

WEST OXFORDSHIRE DISTRICT COUNCIL
FINANCE AND MANAGEMENT OVERVIEW AND SCRUTINY COMMITTEE
8 JUNE 2016

TREASURY MANAGEMENT ACTIVITY AND PERFORMANCE 2016/17

REPORT OF GO SHARED SERVICE HEAD OF FINANCE

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I. PURPOSE

To advise members of the performance of external fund managers for the period 1 April 2016 – 30 April 2016 and inform committee of proposed changes to the Treasury Management Strategy Statement and Investment Strategy for 2016/2017 to 2018/2019.

2. RECOMMENDATION

That treasury management and the performance of external Pooled Funds' activity for the period 1 April 2016 – 30 April 2016.

SUPPORTING INFORMATION

Investment Portfolio Background

- 2.1. The performance of all funds are continually monitored and compared against the 3 month LIBID rate which is 0.46% as at 30 April 2016.

Investment Activity

- 2.2. 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.

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 2016/17.

- 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 via Custodian Service

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.

- 2.3. After a poor year at the back end of 2015 and the beginning of 2016 several of the Fund's values at the end of April 2016 have started to pick up. The table below shows the current value of the Pooled Funds but does not reflect the expected dividend.

Pooled Funds Portfolio

	Initial Investment	1 April Fund Value	30 April Fund Value	Unrealised Gain / (Loss) for 2016/17	Unrealised Gain / (Loss) to Initial Principal
	£	£	£	£	£
Insight LPF – Cash +	2,000,000	2,017,186	2,016,386	(800)	16,386
Payden & Rygel – Cash +	2,000,000	2,034,974	2,035,559	585	35,559
UBS – Bond / Equity	2,000,000	1,949,200	1,950,378	1,178	(49,622)
M&G Strategic – Bond	1,000,000	990,198	999,246	9,048	(754)
Aberdeen – Bond	2,000,000	1,791,237	1,807,564	16,327	(192,436)
Schroders – Equity	1,000,000	972,618	1,007,046	34,428	7,046
Threadneedle – Equity	1,000,000	1,124,886	1,127,519	2,633	127,519
M&G Global - Equity	1,000,000	1,023,951	1,021,672	(2,279)	21,672
	12,000,000	11,904,250	11,965,370	61,120	(34,630)

April saw three of the four equity funds improve mainly down to positive returns on mining, basic materials and energy shares on the global markets. The funds which had exposure to financials (banking) and insurers generated a solid performance after a volatile January and February. Fundamentally investments in companies based in Europe and the US remain in good shape, with little expectations of material deterioration in the short term. However some sectors, most notably those directly exposed to commodity production are under significant earnings pressure with rating agencies turning more negative the longer the situation continues.

- 2.4. **Insight ILF GBP Liquidity Plus Fund** – The Fund aims to preserve capital and provide an investment return in excess of sterling money markets. The fund aims to for a net return equivalent to 0.125% above the 3 month sterling LIBID (currently 0.46%). The performance for 2015/16 was a return of 0.56% which was slightly lower than predicted (0.75%).

Payden Sterling Reserve Fund – The fund invests in a diversified range of sterling-denominated, highly-rated and very liquid government agency securities and corporate fixed – and floating-rate and covered bonds. The Fund has delivered a positive return so far and an income return of 0.75 to 1% is estimated for the year.

UBS Multi-Asset Income Fund – The fund seeks to provide an income, through a diversified portfolio of investments. The fund was increased by a further £1m in April 2015 to £2m but since then has seen its value fall due to the recent poor market returns as highlighted in 2.3. The fund is expected to return income of around 3.5% for the year though.

