

WEST OXFORDSHIRE DISTRICT COUNCIL
FINANCE AND MANAGEMENT OVERVIEW AND SCRUTINY COMMITTEE
30 MARCH 2016

TREASURY MANAGEMENT ACTIVITY AND PERFORMANCE 2015/16

REPORT OF GO SHARED SERVICE HEAD OF FINANCE

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

1. PURPOSE

To advise members of treasury management activity and the performance of internal and external fund managers for the period 1 April 2015 – 29th February 2016.

2. RECOMMENDATIONS

That treasury management and the performance of in-house and external Pooled Funds' activity for the period 1 April 2015 – 29 February 2016 are noted.

3. BACKGROUND

Investment Portfolio Background

- 3.1. The in- house investment balance amounted to £11.035m at 1 April 2015 inclusive of the long term loan to Hanover Housing Association. The average balance of investments for the period to 29th February 2016 rose to £20.408m in line with cash-flow forecasts for 2015/16.
- 3.2. Bonds purchased in 2013/14 (at a cost of £4.942m) were valued at £5.169m at 31st March 2015 and are now valued at £4.980m on 29th February 2016 based on current mid-prices. These bonds were acquired on a principle of holding to maturity.
- 3.3. The performance of all funds is continually monitored and compared against the 3 month LIBID rate which was 0.46% as at 29 February 2016.
- 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.

Long term security of capital remains 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 2015/16. New investments were made in line with policy as quoted in the Investment Strategy for 2015/16:

- 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.

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; financial statements, information on potential government support and reports in the quality financial press

- 3.5. Given the increasing risk and continued low returns from short-term unsecured bank investments, the Authority has a well-balanced and diversified investment portfolio but needs to consider other investment vehicles to counteract risks from changes to bail-in legislation.

The cash investments outstanding at 29 February 2016 are detailed in Appendix A.

Investment Performance

- 3.6 Performance Achieved for the period (excluding outstanding Icelandic investments) is shown below:-

Performance of Fund I April 2015 to 29 February 2016 (annualised returns)	In-House	Bonds
Net Return	1.24%	3.76%

- 3.7 In-house investment achieved a net return of 1.24% which is 0.78% above the 3 month LIBID rate. The outperformance is due to the £5m loan to Hanover Housing Association at a rate of 3.35% and a number of Certificate of Deposits (CD's) with Standard Chartered at the beginning of year with an average rate of 0.71% and a small pick- up in short term rates (3-6 months) over the same period. However it should be noted in-house investments are largely constrained by cash flow commitments such as precept payments, benefit pay-out as well as the capital programme requirements. Also income from Council Tax and Business Rates falls dramatically in February and March (typically taxpayers continue to use ten instalments ending in January) so investment balances will decrease over this period of time.
- 3.8 During August 2015, for technical accounting reasons, after consultation with Arlingclose officers switched all of the Pooled Funds from accumulation funds to income share class. This change allows regular income dividend payments to the Council, (monthly, quarterly or half yearly) as revenue. An estimate for the year's return for these dividends is approximately £180,000. The table below shows the current value of the Pooled Funds but does not reflect the expected dividend.
- 3.9 The table below shows the current valuations after a number of very difficult months in markets, particularly since August, which saw equity markets and bond yields fall led by the stock market turmoil in China. Peak to trough decline in the FTSE was in excess of 20% and although there has since been a recovery indices have not recovered to their previous levels and we have seen the valuations held within the funds reduce over the last few months. The impact on the market is reflected in the Fund Values shown below and Appendix B to the report provides detailed movement in price and value of Funds since the initial investments were made. It should be noted the fall in Fund Value will only be realised at the point of selling any investment.

