

WEST OXFORDSHIRE DISTRICT COUNCIL
FINANCE AND MANAGEMENT OVERVIEW AND SCRUTINY COMMITTEE
WEDNESDAY 28 SEPTEMBER 2016

TREASURY MANAGEMENT ACTIVITY AND PERFORMANCE 2016/17

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 2016 – 31 August 2016.

2. RECOMMENDATIONS

That treasury management and the performance of in-house and external Pooled Funds' activity for the period 1 April 2016 – 31 August 2016 are noted.

3. BACKGROUND

Investment Portfolio Background

- 3.1. The in- house investment balance amounted to £9.510m at 1 April 2016 inclusive of the long term loan to Hanover Housing Association. The average balance of investments for the period to 31 August 2016 rose to £22.208m in line with cash-flow forecasts for 2016/17 achieving a return of 1.27% for the period.
- 3.2. Bonds purchased in 2013/14 (at a cost of £4.942m) were valued at £5.054m at 31st March 2016 and are now valued at £5.027m on 30 August 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 0.41% as at 31 August 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 2016/17. New investments were made in line with policy as quoted in the Investment Strategy for 2016/17:

- AAA-rated Money Market Funds;
- Term Deposits with UK Banks and Building Societies systemically important to the UK banking system;
- Certificate of Deposits (CD's) and Bonds with UK and Non UK banks and corporates.
- 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 30 August 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 1 April 2016 to 30 August 2016 (annualised returns)	In-House	Bonds
Net Return	1.27%	3.76%

- 3.7 The current In-house investments have achieved a net return of 1.27% which is 0.86% 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 deposits taken with Lloyds Bank at the beginning of year with an average rate of 1.05% for the year were achieved. However it should be noted in-house investments returns will fall during the second half of this financial year due to the Bank Base Rate falling from 0.50% to 0.25% at the beginning of August 2016. Also income from Council Tax and Business Rates falls dramatically in February and March so investment balances will decrease over this period of time.

The table below shows the current valuations of the Pooled Funds portfolio at the end of August 2016 compared with the values at the close of the 2015/16 financial year. In the first five months of the year we have seen a gain of over £476.5k.

	Initial Investment	1 April Fund Value	31 August Fund Value	Unrealised Gain / (Loss) for 2016/17	Unrealised Gain / (Loss) to Initial Principal
	£	£	£	£	£
Insight LPF – Cash +	2,000,000	2,017,186	2,017,042	(144)	17,042
Payden & Rygel – Cash +	2,000,000	2,034,974	2,036,076	1,102	36,076
UBS – Bond / Equity	2,000,000	1,949,200	2,021,480	72,280	21,480
M&G Strategic – Bond	1,000,000	990,198	1,061,700	71,502	61,700
Aberdeen – Bond	2,000,000	1,790,194	1,802,630	12,436	(197,370)
Schroders – Equity	1,000,000	972,619	1,029,393	56,774	29,393
Threadneedle – Equity	1,000,000	1,124,886	1,253,536	128,650	253,536
M&G Global - Equity	1,000,000	1,023,951	1,157,890	133,939	157,890
August 2016 Total	12,000,000	11,903,208	12,379,747	476,539	379,747
Previous Report – June 2016				126,627	29,835

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 for a net return equivalent to 0.125% above the 3 month sterling LIBID (currently 0.41%). The performance for 2016/17 is estimated to make a return of 0.50% to 0.75% which is on target with the budget.

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 0.80% is estimated for the year, slightly up on the budgeted return (0.70%).

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 and has recently seen its capital value increase from a negative position in the last report. The fund is expected to return income of around 3% to 3.5% for the year.

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 has seen a significant decrease in value since April 2015, however the current value has increased from April 2016, 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 between 1% and 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 between 7% - 7.5% compared with a budgeted estimate of 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 strongly in the first five months of this financial year. Estimated income dividend return for the year is 3.5% - 4%.

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, and the fund has now started to improve recently and it is hoped will see a big improvement in 2016. Income return on this fund is expected to be around 3.25% - 3.75% 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. An annual return of 2.5% is expected from income dividends.

4. Economic and Interest Rate Forecast

4.1 The economic trajectory for the UK has been immeasurably altered following the vote to leave the EU. The long-term position of the UK economy will be largely dependent on the agreements the government is able to secure with the EU and other countries. The short to medium-term outlook is somewhat more downbeat due to the uncertainty generated by the result and the forthcoming negotiations. The rapid installation of a new prime minister and cabinet lessened the political uncertainty, and the government/Bank of England has been proactive in tackling the economic uncertainty.