Aberdeen Absolute Return Bond Fund – The Fund aims to achieve a positive capital return, regardless of market conditions, over rolling 12 month periods. Emphasis on credit and currency positions is the strategy for fixed income. To date the fund value had seen a significant decrease in value since April 2015, however the current value for April did see a

small improvement but is still lower than the original sum invested due to the poor performance made last year. The decision was made in April 2015 to withdraw £2m from this fund and re-invest £1m into UBS Multi-Asset Income Fund and to open a new fund with M&G Strategic Corporate Bond Fund using the remaining £1m. Estimated income dividend returns for the year are expected to be around 1.5%.

Schroder Income Maximiser Fund – The Fund’s investment objective is to provide income with potential for capital growth primarily through investment in equity and equity related securities of UK companies. The fund aims to deliver a target yield of 7% per year. Since 1 April 2016 this fund has risen in value again due to its positioning mainly in the financials and oil industries. An income dividend is estimated to achieve around 5%.

Threadneedle Global Equity Income Fund – The aim of the Fund is to provide income with the potential to grow the amount invested as well. The fund invests two thirds of its assets in shares of companies worldwide. The value of this fund has risen slightly in the first month of this financial year. Estimated income dividend return for the year is 3.5%.

M&G Global Dividend Fund – The fund aims to deliver a dividend yield above the market average, by investing mainly in a range of global equities. The fund aims to grow distributions over the long term whilst also maximising total return. The fund will usually hold around 50 stocks, with a long-term investment view and a typical holding period of three to five years. It has been a challenging 12 months for the M&G Global Dividend Fund with the energy-related holdings, focused on infrastructure and chemical companies (they do not own any oil-producing companies), however they have started to improve recently and it is hoped this fund will see an improvement in 2016. Income return on this fund is expected to be around 3.5% for the year.

M&G Strategic Corporate Bond Fund* - The aim of the Fund is to provide income and capital growth, through a top-down approach of the fund manager’s economic outlook determining the fund duration, the sector allocation and stock concentration. It invests primarily in investment grade corporate bonds. This fund was opened in April 2015; however the initial investment of £1m has seen its value reduce. An annual return of 2.5% is expected from income dividends.

Interest rate forecast

- 2.5 The forthcoming referendum on the UK’s membership of the European Union has made describing the outlook for inflation and growth more challenging for the MPC than usual. The MPC have conditioned their updated projections on an assumed continuation of EU membership.
- 2.6 The MPC continues to expect inflation to pick up over the next year as past falls in commodity prices disappear and the past appreciation of sterling fades. The recovery for inflation is likely to be further supported by the recent sharp rise in oil prices and stimulus from lower market interest rates.
- 2.7 UK GDP growth slowed in Q1 and a further drop is expected in Q2. There are increasing signs that uncertainty associated with the EU referendum has begun to weigh on activity. The MPC expects activity growth to recover later in the year, but not to rates that are below their historical average. Growth over the forecast horizon is expected to be slightly weaker than in previous projections.
- 2.8 The Committee judges that inflation will return back to 2% by mid-2018 and slightly beyond as a result of modest excess demand. The central projections set out in the report are based on a

gentle rise in interest rates over the forecast period. The MPC judges it more likely than not that the Bank Rate will need to be higher at the end of the forecast period in order to return inflation to target in a sustainable.

	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Official Bank Rate												
Upside risk	-	-	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50
Central case	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	0.75	0.75	0.75
Downside risk			-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.50	-0.50	-0.50	-0.50

Treasury Management Strategy Statement and Investment Strategy 2016/17 to 2018/19

2.9 The Council approved its Treasury Management Strategy Statement in February 2016. Within that strategy included the Council’s capital programme that was fully funded from current resources such as capital receipts, grants, developer contributions and revenue finance. The Council is debt free and at the time of approving the current capital programme, intended to maintain that status. However, in recent weeks a number of issues have come to the fore.

- Firstly, the opportunity has arisen to acquire two investment properties in Witney circa £7.5 million
- Secondly, the potential consequences of the new Waste Services contract from October 2017 which will require capital investment of approximately £7 million.

The implications of new capital expenditure of £14.5 million will require a change to the Council’s current Borrowing Strategy.