Pooled Funds Portfolio

	Initial Investment	1 April Fund Value	29 February Fund Value	Unrealised Gain / (Loss) for 2015/16	Unrealised Gain / (Loss) to Initial Principal
	£	£	£	£	£
Insight LPF – Cash +	2,000,000	2,016,036	2,017,227	1,191	17,227
Payden & Rygel – Cash +	2,000,000	2,025,667	2,029,191	3,524	29,191
UBS – Bond / Equity	2,000,000	1,065,124	1,894,204	(170,920)	(105,796)
M&G Strategic – Bond	1,000,000	0	969,690	(30,310)	(30,310)
Aberdeen – Bond	2,000,000	3,830,882	1,790,571	(40,311)	(209,429)
Schroders – Equity	1,000,000	1,105,041	939,601	(165,440)	(60,399)
Threadneedle – Equity	1,000,000	1,121,811	1,099,374	(22,437)	99,374
M&G Global - Equity	1,000,000	1,075,292	981,502	(93,790)	(18,498)
February 2016 Total	12,000,000	12,239,853	11,721,360	(518,493)	(278,640)
Previous Report - December			11,790,820	(448,791)	(209,180)

Interest rate outlook

- 3.10 The global economy is facing a period of slower growth, as China reorients slowly towards domestic demand. Lower demand for raw materials will depress growth in mainly developing countries. Falling oil prices have seen exporting countries suffer too. Negative interest rates in Europe and more recently in Japan and Sweden are hoping to stimulate growth.
- 3.11 The weak global environment and resulting low inflation expectations are likely to dampen long term interest rates. Equity and bond markets remain volatile due to the uncertainties of China's slowdown and its consequent impact on Far Eastern and emerging markets and indeed global consumption and growth and the plummeting price of oil, driven both by falling demand and over-supply, which is influencing low inflation. The view of Arlingclose Interest rate forecast is too see a push back of the first Bank Rate rise to Quarter 2 2018 as can be seen from the table below

	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
Official Bank Rate												
Upside risk	-	-	-	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50
Central case	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	0.75
Downside risk											0.25	0.25

Bail-in Risk- Reverse Purchase Agreements ('Repos') and Covered Bonds

- 3.12 As mentioned in 3.5 above changes to banking legislation now mean that the Council is exposed to credit risk alongside equity holders.
- 3.13 Bail-in allows regulatory authorities to keep a failing bank open for essential business, but passes the cost of that failure onto investors instead of taxpayers via a bail-out. Previously, bondholders and depositors would only lose money if a bank entered insolvency. Under a bail-in regime, the regulator can apply a 'haircut' to bonds and deposits to reduce a bank's liabilities and therefore increase its equity capital, without interrupting the provision of current accounts, mortgages and business loans.
- 3.14 Given the practicalities of day to day cash management, it is unlikely the Council will be able to avoid making any unsecured investments in banks and building societies. Money Market Funds provide an instant access alternative, but since they mostly invest in unsecured certificates of deposit issued by banks, the only risk reduction is through diversification. Government MMFs, which mostly invest in treasury bills and repurchase agreements (repos), are a low risk solution with consequent returns after fees typically being very low.
- 3.15 Reverse Purchase Agreements ('Repos') provide a secured way for an investor to make a loan to a bank. Legally there are two linked transactions: the sale of bonds by the bank, normally valued higher e.g. 105%, of the principal amount of the loan agreement. Consequently, the bank has a forward agreement to repurchase them on maturity, but if the bank defaults, the investor would retain ownership of the bond; the economic effect is a short-term loan by the investor to a bank and they are accounted for as such.
- 3.16 As reverse repurchase agreements with banks are exempt from bail-in, they make prudent investment sense for local authorities whose investments with banks such as call accounts, term deposits and certificates of deposit are as unsecured investors and subject to bail-in. Covered bonds offer similar suitable vehicles.
- 3.17 Working with Arlingclose officers included both Repo's and Covered Bonds within the strategy last year and as a consequence officers will, as the banking legislations comes into force, move bank deposits to Repo's and Covered Bonds. Currently repo rates for short-dated lending (1-6 months) are very close to those for unsecured investments with banks (deposits/CDs) and therefore on a risk/return basis provide exceptional value.

