenue Stream – this is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs. The ratio is based on costs net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2014/15 Approved %	2014/15 Actual %	31/03/2016 Estimate %	31/03/2017 Estimate %
General Fund	-7	-8	-8	-10

As the Council is in a net investment position the ratio is showing negative results.