Agenda Item No. 9

WEST OXFORDSHIRE DISTRICT COUNCIL

FINANCE AND MANAGEMENT OVERVIEW AND SCRUTINY COMMITTEE WEDNESDAY, 31 MAY 2017

TREASURY MANAGEMENT ACTIVITY AND PERFORMANCE – 2016/17

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 2016/17.

2. RECOMMENDATION

That treasury management and the performance of in-house and external fund managers' activity for 2016/17 are 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 2016 and 31 March 2017 regarding investment activities, performance, an annual treasury management report plus the proposed Treasury Management Strategy Statement for 2017/18 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: 22 May 2017

Appendix A

Annual Treasury Management Report

1. Economic Background

1.1 Politically, 2016/17 was an extraordinary twelve month period which defied expectations when the UK voted to leave the European Union and Donald Trump was elected as the new President of the USA. Uncertainty over the outcome of the US presidential election, the UK's future relationship with the EU and the slowdown witnessed in the Chinese economy in early 2016 all resulted in significant market volatility during the year. Article 50 of the Lisbon Treaty, which sets in motion the 2-year exit period from the EU, was triggered on 29th March 2017.

1.2 UK inflation had been subdued in the first half of 2016 as a consequence of weak global price pressures, past movements in sterling and restrained domestic price growth. However the sharp fall in the Pound following the referendum had an impact on import prices which, together with rising energy prices, resulted in CPI rising from 0.3% year on year in April 2016 to 2.3% in March 2017.

1.3 In addition to the political fallout, the referendum's outcome also prompted a decline in household, business and investor sentiment. The repercussions on economic growth were judged by the Bank of England to be sufficiently severe to prompt a cut to the Bank Rate to 0.25% in August and embark on further gilt and corporate bond purchases as well as providing cheap funding for banks via the Term Funding Scheme to maintain the supply of credit to the economy.

1.4 Despite growth forecasts being downgraded, economic activity was fairly buoyant and GDP grew 1.8% over the past three quarters in 2016. The labour market also proved resilient, with the official unemployment rate dropping to 4.7% in February 2017, its lowest level in 11 years.

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 2016/17. 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 £9.510m at 1 April 2016 and the average balance of investments for the period to 31 March 2017 was £23.365 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 included 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 with the Council's investment strategy; although amendments are informed to Officers immediately as they occur.

The investment income budget for 2016/17 was set at £657,500 assuming an average investment balance of £34m, achieving an overall return of 1.95%. Investment receipts exceeded budget by £76,476 with the overall level of return of 1.85% and with an average investment balance of £39.5m. This is detailed in paragraph 2.4 below.

Externally Managed Funds

During the 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.

The funds were originally invested in a broad split of £4m short dated liquidity funds; £4m medium dated bond funds; £4m equity income funds. This was intended to give a balanced approach to liquidity and risk.

Pooled Funds

Fund Manager	Investment	31st March 2016	31st March 2017	31st March 2017 Dividend	2016/17 Gain/(Loss)	Gain/(Loss) v Orig Investment
	£	£	£	£	£	£
Insight LPF (L)	2,000,000	2,017,186	2,020,017	15,351	2,831	20,017
Payden & Rygel (L)	2,000,000	2,034,974	2,045,356	15,281	10,382	45,356
UBS (B/E)	2,000,000	1,949,200	2,004,981	77,387	55,781	4,981
Aberdeen(B)	**2,000,000	1,790,194	0	13,100	(174,400)	(174,400)
Royal London (L)	*2,000,000	0	2,000,224	6,161	224	224
Schroders (E)	1,000,000	972,619	1,086,168	72,326	113,549	86,168
Threadneedle (E)	1,000,000	1,124,886	1,379,098	45,273	254,212	379,098
M&G Global (E)	1,000,000	1,023,951	1,349,619	36,555	325,668	349,619
M&G Strategic (B)	1,000,000	990,198	1,030,971	30,393	40,773	30,971
	12,000,000	**11,903,208**	**12,916,434**	**311,827**	**629,020**	**742,034**

* Purchased £2m units with Royal London on 06/01/2017

** The Aberdeen Fund was sold on 12/12/16

(L = Liquidity ; B= Bond; E= Equity)

