Agenda Item No.8

WEST OXFORDSHIRE DISTRICT COUNCIL

FINANCE AND MANAGEMENT OVERVIEW AND SCRUTINY COMMITTEE WEDNESDAY, 8 JUNE 2016

TREASURY MANAGEMENT ACTIVITY AND PERFORMANCE – 2015/16

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 2015/16.

2. RECOMMENDATION

That treasury management and the performance of in-house and external fund managers' activity for 2015/16 be noted.

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 seven reports between 1 April 2015 and 31 March 2016 regarding investment activities, performance, an annual treasury management report plus the proposed Treasury Management Strategy Statement for 2016//17 onwards.

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 the 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

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.

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Date: 31 May 2016

Appendix A

Annual Treasury Management Report

1. Economic Background

1.1 The UK economy slowed in 2015 with GDP growth falling to 2.3% from a robust 3% the year before. CPI inflation hovered around 0% through 2015 with deflationary spells in April, September and October. The prolonged spell of low inflation attributed to the continued collapse in the price of oil from $67 a barrel in May 2015 to just under $28 a barrel in January 2016, the appreciation of sterling since 2013 pushing down import prices and weaker than anticipated wage growth resulting in subdued unit labour costs.

1.2 The Bank of England's MPC maintained interest rates at 0.5% and asset purchases (QE) at £375bn. In its Inflation Reports and monthly monetary policy meeting minutes, the Bank was at pains to stress and reiterate that when interest rates do begin to rise they were expected to do so more gradually and to a lower level than in recent cycles.

1.3 The slowdown in the Chinese economy became the largest threat to the South East Asian region, particularly on economies with large trade dependency on China and also to prospects for a global growth as a whole. The effect of the Chinese authorities' intervention in their currency and equity markets was temporary and led to high market volatility as a consequence. There were falls in prices of equities and risky assets and a widening in corporate credit spreads. As the global economy entered 2016 there was high uncertainty about growth, the outcome of the US presidential election and the consequences of June's referendum on whether the UK is to remain in the EU. Between February and March 2016 sterling had depreciated by around 3%, a significant proportion of the decline reflecting the uncertainty surrounding the referendum result.

1.4 The UK labour market continued to improve through 2015 and in Q1 2016, the latest figures (Jan 2016) showing the employment rate at 74.1% (the highest rate since comparable records began in 1971) and the unemployment rate at a twelve year low of 5.1%. Wage growth has however remained modest at around 2.2% excluding bonuses, but after a long period of negative real wage growth (i.e. after inflation) real earnings were positive and growing at their fastest rate in eight years, boosting consumers' spending power.

1.5 On the continent, central bankers in the Eurozone, Switzerland, Sweden and Japan were forced to take policy rates into negative territory. The European Central Bank also announced a range of measures to inject sustained economic recovery and boost domestic inflation which included an increase in asset purchases (Quantitative Easing).

1.6 Improvement in household spending, business fixed investment, a strong housing sector and solid employment gains in the US allowed the Federal Reserve to raise rates in December 2015 for the first time in nine years to take the new Federal funds range to 0.25%-0.50%.

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 2015/16. 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 £14.796m at 1 April 2015 and the average balance of investments for the period to 31 March 2016 was £16.153 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 accordance to the Council's investment strategy; although amendments are informed to officers immediately they occur.

The investment income budget for 2015/16 was set at £550k assuming an average investment balance of £37m, achieving an overall return of 1.50%. Investment receipts exceeded budget by £79,111 with the overall level of return of 1.62%. This is detailed in paragraph 2.4 below.

Externally Managed Funds

At the back end of 2013/14 financial year the authority decided to invest £12m over several pooled funds recommended by Arlingclose Ltd. The performance of each of the Pooled Funds can be seen in the table below.

Pooled Funds

Fund Manager	Investment	31st March 2015	31st March 2016	2015/16 Gain/(Loss)	Gain/(Loss) v Orig Investment
	£	£	£	£	£
Insight LPF	2,000,000	2,016,036	2,017,186	1,149	17,186
Payden & Rygel	2,000,000	2,025,667	2,034,973	9,307	25,980
UBS	*2,000,000	1,065,124	1,949,200	(115,924)	(50,800)
Aberdeen	**2,000,000	3,830,882	1,791,237	(39,645)	(209,806)
Schroders	1,000,000	1,105,041	972,619	(132,422)	(27,381)
Threadneedle	1,000,000	1,121,811	1,124,886	3,075	124,886
M&G Global	1,000,000	1,075,050	1,023,951	(51,099)	23,951
M&G Strategic	***1,000,000	0	990,198	(9,802)	(9,802)
	12,000,000	**12,239,611**	11,904,250	**(335,361)**	**(95,750)**

* Purchased an additional £1m of units in April 2015.