4.2 UK CPI inflation (currently 0.6% year/year) will rise close to target over the coming year as previous rises in commodity prices and the sharp depreciation in sterling begin to drive up imported material costs for companies. The rise in inflation is highly unlikely to prompt monetary tightening by the Bank of England, with policymakers looking through import-led CPI spikes to the negative effects of Brexit on economic activity and, ultimately, inflation. The view of Arlingclose Interest rate forecast is the possibility of a further cut in Base Rate close to zero, with a small chance of a reduction below zero as can be seen from the table below.

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

5. BORROWING STRATEGY

- 5.1. At the time of writing this report the Council is finalising the purchase of an investment property. In the short term the Council will also be making further capital investments in property, vehicles and equipment and will need to undertake a level of borrowing from internal and external sources. With regard this initial purchase, the council is looking at the possibility of taking out a loan as well as using current investments to fund this transaction. The objective when borrowing continues to be striking a low risk balance between securing low interest costs and achieving cost certainty over the period for which the funds are required, with flexibility to renegotiate loans should the council's long-term plans change.
- 5.2. At the moment short-term interest rates are very low, and are likely to remain that way for a significant period (lower than long-term rates). Consequently, it may be appropriate to initially borrow short term to cover the cash flow implications of the investment purchase. Alternatively, the Council could use some of its current investments held in Pooled Funds and /or other deposits. The benefits of this (known as internal borrowing) will need to be closely monitored against the potential for incurring additional costs by deferring borrowing into future time periods when long-term borrowing rates are forecast to rise.
- 5.3. The large fall in gilt yields and Public Works Loan Board (PWLB) rates in the period leading up to and following the EU referendum vote result has provided an opportunity to borrow from the PWLB, which is the Council's preferred source of borrowing given the transparency and control that its facilities continue to provide.
- 5.4. Arlingclose Ltd the council's treasury advisors will be consulted on all of the options available before any decisions are made.

6. 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 1.95%. The breakdown of the budget and a forecast for the year is as follows:

	2016/17 Budget (£)	2016/17 Forecast Return (£)
Pooled Fund Managers	249,700	264,000
In-House Investments	68,500	40,000
Hanover Housing Assoc	167,500	167,500
Bonds	171,800	171,800
Total	657,500	643,300

The above forecast has assumed £4m will be recalled from the Pooled Funds to part fund the asset purchase in September 2016, but even with this level of withdrawal the Pooled Funds dividends are estimated to exceed what was initially budgeted. However, the reduced interest rates achievable by the In-House investments means that in bottom line terms there will be a budget shortfall of approximately £14,200. If the Bank of England do make a further cut to the Base Rate then the In- House investments returns could worsen.

The above forecast is only one scenario of recalling some of the Pooled Fund portfolio. However, as mentioned in paragraph 5.2 above there are alternative short term borrowing options. It should be noted that the cash flow impact of the investment property purchase and the consequent shortfall in investment interest, this financial year and on-going, will be more than compensated by additional rental income.

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Date: 9th September 2016
Background Papers
Valuation 31 August 2016 – Pooled Funds & Bonds
In – House investment as at 31 August 2016

SCHEDULE OF CASH INVESTMENTS OUTSTANDING AT 30 AUGUST 2016

NAME OF COUNTERPARTY	VALUE DATE	NOMINAL AMOUNT (£)	MATURITY DATE	RATE OF INTEREST	Fitch Credit Rating / Fitch Credit			
					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
Barclays	05.08.16	1,000,000	07.11.16	0.20%	A	FI	a	5
Lloyds	01.04.16	2,000,000	31.03.17	1.05%	A+	FI	a	5
Lloyds	13.04.16	1,700,000	13.04.17	1.05%	A+	FI	a	5
Lloyds	15.04.16	1,000,000	13.01.17	0.90%	A+	FI	a	5
Rabobank International	06.05.16	1,000,000	06.02.17	0.70%	AA-	FI	a	5
Nationwide Building Society	15.04.16	1,000,000	14.10.16	0.71%	A	FI	a	5
Nationwide Building Society	16.05.16	2,000,000	16.11.16	0.71%	A	FI	a	5
Nationwide Building Society	05.07.16	1,000,000	05.01.17	0.55%	A	FI	a	5
Nationwide Building Society	01.08.16	1,000,000	01.02.17	0.48%	A	FI	a	5
Goldman Sachs MMF	31.08.16	3,130,000		0.35%	AAAmmf			
Invesco AIM MMF	31.08.16	4,020,000		0.39%	AAAmmf			
TOTAL IN-HOUSE		23,850,000						
ICELANDIC BANK								
Kaupthing Singer Friedlander	02.07.07	138,828		-				
TOTAL ICELANDIC		138,828						