2.3 The Pooled Funds' have performed well in producing dividends amounting to £311,827 against a budgeted figure of £249,700 returning 2.59% for the year on the original £12m invested. On top of this we also saw the capital value of the Funds increase by £629k compared to the same time as last year. The total funds value is now £916k more than the initial investments made (£12m), but there was also a loss on the sold Aberdeen Fund shares for £174.4k to take into account, bringing the additional value down to £742k. 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 The overall performance is shown in the table below:-

Performance of Fund 1 April 2016 to 31 March 2017	**Pooled Funds**	**In-House**	**Housing Assoc Bonds**	**Total**
Budget (£)	£249,700	236,000	£171,800	£657,500
Budgeted return (%)	2.14%	1.00%	3.57%	2.00%
Gross interest (£)	£311,827	£271,802	£150,347	£768,334
Gross rate of Return (%)	2.59%	1.16%	3.57%	1.85%

2.5 The In-house team were budgeted to achieve £236k for the year which included the loan to a Housing Association. Their actual was £271.8k, averaging a return of 1.60% from fixed term deposits and 0.36% from Money Market Funds (MMFs) an overall return of 1.16%. 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 £1.117m at 1 April 2016 but did not budget for the return of these funds in terms of capital or interest. In June 2016 the Council participated in an auction to sell its Icelandic Krona held in a Glitnir Escrow account and £1.009m was received in July 2016. The outstanding liability now stands at £256k which is held with Kaupthing Singer and Friedlander (KSF) however it is anticipated that the Council will receive a further £23k in future creditor pay-outs. Interest accrued for 2016/17 from the Glitnir and KSF investments totalled £13.5k. More detail on these transactions is given in section 4 below.

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

Movement of Cash Balances 1 April 2016 – 31 March 2017

	Pooled Funds	In-House	Bonds	Housing Assoc	Total Cash
	£	£	£	£	£
Fund Value/Cash at 1 April 2016	11,904,250	4,510,000	5,053,505	5,000,000	26,467,755
Cash Invest / (Withdraw)from Fund	174,400	7,755,000	(2,300,000)	0	5,629,400
Increase/(Decrease) in Cash/Value during the period	837,785	0	31,245	0	869,030
Fund Valuation /Cash At 31 March 2017	12,916,435	12,265,000	2,784,750	5,000,000	32,966,185

The cash investments for all funds as at 31 March 2017 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)
31/03/2016	4.90	A+	5.07	A+	771
30/06/2016	5.06	A+	5.07	A+	504
30/09/2016	5.08	A+	5.06	A+	250
31/12/2016	4.93	A+	5.00	A+	358
31/03/2017	4.81	A+	5.02	A+	460

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.

Financial Markets

3.2 The Financial Markets following the referendum result, gilt yields fell sharply across the maturity spectrum on the view that Bank Rate would remain extremely low for the foreseeable future. After September 2016 there was a reversal in longer-dated gilt yields which moved higher, largely due to the MPC revising its earlier forecast that Bank Rate would be dropping to near 0% by the end of 2016.

3.3 After recovering from an initial sharp drop in Quarter 2, equity markets rallied and the FTSE-100 and FTSE All Share indices closed 18% higher at 31 March 2017 compared with a year ago. Commercial property values fell around 5% after the referendum, but had mostly recovered by the end of March.

3.4 Fitch and Standard & Poor's downgraded the UK's sovereign rating to AA. All three of major credit agencies have a negative outlook on the UK. Moody's has a negative outlook on those banks and building societies that it perceives to be exposed to a more challenging operating environment arising from the 'leave' outcome.

3.5 None of the banks on the Authority's lending list failed the stress tests conducted by the European Banking Authority in July and by the Bank of England in November, the latter being designed with more challenging stress scenarios, although the Royal Bank of Scotland was one of the weaker banks in both tests.

3.6 On the advice of Arlingclose, new investments with Deutsche Bank and Standard Chartered were suspended in March 2016 due to the banks relatively higher credit default swap (CDS) levels and disappointing 2015 financial results. Standard Chartered was reintroduced to the counterparty list in March 2017 following its strengthening financial position, but Deutsche Bank was removed altogether from the list.