** Sold £2m of the £4m Aberdeen Fund units held as at 31st March 2015 in April 2015.

*** Purchased £1m units in April 2015

2.3 The Pooled Funds' have performed well in producing dividends amounting to £186,518 against a budgeted figure of £120,000 returning 1.55% for the year but saw £335.3k wiped off their value compared to the same time as last year. The funds value is now £95.75k under the initial investments made (£12m). However these values can fluctuate from one year to another, and their performance and suitability in meeting the Authority's investment objectives are monitored regularly and discussed with Arlingclose.

2.4

Performance of Fund 1 April 2015 to 31 March 2016	Pooled Funds	In-House	Housing Assoc / Bonds	Total
Budget (£)	£120,000	£72,500	£357,500	£550,000
Budgeted return (%)	1.00%	0.60%	3.31%	1.50%
Gross interest (£)	£186,518	£87,399	£355,194	£629,111
Gross rate of Return (%)	1.55%	0.54%	3.29%	1.62%

2.5 The In-house team were budgeted to achieve £72.5k for the year. Their actual was £87,399, averaging a return of 0.62% from fixed term deposits and 0.44% from Money Market Funds

(MMFs) an overall return of 0.54%. The In-house team are constrained by having to meet cash flow requirements to conduct the Council's business and consequently invested for short time periods especially with Money Market Funds.

The Council held Icelandic investments of £1.137m at 1 April 2015 but did not budget for the return of these funds in terms of capital or interest. The outstanding liability now stands at £1.117m. Interest accrued for 2015/16 from the Glitnir and KSF investments totalled £43k. On top of this the Authority made a gain on the exchange rate on monies held in the Escrow Account of £168k. In total £210k has been made to the investment interest account. This surplus has been identified to a nominated reserve to cover any future exchange rate fluctuations.

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

Movement of Cash Balances 1 April 2015 – 31 March 2016

	Pooled Funds	**In-House**	**Bonds**	**Housing Assoc**	**Total Cash**
	£	£	£	£	£
Fund Value/Cash at 1 April 2015	12,239,611	6,035,000	5,203,612	5,000,000	28,478,223
Cash Invest / Withdraw from Fund	0	(1,525,000)	0	0	(1,525,000)
Increase/(Decrease) in Cash/Value during the period	(335,361)	0	(150,107)	0	(485,468)
Fund Valuation /Cash At 31 March 2016	11,904,250	4,510,000	5,053,505	5,000,000	26,467,755

The cash investments for all funds as at 31 March 2016 are shown in Appendix B

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)
31/03/2015	4.55	A+	4.11	A+	908
30/06/2015	4.32	AA-	3.64	AA-	344
30/09/2015	4.23	AA-	3.75	AA-	594
31/12/2015	4.17	AA-	3.69	AA-	471
31/03/2016	4.22	AA-	3.80	AA-	771

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

<u>Scoring:</u>
-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.

Counterparty Update

3.2 The transposition of two European Union directives into UK legislation placed the burden of rescuing failing EU banks disproportionately onto unsecured institutional investors which include local authorities and pension funds. During the year, all three credit ratings agencies reviewed their ratings to reflect the loss of government support for most financial institutions and the potential for loss given default as a result of new bail-in regimes in many countries. Despite reductions in government support many institutions saw upgrades due to an improvement in their underlying strength and an assessment that that the level of loss given default is low.

3.3 Fitch reviewed the credit ratings of multiple institutions in May. Most UK banks had their support rating revised from 1 (denoting an extremely high probability of support) to 5 (denoting external support cannot be relied upon). This resulted in the downgrade of the long-term ratings of Royal Bank of Scotland (RBS), Deutsche Bank, Bank Nederlandse Gemeeten and ING. JP Morgan Chase and the Lloyds Banking Group however both received one notch upgrades.

3.4 Moody's concluded its review in June and upgraded the long-term ratings of Close Brothers, Standard Chartered Bank, ING Bank, Goldman Sachs International, HSBC, RBS, Coventry Building Society, Leeds Building Society, Nationwide Building Society, Svenska Handelsbanken and Landesbank Hessen-Thuringen.

3.5 S&P reviewed UK and German banks in June, downgrading the long-term ratings of Barclays, RBS and Deutsche Bank. &P also revised the outlook of the UK as a whole to negative from stable, citing concerns around the referendum on EU membership and its effect on the economy.