4. FINANCIAL IMPLICATIONS

- 4.1. The original investment interest budget for 2015/16 was set at £550,000 which was based on an average balance of £32.9 million from all the different type of investments (e.g. fixed term deposits, pooled funds, bonds) achieving an overall average return of 1.67%. The breakdown of the budget and a comparative forecast is as follows:

	2015/16 Budget (£)	2015/16 Forecast (£)
Pooled Fund Managers	120,000	190,000
In-House Investments	72,500	85,000
Hanover Housing Assoc	167,500	167,500
Bonds	190,000	188,000
Total	550,000	630,500

At present there are fluctuations within Pooled Funds and Bond valuations, however officers are comfortable the overall budget will be achieved this financial year and it is important to look through temporary capital value fluctuations.

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(Author: Andrew Sherbourne), Tel: (01242 264337)
Date: 16 March 2016
Background Papers
Valuation 29 February 2016 – Pooled Funds & Bonds
In – House investment as at 29 February 2016

SCHEDULE OF CASH INVESTMENTS OUTSTANDING AT 29 FEBRUARY 2016

NAME OF COUNTERPARTY	VALUE DATE	NOMINAL AMOUNT (£)	MATURITY DATE	RATE OF INTEREST	Fitch Credit Rating			
					Long Term	Short Term	Viability	Support
IN HOUSE MANAGEMENT								
Hanover Housing Association	24.07.13	5,000,000	24.07.18	3.35%	A	FI	a	5
Lloyds	11.09.15	1,000,000	11.03.16	0.75%	A	FI	a	5
Standard Chartered	01.10.15	2,000,000	01.03.16	0.66%	A	FI	a	5
Nationwide	02.10.15	1,000,000	02.03.16	0.60%	A	FI	a	5
Lloyds	13.10.15	2,000,000	14.03.16	0.65%	A	FI	a	5
Nationwide	05.01.16	1,000,000	05.07.16	0.71%	A	FI	A	5
Goldman Sachs MMF	29.02.16	1,340,000		0.43%	AAAmf			
Invesco AIM MMF	31.12.15	1,800,000		0.50%	AAAmf			
TOTAL IN-HOUSE INVESTMENTS		15,140,000						
ICELANDIC BANK DEPOSITS								
Glitnir Escrow	27.06.07	236,166		4.20%				
Kaupthing Singer Friedlander	02.07.07	159,144		-				
Glitnir Escrow (Tradition)	31.08.07	538,041		4.20%				
TOTAL ICELANDIC DEPOSITS		933,351						

Appendix B

POOLED FUND & BONDS PORTFOLIO VALUATION AT 29 FEBRUARY 2016

	INLIQP3		PAYSRSA		UMAIGLA	
	Insight Liquidity Plus Fund - Share Class 3		Payden & Rygel Sterling Reserve Fund - Accumulation		UBS Multi Asset Income Fund - L Class Accumulation Gross	
Transaction Ref	33544		AA1771001		0000486436	
Date of purchase	31/03/2014		28/03/2014		28/03/2014	
Number of units/shares	1,520,045.601		189,845.181		1,866,019.780	
Purchase Price £	1.31575		10.5349		0.536	
Initial investment 2013/14 £	2,000,000		2,000,000		1,000,000	
Initial investment 2014/15						
Transactions 2015/16						
Number of units/shares					1,747,030.049	
Purchase/Sale Price £					0.5724 1,000,000	
Apr-15	1.3269	2,016,979	10.6679	2,025,249	0.57210	1,067,550
May-15	1.3275	2,017,921	10.6759	2,026,768	0.57240	2,068,110
Jun-15	1.3280	2,018,545	10.6693	2,025,515	0.56170	2,029,450
Jul-15	1.3279	2,018,453	10.6679	2,025,249	0.56550	2,043,180
Transaction Ref	A30R682650459433		1474		0000552409	
Date of switch	17/08/2015		07/08/2015		07/08/2015	
Ticker/Number of income shares	INLIQP5	2,051,799.720	PAYSRS	200,707.339	UMAIGLI	3,928,254.420
Price of income shares /Value	0.98397	2,018,909	10.0951	2,026,161	0.5204	2,044,264
Aug-15	0.9841	2,019,074	10.0996	2,027,064	0.5069	1,991,232
Sep-15	0.9838	2,018,643	10.0840	2,023,933	0.4977	1,955,092
Oct-15	0.9834	2,017,760	10.0846	2,024,053	0.5079	1,995,160
Nov-15	0.9835	2,017,966	10.0964	2,026,422	0.5077	1,994,375
Dec-15	0.9837	2,018,294	10.0770	2,022,528	0.4972	1,953,128
Jan-16	0.9836	2,018,150	10.0989	2,026,923	0.4859	1,908,739
Feb-16	0.9832	2,017,227	10.1102	2,029,191	0.4822	1,894,204
Capital variance to original Investment	17,227		29,191		(105,796)	
	<i>Div payable monthly</i>		<i>Div payable quarterly</i>		<i>Div payable quarterly</i>	