3.7 In July, following a review of unrated building societies' annual financial statements, Cumberland, Harpenden and Vernon building societies were removed from the Authority's list due to deterioration in credit indicators. A further eleven building societies were also lowered from 6 months to 3 months due to uncertainty facing the UK housing market following the EU referendum.

4. Update on Iceland Investment

4.1 As of the 31 March 2017 the Council had received £9.148m 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	5,235,160	100
Kaupthing Singer Friedlander	1,500,000	1,369,298	84
Total	9,000,000	9,148,165	95

4.2 KSF the Council received its fourteenth repayment in November 2016 amounting to 0.5p in the £, taking the amount received to 84.25p in the £. The Administrator has estimated a recovery rate of 86.5p. The next repayment was made in May 2017 with a payment of 0.9p in the pound.

4.3 Glitnir – In June 2016 the Council participated in an auction to sell its Icelandic Krona held in a Glitnir Escrow account and £1.009m was received in July 2016. The account is fully repaid now.

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 2016/17, which were set in February 2016 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 2016/17. 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 2016/17, 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 2016/17 is 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 2017

NAME OF COUNTERPARTY	VALUE DATE	NOMINAL AMOUNT (£)	MATURITY DATE	RATE OF INTEREST	Fitch Credit Rating
IN HOUSE MANAGEMENT					
Invesco MMFs	31.03.17	2,265,000	01.04.17	0.30%	AAA/MMF
Deutsche Global Asset MMF	31.03.17	4,300,000	01.04.17	0.25%	AAA/MMF
Hanover Housing Association	24.07.13	5,000,000	24.07.18	3.35%	AA
Canadian Imperial Bank of Commerce	18.10.16	1,000,000	18.10.17	0.64%	AA-
Lloyds Bank	13.04.16	1,700,000	13.04.17	1.05%	A+
Lloyds Bank	13/01/17	1,000,000	15.01.18	0.90%	A+
Lloyds Bank	31/03/17	2,000,000	29/03/18	0.80%	A+
TOTAL IN-HOUSE INVESTMENTS		**17,265,000**			

ICELANDIC BANK DEPOSITS					
Kaupthing Singer Friedlander	02.07.07	130,702	02.07.09	6.590%	
TOTAL ICELANDIC DEPOSITS		**130,702**			

BONDS	BOOK COST(£)	MARKET VALUE (£)
A2D Bond (4.75%)	2,500,000	2,784,750
TOTAL VALUE OF BONDS	**2,500,000**	**2,784,750**

MANAGED FUNDS		NOMINAL VALUE (£)	MARKET VALUE (£)
Royal London Cash Plus Fund	31.03.17	2,000,000	2,000,224
Payden Sterling Reserve Fund	31.03.17	2,000,000	2,045,356
M&G Global Dividend Fund	31.03.17	1,000,000	1,349,620
Threadneedle Global Equity Fund	31.03.17	1,000,000	1,379,098
Insight Liquidity Plus Fund	31.03.17	2,000,000	2,020,017
UBS Multi-Asset Income Fund	31.03.17	2,000,000	2,004,981
Schroders Income Maximiser Fund	31.03.17	1,000,000	1,086,168
M&G Strategic Bond Fund	31.03.17	1,000,000	1,030,971
TOTAL VALUE OF FUND		**12,000,000**	**12,916,435**

Appendix C

Capital Expenditure 2016/17

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	2016/17 Approved £	2016/17 Actual £
General Fund	9,833,700	7,904,331

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

Capital Financing	2016/17 Approved £	2016/17 Actual £
Capital receipts	2,432,000	815,000
Government Grants /Contributions	576,200	665,080
Internal borrowing	4,810,381	4,693,545
Revenue contributions	2,015,119	1,730,706
Total Financing	**9,833,700**	**7,904,331**

3. Ratio of Financing Costs to Net Revenue Stream – this is an indicator of affordability and highlights the revenue implications of existing 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	2016/17 Estimate %	2016/17 Actual %
General Fund	-10%	-7.8%

As the Council is in a net investment position the ratio is showing negative results, indicating that investment income exceeds borrowing costs.