

Strategy and Resources Committee  
25 September 2018

**Treasury Management – Year End Performance 2017/18**

<b>Report of the:</b>	Chief Finance Officer
<b>Contact:</b>	Lee Duffy
<b>Urgent Decision?(yes/no)</b>	No
<b>If yes, reason urgent decision required:</b>	N/A
<b>Annexes/Appendices (attached):</b>	<b>Annex 1</b> - Treasury Management Review 2017/18 <b>Annex 2</b> - Prudential indicators 2017/18
<b>Other available papers (not attached):</b>	Fund Manager Performance Reports 2017/18 and Final Accounts Working Papers 2017/18.

**Report Summary**

This report reviews the performance of the council's treasury management function in 2017/18 and provides an update on Ministry of Housing, Communities and Local Government's (MHCLG) new Statutory Guidance on Local Government Investments.

**Recommendation (s)**

That the Committee:-

- (1) receives the report on the Council's treasury management performance 2017/18;
- (2) approves the actual 2017/18 prudential indicators;
- (3) notes MCHLG's Statutory Guidance on Local Government Investments;
- (4) notes the suspension of further out-of-Borough investment property acquisitions, where the main purpose is purely to profit, until further guidance or case law is published that clarifies the Council's related vires.

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### **1 Implications for the Council's Key Priorities, Service Plans and Sustainable Community Strategy**

- 1.1 Income earned from investments is used to help finance Council's services. The Treasury Management Strategy, approved by Council in February 2018, sets out the strategy and procedures that are adopted to manage the investment of reserves, provisions and cash flow.

### **2 Introduction**

- 2.1 A review of treasury management performance and activity is prepared on an annual basis. This is completed in line with Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management in the Public Sector and the Treasury Management Strategy approved by Council.
- 2.2 The reporting requirements of the annual performance review meet the requirements of the CIPFA Prudential Code.

### **3 Background**

- 3.1 The Council, as part of its financial strategy, maintains revenue reserves, provisions and capital reserves. For several years the main part of the Council's cash balances have been invested with external fund managers who use their expertise to invest on the money market to achieve maximum returns within defined risk parameters. The Council currently uses one external fund manager, Aberdeen Asset Management. At the end of March 2018 the Council had £7.1 million invested with this fund manager.
- 3.2 Internally managed balances can be invested in long term gilts or deposits with a balance retained to meet short term cash flows invested in temporary loans or money market funds. At the end of March 2018 the Council had £5.5 million held in money market funds.
- 3.3 At the end of March 2018, the Council's investments totalled £12.6m, which was £16.3m lower than the equivalent balance of £28.9m at the end of March 2017. The reduction in investment balances is principally because in-year surplus cash totalling £20.1m has been used to reduce the level of external borrowing needed to fund the Council's investments in commercial property. This substantially reduces the interest that the Council would otherwise pay on borrowings. Interest on external borrowings is typically paid at around 2.5%, whereas the net return on the Council's investments averaged 0.64% in 2017/18.
- 3.4 At the end of March 2018, the Council had external debt with the Public Works Loans Board of £64.4m (£19.1m March 2017).

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- 3.5 The Committee will note that the Pension Fund does not form part of the Council's investments and is managed on our behalf by Surrey County Council.
- 3.6 The aim of treasury management is to ensure that funds are invested with institutions that balance the need to maximise investment returns with that of minimising risk on the monies invested. This means not investing in banks/building societies that are offering high investment returns but are at high risk of defaulting.