SWABRDA	MGSCBIA	SCAIMZA
Aberdeen (SWIP) Absolute Return Bond Fund - D Class Accumulation	M&G Strategic Corporate Bond Fund I Class Accumulation	Schroders Income Maximiser Fund - Z Class Accumulation
P3B/003072Z/1 25/03/2014 3,676,470.588 1.088 4,000,000		0016426876 08/04/2014 1,509,206.160 0.6626 1,000,000
- 1,917,545.542 1.043 (2,000,000)	86,261.182 11.59270 1,000,000	
1.0520 1,850,389		0.7375 1,113,040
1.0552 1,856,018	11.6181 1,002,191	0.7506 1,132,810
1.0570 1,859,184	11.4077 984,042	0.7175 1,082,855
1.0510 1,848,630	11.4784 990,140	0.7184 1,084,214
0055105862 07/08/2015	0236981915 10/08/2015	00184184431 06/08/2015
ABARBII 1,884,216.379	MGSCBII 93,089.085	SCHIMZI 2,013,286.550
0.9799 1,846,344	10.6691 993,177	0.5470 1,101,268
0.9751 1,837,299	10.5952 986,297	0.5065 1,019,730
0.9650 1,818,269	10.5020 977,622	0.4791 964,566
0.9637 1,815,819	10.5101 978,376	0.4972 1,001,006
0.9674 1,822,791	10.6398 990,449	0.4947 995,973
0.9648 1,817,892	10.5060 977,994	0.4772 960,740
0.9609 1,810,544	10.4866 976,188	0.4581 922,287
0.9503 1,790,571	10.4168 969,690	0.4667 939,601
(209,429)	(30,310)	(60,399)

Div payable semi-annually

Div payable quarterly

Div payable quarterly

THNZNAG

MGGDIAG

Threadneedle Global Equity Income Fund - Z Class Accumulation Net		M&G Global Dividend Fund - Class I Accumulation	
0006673718		0226768331	
01/04/2014		26/03/2014	
973,709.835		489,993.898	
1.0270		2.041	
			1,000,000
	1,000,000		
1.1430	1,112,950	2.2121	1,083,916
1.1608	1,130,282	2.2297	1,092,539
1.0877	1,059,104	2.1000	1,028,987
1.0938	1,065,044	2.0796	1,018,991
0010119872		023697193	
07/08/2015		10/08/2015	
THGQZNI	907,898.550	MGGDIIG	616,095.772
1.1792	1,070,594	1.6271	1,002,449
1.1291	1,025,108	1.5348	945,584
1.1087	1,006,587	1.4678	904,305
1.1900	1,080,399	1.5667	965,237
1.1952	1,085,120	1.5773	971,768
1.1977	1,087,390	1.5466	952,854
1.1171	1,014,177	1.4759	909,296
1.2109	1,099,374	1.5931	981,502
	99,374		(18,498)
<i>Div payable quarterly</i>		<i>Div payable quarterly</i>	