- 2.10 Negotiations are on-going at the time of writing this report with regard the purchase of the two Witney properties. However, should the purchases proceed it is proposed to utilise earmarked reserves and uncommitted capital receipts to part fund the purchase and the remaining balance, circa £4 million, financed from internal borrowing. This would entail, in consultation with Arlingclose the Council’s treasury advisors, dis-investing parts of the Pooled Funds portfolio to generate the money required.
- 2.11 In terms of business case for taking this course of action, the level of return from the new investment properties would exceed any loss of investment interest plus the revenue cost of repaying the internal loan. It is felt that the Council could trim the investment portfolio by £4 million, especially from holdings that are accruing relatively low levels of return.
- 2.12 The Waste Services contract potential capital implications of £7 million, it is felt could not be met from internal borrowing and consequently would require the Council to borrow either from the Public Works Loan Board or an external finance source. This borrowing would also have a revenue cost. However, the medium term financial strategy had already made some provision for the impact of the Waste Contract, although the full extent of any shortfall is still to be determined.

2.13 It is proposed to take a revised Treasury Management Strategy Statement and Investment Strategy 2016/17 to 2018/19 to the 22 June Cabinet on 22 June 2016 (and the following Council meeting) updating the capital programme whilst setting out a proposed borrowing strategy and its impact on the investment strategy. This will include amending a number of the Council's Prudential Indicators which demonstrate affordability and borrowing limits, whilst also confirming our Minimum Revenue Provision (the revenue implications of repaying the loans).

3. FINANCIAL IMPLICATIONS

The original investment interest budget for 2016/17 was set at £657,500 which was based on an average balance of £33.669 million from all the different type of investments (e.g. fixed term deposits, pooled funds, bonds) achieving an overall average return of 2%. The breakdown of the budget is as follows:

	2016/17 Budget (£)
Pooled Fund Managers	249,700
In-House Investments	68,500
Hanover Housing Assoc	167,500
Bonds	171,800
Total	657,500

At present there are fluctuations within Pooled Funds and Bond valuations and it is too early to forecast to the end of the financial year with any great accuracy. However, depending on the timing of any dis-investment mentioned in paragraph 2.10 above there will need to be revision to the level of Investment Interest that will be achieved this financial year, although this will be more than compensated for due to additional rental income.

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Background Papers
Valuation 30 April 2016 – Pooled Funds & Bonds
Arlingclose Economic and Interest rate forecast

SCHEDULE OF CASH INVESTMENTS OUTSTANDING AT 30 April 2016

NAME OF COUNTERPARTY	VALUE DATE	NOMINAL AMOUNT (£)	MATURITY DATE	RATE OF INTEREST	Long Term	Fitch Credit Rating		
						Short Term	Viability	Support
IN HOUSE MANAGEMENT								
Hanover Housing Association	24.07.13	5,000,000	24.07.18	3.35%	A	FI		
Nationwide BS	05.01.16	1,000,000	05.07.16	0.71%	A	FI	a	5
Lloyds Bank	01.04.16	2,000,000	31.03.17	1.05%	A+	FI	a	5
Lloyds Bank	13.04.16	1,700,000	13.04.17	1.05%	A+	FI	a	5
Nationwide BS	15.04.16	1,000,000	14.10.16	0.71%	A	FI	a	5
Lloyds Bank	15.04.16	1,000,000	13.01.17	0.90%	A+	FI	a	5
Goldman Sachs MMF	30.04.16	4,630,000		0.45%	AAAmmf			
Invesco AIM MMF	30.04.16	860,000		0.50%	AAAmmf			
TOTAL IN-HOUSE INVESTMENTS		17,190,000						
ICELANDIC BANK DEPOSITS								
Glitnir Escrow	27.06.07	236,166		4.22%				
Kaupthing Singer Friedlander	02.07.07	138,828		-				
Glitnir Escrow (Tradition)	31.08.07	538,041		4.22%				
TOTAL ICELANDIC DEPOSITS		913,035						