### 4 Performance Review

- 4.1 A report on Treasury Management performance for 2017/18 is attached to this report at Annexe 1.
- 4.2 No temporary borrowings were required in 2017/18 except use of the Council's bank overdraft facility.
- 4.3 The average return achieved for 2017/18 of 0.64% compares favourably with the benchmark seven day London Interbank Bid (LIBID) rate of 0.21%. This amounted to total net income for the year of £196,104, generated on reserves, working balances and cash flow.
- 4.4 This compares favourably to the forecast reported in the half year report to Financial Policy Panel in December 2017, when it was anticipated that income from investments would be £179,000 at the end of the year.
- 4.5 The performance for 2017/18 on the Council's investments were as follows;

	Average Investment	Interest Received	Average Rate of Return
Internally Managed Funds	£'m	£'000	%
Money Market Funds	5.8	21	0.37
Interest Bearing Account	0.4	1	0.17
Fixed Rate Deposit	6.5	67	1.03

Externally Managed Funds			
Aberdeen Asset Management	18.1	107	0.59
<b>Total</b>	<b>30.9</b>	<b>196</b>	<b>0.64</b>

- 4.6 Returns on investments for 2017/18 were £28,000 more than the budgeted income for the year and the average annualised return on investments was 0.64%.

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- 4.7 Epsom and Ewell Borough Council has achieved this performance by following the strategy of investing its long to medium term funds in 1 year fixed term deposits and with its external fund manager, Aberdeen Asset Management and keeping short term funds mainly in money market funds or in an interest bearing instant access account.

### **5 Internally Managed Funds**

#### **Money Market Funds**

- 5.1 Money market funds are pooled investments that allow instant access to withdraw monies. The benefit of MMFs is that the risk on the investment is very low as the money invested in the fund is spread across a range of counterparties, which limits the exposure of a significant sum be invested with a defaulting counterparty.
- 5.2 The return made on money market funds of 0.37% compared favourably to the benchmark of 0.21%. Investment in money market funds has been limited to short term investments from surplus funds which can be called back with no notice required.

#### **Interest Bearing Accounts**

- 5.3 Interest bearing accounts offer the same instant access as the money market funds and deliver a rate of return linked to base rate set by the Bank of England.
- 5.4 The risk on these investments is higher than the money market funds as money is deposited with one counterparty. Funds invested in this type of investment tend to be surpluses of daily cash flows which need to be called back at short notice.
- 5.5 The return made on interest bearing accounts of 0.17% compared to the benchmark of 0.21%.

#### **Fixed Interest Investments**

- 5.6 The Council had no fixed term deposits at the end of March 2018. During the 2017/18 year, the amount invested in fixed term deposits averaged £6.5m. The average return made on these investments was 1.03% compared to the benchmark of 0.21%.
- 5.7 The current strategy and guidance obtained from our independent advisors is to limit fixed term investments to a period of one year.

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### 6 Externally Managed Funds

- 6.1 In continuing difficult market conditions our external fund manager delivered returns of 0.59% for 2017/18 which compares to 1.05% for 2016/17. For the majority of 2017/18, the Bank of England base rate was 0.25%, until November 2017 when it increased to 0.5%. Returns have remained at historically low levels since October 2009 and opportunities for delivering significant returns remain limited.
- 6.2 The Council continues to invest a significant element of its medium to long term funds with Aberdeen Asset Management (formerly known as Scottish Widows).
- 6.3 The main benefit to the Council of using external fund managers is to minimise the Council's risk, as the funds invested with Aberdeen Asset Management are spread across a wide portfolio of financial institutions. This results in the overall exposure to a potential defaulting bank being limited to a small percentage of the overall holding.

### 7 Investment Properties Update

- 7.1 In September 2017, Council agreed to set up Epsom & Ewell Property Investment Company (EPIPIC). EPIPIC subsequently acquired two out-of-Borough commercial properties in 2017 which, after deducting interest payments and contributions to reserves, will provide an overall benefit to the Council's general fund in 2019/20 of around £700,000. This funding is included in the base budget.
- 7.2 From 01 April 2018, new Statutory Guidance on Local Government Investments was introduced by MHCLG. The guidance aims to restrict the ability of Local Authorities to purchase out-of-Borough investment properties, through the following clause 46:
- 7.3 *“Authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed”.*
- 7.4 The new guidance means that future out-of-Borough acquisitions that are funded by borrowing and where the intention is purely to profit from the investment, would not meet the requirements of the guidance in terms of borrowing.
- 7.5 However, there could be circumstances where out-of-Borough investments may be acceptable if, for example, the property were close to the Council's boundary and the main purpose for the investment was not for profit, but for regeneration.