3.6 At the end of July 2015, Arlingclose advised an extension of recommended durations for unsecured investments in certain UK and European institutions following improvements in the global economic situation and the receding threat of another Eurozone crisis. A similar extension was advised for some non-European banks in September, with the Danish Danske Bank being added as a new recommended counterparty and certain non-rated UK building societies also being extended.

3.7 In December the Bank of England released the results of its latest stress tests on the seven largest UK banks and building societies which showed that the Royal Bank of Scotland and Standard Chartered Bank were the weakest performers. However, the regulator did not require either bank to submit revised capital plans, since both firms had already improved their ratios over the year.

3.8 The first quarter of 2016 was characterised by financial market volatility and a weakening outlook for global economic growth. In March 2016, following the publication of many banks' 2015 full-year results, Arlingclose advised the suspension of Deutsche Bank and Standard Chartered Bank from the counterparty list for unsecured investments. Both banks recorded large losses and despite improving capital adequacy this will call 2016 performance into question, especially if market volatility continues. Standard Chartered had seen various rating actions taken against it by the rating agencies and a rising CDS level throughout the year. Arlingclose will continue to monitor both banks.

4. Update on Iceland Investment

4.1 As of the 31 March 2016 the Council had received £8.130m 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	1.00
Glitnir	5,000,000	4,225,794	0.85
Kaupthing Singer Friedlander	1,500,000	1,361,172	0.84
Total	9,000,000	8,130,673	0.90

4.2 KSF the Council received its thirteenth repayment in March 2016 amounting to 1.25p in the £, taking the amount received to 83.75p in the £. The Administrator has estimated a recovery rate of to be 86.5p. It is estimated the next repayment will be in December 2016.

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. In the meantime these funds remain in Iceland held in an escrow account accruing interest at the rate of just over 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 2015/16, which were set in February 2015 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 2015/16. 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 2015/16, 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 2015/16 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 2016

NAME OF COUNTERPARTY	VALUE DATE	NOMINAL AMOUNT (£)	MATURITY DATE	RATE OF INTEREST	Fitch Credit Rating
IN HOUSE MANAGEMENT					
Invesco MMFs	31.03.16	3,050,000	01.04.16	0.50%	AAA/MMF
Goldman Sachs MMF	31.03.16	460,000	01.04.16	0.41%	AAA/MMF
Hanover Housing Association	24.07.13	5,000,000	24.07.18	3.35%	AA
Nationwide Building Society	05.01.16	1,000,000	05.07.16	0.71%	A
TOTAL IN-HOUSE INVESTMENTS		**9,510,000**			

ICELANDIC BANK DEPOSITS				
GLITNIR	27.06.07	236,166	29.06.09	6.520%
Kaupthing Singer Friedlander	02.07.07	138,828	02.07.09	6.590%
GLITNIR (Tradition)	31.08.07	538,041	28.08.09	6.350%
TOTAL ICELANDIC DEPOSITS		**913,035**		

BONDS	BOOK COST(£)	MARKET VALUE (£)
A2D Bond (4.75%)	2,500,000	2,675,792
Place for People Bond (5%)	2,445,276	2,377,713
TOTAL VALUE OF BONDS	**4,945,286**	**5,053,505**

MANAGED FUNDS		NOMINAL VALUE (£)	MARKET VALUE (£)
Aberdeen Absolute Return Bond Fund	31.03.16	2,000,000	1,791,237
Payden Sterling Reserve Fund	31.03.16	2,000,000	2,034,974
M&G Global Dividend Fund	31.03.16	1,000,000	1,023,951
Threadneedle Global Equity Fund	31.03.16	1,000,000	1,124,886
Insight Liquidity Plus Fund	31.03.16	2,000,000	2,017,186
UBS Multi-Asset Income Fund	31.03.16	2,000,000	1,949,200
Schroders Income Maximiser Fund	31.03.16	1,000,000	972,618
M&G Strategic Bond Fund	31.03.16	1,000,000	990,198
TOTAL VALUE OF FUND		**12,000,000**	**11,904,250**

Appendix C

Capital Expenditure 2015/16

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	2015/16 Approved £	2015/16 Actual £
General Fund	2,414,200	1,150,365

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

Capital Financing	2015/16 Approved £	2015/16 Actual £
Capital receipts	935,500	147,848
Government Grants /Contributions	1,664,300	358,423
Revenue contributions	800,000	644,094
Total Financing	2,414,200	1,150,365

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	2015/16 Original %	2015/16 Revised %	2015/16 Actual %
General Fund	-8.00	-6.00	-6.45

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