POOLED FUND & BONDS PORTFOLIO VALUATION AT 30 April 2016

	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		486436	
Date of purchase	£41,729.00		£41,726.00		£41,726.00	
Number of units/shares	£1,520,045.60		£189,845.18		£1,866,019.78	
Purchase Price £	£1.32		£10.53		£0.54	
Initial investment 2013/14		£2,000,000.00		£2,000,000.00		£1,000,000.00
Initial investment 2014/15						
	Unit price	Value	Unit price	Value	Unit price	Value
Mar 2015	£1.33	£2,016,036.48	£10.67	£2,025,667.07	£0.57	£1,065,124.09
Variance to initial investment	£0.01	£16,036.48	£0.01	£25,667.07	£0.07	£65,124.09
Mar 2016	£0.98	£2,017,185.86	£10.09	£2,034,974.00	£0.50	£1,949,199.84
Capital variance to 31/3/2015		£1,149.38		£9,306.93		-£115,924.25
Variance to initial investment		£17,185.86		£34,974.00		-£50,800.16
	<i>Div payable monthly</i>		<i>Div payable quarterly</i>		<i>Div payable quarterly</i>	
April 2016	£0.98	£2,016,385.66	£10.10	£2,035,558.64	£0.50	£1,950,378.32
Variance during year 2016/17		-£800.20		£584.64		£1,178.48
Variance to initial investment		£16,385.66		£35,558.64		-£49,621.68

	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	
Transaction Ref	P3B/003072Z/1				16426876	
Date of purchase	£41,723.00				£41,737.00	
Number of units/shares	£3,676,470.59				£1,509,206.16	
Purchase Price £	£1.09				£0.66	
Initial investment 2013/14	£4,000,000.00					
Initial investment 2014/15					£1,000,000.00	
	Unit price	Value			Unit price	Value
Mar 2015	£1.04	£3,830,882.35			£0.73	£1,105,040.75
Variance to initial investment	-£0.04	-£169,117.65			£1.11	£1,105,040.75
Mar 2016	£0.94	£1,791,237.22	£10.64	£990,197.91	£0.48	£972,618.73
Capital variance to 31/3/2015					-£132,422.02	
Variance to initial investment	-£122,473.23		-£9,802.18		-£27,381.27	
	<i>Div payable semi-annually</i>		<i>Div payable quarterly</i>		<i>Div payable quarterly</i>	
April 2016	£0.95	£1,807,564.34	£10.73	£999,246.17	£0.50	£1,007,045.93
Variance during year 2016/17	£16,327.12		£9,048.26		£34,427.20	
Variance to initial investment	-£106,146.11		-£753.93		£7,045.93	

	Threadneedle Global Equity Income Fund - Z Class Accumulation Net		M&G Global Dividend Fund - Class I Accumulation	
Transaction Ref	6673718		226768331	
Date of purchase	£41,730.00		£41,724.00	
Number of units/shares	£973,709.83		£489,993.90	
Purchase Price £	£1.03		£2.04	
Initial investment 2013/14				£1,000,000.13
Initial investment 2014/15		£1,000,000.00		
	Unit price	Value	Unit price	Value
Mar 2015	£1.15	£1,121,811.10	£2.19	£1,075,291.61
Variance to initial investment	£0.12	£121,811.10	£0.08	£75,291.48
Mar 2015	£1.24	£1,124,886.30	£1.66	£1,023,951.17
Capital variance to 31/3/2015		£3,075.20		-£51,340.44
Variance to initial investment		£124,886.30		£23,951.05
	<i>Div payable quarterly</i>		<i>Div payable quarterly</i>	
April 2016	£1.24	£1,127,519.21	£1.66	£1,021,671.62
Variance during year 2016/17		£2,632.91		-£2,279.55
Variance to initial investment		£127,519.21		£21,671.49