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- 7.6 The operation of the new guidance has not yet been tested in the courts. As such, officers consider that it is prudent to suspend any further out-of-Borough investment property purchases, where the main purpose is purely to profit, until further guidance or case law comes to light that would clarify the Council's ability to invest out-of-Borough.
- 7.7 The new guidance does not impact on the two out-of-Borough purchases already made through EEPIC in 2017, since they occurred before the new guidance took effect this financial year.
- 7.8 For in-Borough investment property acquisitions that are funded by borrowing, these are still considered to be within a Council's powers, provided the main purpose of an acquisition is not to generate a profit, but instead (for example) to regenerate the local area or to safeguard jobs in the locality.

## 8 Financial and Manpower Implications

- 8.1 In line with previously agreed policy, income is credited to revenue reserves, trust funds and other accounts based on the total return for the year. In summary, income was credited to the following accounts:

	£'000	Purpose
General Fund Revenue Account	132	Used to maintain low Council Tax and finance services
Hospital Cluster Interest Reserve	1	Contingency for funding Hospital Cluster works
Repair and Renewals Fund	2	Used to fund the replacement of equipment
Insurance Reserve	3	Used to finance self-insured losses (e.g. sums below excess limits)
Hospital Cluster Commuted Sums	39	Used to fund maintenance costs
Property Maintenance Reserve	3	Used to fund backlog property repairs
Corporate Project Reserve	10	Provision for any high priority projects
Community Safety Partnership Fund	1	Used to finance community safety projects
Other Reserves/Accounts	5	Nonsuch Park Joint Management Committee and Epsom, Walton Downs Conservators, trust funds and bonds held
<b>Total Interest Applied</b>	<b>196</b>	
<b>Funded by:</b>		
<b>Interest from Investments</b>	<b>(196)</b>	

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8.1 **Chief Finance Officer's comments:** *The financial implications are set-out in the body of the report.*

8.2 *Further out-of-Borough investment property acquisitions, where the main purpose is purely to profit, are now considered contra to the requirements of MHCLG's new statutory guidance. However, the Council can continue to seek local investment property opportunities through its approved in-Borough Commercial Property Acquisition Fund, which has a remaining balance of £55.6m.*

### 9 Interest Equalisation Reserve

9.1 The interest equalisation reserve was set up to enable variations in investment returns to be accommodated within the general fund budget without having an adverse effect on the levels of funds available for the delivery of services in year.

9.2 The overall balance on this reserve as at the end of the financial year remains at £631,000.

### 10 Legal Implications (including implications for matters relating to equality)

10.1 **Monitoring Officer's comments:** *The legal issues around treasury management have been picked up in the body of the report. The key issue is to appropriately manage the risks around investment, and to ensure that all decisions are taken in accordance with the established governance arrangements.*

### 11 Risk Assessment and Conclusion

11.1 Investment performance exceeded the benchmark level in 2017/18. The external fund manager, Aberdeen Asset Management, performed well against the benchmark.

11.2 The Strategy and Resources Committee approved the Treasury Management Strategy for 2017/18, which includes a risk management approach to investment of funds and returns.

11.3 At 0.75%, the Bank of England base interest rate is marginally above the historic low levels seen since 2009. However, any further increases in interest rates are expected to be gradual and slow. The Council is still following a policy of restricting the length of investments, which reduces the risks of loss of capital invested and investments being tied in at lower rates when interest rates do rise. However, this also reduces the level of return that can be achieved on investments.

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- 11.4 The Council's externally managed investments of approximately £12 million (at 31/07/2018) are held within a pooled fund, currently valued at around £4.6 billion. This spreads the risk across a much wider number of holdings and reduces the level of fluctuation of the fund throughout the year.
- 11.5 It is currently envisaged that the fund manager will be able to achieve investment returns at around 0.85% for 2018/19; this compares to an anticipated return built into the budget of 0.80%.
- 11.6 Any Councillors who have any questions on the treasury management performance for 2017/18 are requested to contact the Chief Finance Officer prior to the meeting.

**Ward(s) Affected:** (All Wards)