West Oxfordshire DC - Pooled Funds

	Insight Liquidity Plus Fund - Share Class 3		Payden & Rygel Sterling Reserve Fund - Accumulation		UBS Multi Asset Income Fund - L Class Accumulation Gross		Aberdeen (SWIP) Absolute Return Bond Fund - D Class Accumulation	
Date of purchase	31/03/2014		28/03/2014		28/03/2014		25/03/2014	
Number of units/shares	1,520,045.60		189,845.18		1,866,019.78		3,676,470.59	
Purchase Price £	1.31575		10.5349		0.536		1.088	
Initial investment 2013/14 £	2,000,000		2,000,000		1,000,000		4,000,000	
Initial investment 2014/15								
Date of switch	17/08/2015		07/08/2015		07/08/2015		07/08/2015	
Ticker/Number of income shares	INLIQP5	2,051,799.72	PAYSRSD	200,707.34	UMAIGLI	3,928,254.42	ABARBII	1,884,216.38
Price of income shares /Value	0.98397	2,018,909	10.0951	2,026,161	0.5204	2,044,264	0.9799	1,846,344
Aug-15	0.9841	2,019,074	10.0996	2,027,064	0.5069	1,991,232	0.9751	1,837,299
Balance as at 31/03/2016	0.9831	2,017,186	10.0942	2,034,974	0.4962	1,949,200	0.9501	1,790,194
Capital variance to 31/3/2015	1,149		9,306		-115,924			
Variance to initial investment	17,186		34,974		-50,800		-123,516	
	<i>Div payable monthly</i>		<i>Div payable quarterly</i>		<i>Div payable quarterly</i>		<i>Div payable semi-annually</i>	
Apr-16	0.9827	2,016,386	10.0971	2,026,562	0.4965	1,950,378	0.9521	1,793,962
May-16	0.9818	2,014,519	10.1107	2,029,292	0.4977	1,955,092	0.9559	1,801,122
Jun-16	0.9813	2,013,328	10.1084	2,028,830	0.5023	1,973,162	0.9525	1,794,716
Jul-16	0.9818	2,014,395	10.1277	2,032,704	0.5087	1,998,303	0.959	1,806,964
Aug-16	0.9831	2,017,042	10.1445	2,036,076	0.5146	2,021,480	0.9567	1,802,630
Capital variance to 31/3/2016	-144		1,102		72,280		12,436	
Variance to initial investment	17,042		36,076		21,480		-111,081	

	M&G Strategic Corporate Bond Fund I Class Accumulation		Schroders Income Maximiser Fund - Z Class Accumulation		Threadneedle Global Equity Income Fund - Z Class Accumulation Net		M&G Global Dividend Fund - Class I Accumulation	
Date of purchase			08/04/2014		01/04/2014		26/03/2014	
Number of units/shares			1,509,206.16		973,709.84		489,993.90	
Purchase Price £			0.6626		1.027		2.041	
Initial investment 2013/14 £								1,000,000
Initial investment 2014/15				1,000,000		1,000,000		
Date of switch	10/08/2015		06/08/2015		07/08/2015		10/08/2015	
Ticker/Number of income shares	MGSCBII	93,089.09	SCHIMZI	2,013,286.55	THGQZNI	907,898.55	MGGDIIG	616,095.77
Price of income shares /Value	10.6691	993,177	0.547	1,101,268	1.1792	1,070,594	1.6271	1,002,449
Aug-15	10.5952	986,297	0.5065	1,019,730	1.1291	1,025,108	1.5348	945,584
Balance as at 31/03/2016	10.6371	990,198	0.4831	972,619	1.239	1,124,886	1.662	1,023,951
Capital variance to 31/3/2015				-132,422		3,075		-51,340
Variance to initial investment		-9,802		-27,381		124,886		23,951
	<i>Div payable quarterly</i>		<i>Div payable quarterly</i>		<i>Div payable quarterly</i>		<i>Div payable quarterly</i>	
Apr-16	10.7343	999,246	0.5002	1,007,046	1.2419	1,127,519	1.6583	1,021,672
May-16	10.7737	1,002,914	0.4946	995,772	1.2236	1,110,905	1.6366	1,008,302
Jun-16	10.793	1,004,710	0.4735	953,291	1.3111	1,190,346	1.7391	1,071,452
Jul-16	11.1338	1,036,435	0.4959	998,389	1.3869	1,259,164	1.8216	1,122,280
Aug-16	11.4052	1,061,700	0.5113	1,029,393	1.3807	1,253,536	1.8794	1,157,890
Capital variance to 31/3/2016		71,502		56,775		128,649		133,939
Variance to initial investment		61,700		29,393		253,536		157,890