

## Treasury Management – Interim Report

<b>Report of the:</b>	Director of Finance & Resources
<b>Contact:</b>	Lee Duffy, Head of Financial Services
<b><i>Urgent Decision?(yes/no)</i></b>	No
<b><i>If yes, reason urgent decision required:</i></b>	N/A
<b>Annexes/Appendices (attached):</b>	None
<b>Other available papers (not attached):</b>	Treasury Management Strategy Report 2016/17 Treasury Policy Statement Guidance Notes and Procedures Prudential Code Code of Practice for Treasury Management in Local Authorities (CIPFA) ODPM (CLG) Investment Guidance

### Report Summary

This report sets out an update on treasury management performance for the first six months of 2017/18.

### Recommendation (s)

That the Panel:

- (1) Agrees for Aberdeen Asset Management plc to continue to manage the Council's external funds;
- (2) Notes the performance on return of investments for the first six months of 2017/18;
- (3) Notes the current investment decisions being made within the terms sets out in the Treasury Management Strategy.

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

- 1.1 The Council's Treasury Management Strategy supports the achievement of the Council's Medium Term Financial Strategy.

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- 1.2 The Treasury Management Strategy for 2017/18 agreed by Strategy & Resources Committee in March aims to ensure maximum return on investments for the Council within reasonable risk constraints.

## **2 Introduction**

- 2.1 The Council's Treasury Management Policy accords with the Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice on Treasury Management in the Public Services.
- 2.2 The current policy requires officers to produce an interim report on investment performance to a meeting of the Financial Policy Panel. This report covers the performance of the treasury management function for the period 1st April 2017 to 30<sup>th</sup> September 2017.
- 2.3 The Audit Commission report "Risk and Return", prompted by the problems experienced by the Icelandic Banks, identified that regular engagement of elected members in the Treasury Management function is good practice.

## **3 Overview of Treasury Management**

- 3.1 The treasury function deals with the management of cash funds held by the Council. The level of funds held during the year will vary but, on average, amounts to around £30 million.
- 3.2 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 (for example the Icelandic Banks in 2008).
- 3.3 Before an investment decision is made, officers will investigate any proposed counterparty to ensure its financial rating makes it eligible for investment. Even if the institution meets the criteria as set out in the financial strategy, independent advice will be sought from our external financial advisors before the investment is made.

## **4 Security, Liquidity and Yield**

- 4.1 The Council's investment strategy and practice is to put security of investment at a higher priority than rate of return/yield. The day to day practice continues to be reviewed and refined, within the boundaries of the approved policy, in response to challenging market conditions. The cornerstones of current policy/practice are:
  - 4.1.1 to restrict lending to only those institutions which fit the Council's policy in terms of financial standing, credit ratings etc;
  - 4.1.2 generally, to restrict lending to the short-term (typically one year or less) or to cover precept dates for the remainder of the year

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4.1.3 to update financial limits to each institution depending the quality of their financial ratings.

### 5 Current Performance

- 5.1 The average return from investments for 2017/18 was anticipated at 0.56%. This amounted to total budgeted income for the year of £168,000, generated on reserves, working balances and cash flow.
- 5.2 The performance for the first six months of 2017/18 on the Council's investments were as follows;

	Average Investment (Apr-Sept) £'m	Interest Received (Apr-Sept) £'000	Average Rate of Return %
<b>Internally Managed Funds</b>			
Money Market Funds	5.4	4.3	0.14
Fixed Rate Deposits	10.8	48.3	0.90
Interest Bearing Account	0.7	0.1	0.01
<b>Total Internally Managed</b>	<b>16.9</b>	<b>52.7</b>	<b>0.62</b>
<b>Externally Managed Funds</b>			
Aberdeen Asset Management	18.3	40.5	0.44
<b>Grand Total</b>	<b>35.2</b>	<b>93.2</b>	<b>0.53</b>

- 5.3 Despite low returns investments for the first six months met the profiled budgeted income for the same period, with an average annualised return on investments of 0.53%.
- 5.4 The average return achieved for the first six months of 2017/18 of 0.53% compares favourably with the benchmark seven day London Interbank Bid (LIBID) rate of 0.11%.
- 5.5 The Council has achieved this performance by following the strategy of investing the majority of its long to medium term funds with its external fund manager, Aberdeen Asset Management and investing in a number of one year fixed rate investments with a return of around one percent. Short term funds have been invested in money market funds or in an interest bearing instant access account. .

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### **6 Internally Managed Funds**

#### **Money Market Funds**

- 6.1 Money market funds are pooled investments that allow instant access to these 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 being invested with a defaulting counterparty.
- 6.2 The return made on money market funds of 0.14% is higher than the benchmark of 0.11%. Investment in money market funds has been limited to short term investments from surplus funds which will need to be called back with no notice required.

#### **Fixed Rate Term Deposits**

- 6.3 As at the end of September the Council had three fixed term deposits of £2,500,000, these investments are one year fixed rate deposits, invested at rates of 1%, 0.85% and 0.77% with maturity dates between October 2017 and February 2018.
- 6.4 The current strategy and recent guidance obtained from our independent financial advisors is to limit fixed term investments to a period of one year until there is improved stability within the financial markets.

#### **Interest Bearing Accounts**

- 6.5 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.
- 6.6 Rates achievable on this account have been cut significantly in the last 12 months and is now only used if other investments have reached their counterparty limits. 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.
- 6.7 The return made on interest bearing accounts of 0.01% compared to the benchmark of 0.11%.

### **7 Externally Managed Funds**

- 7.1 Aberdeen Asset Management plc, previously Scottish Widows, has been the Council's external fund manager since 31<sup>st</sup> October 2007. .

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- 7.2 Initially, the external fund manager produced some exceptional returns for the Council. Since October 2009 returns have fallen back as opportunities to deliver significant returns have become very limited due to difficult market condition. However, the fund manager has still consistently produced returns above the benchmark.
- 7.3 The Council has adopted a policy of investing the majority of our medium to long term funds with this fund manager. This has two benefits to the Council: the first is it minimises the Council's risk, as the funds invested with Aberdeen Asset Management plc 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; the second benefit is that Aberdeen Asset Management plc are able to attract more favourable rates due to the size of the fund and having access to detailed information regarding the various institutions.
- 7.4 Due to the performance of Aberdeen Asset Management plc over the past eight years it is proposed that the Council continues to use Aberdeen Asset Management plc as its external fund manager and review the position again in 12 months.

## **8 Treasury Management Policy**

- 8.1 In previous years the Council has recognised the increased levels of risk due to the uncertainty in the financial markets and consequently restricted the number of investments held over a fixed term. It still remains unlikely that there will be an increase in interest rates in the near future, so at present the majority of the funds are being maintained over the short term.
- 8.2 Officers have entered into a number of fixed rate one year investments and are in the process of exploring other types of investments that potentially can increase yields without significantly increasing the risk to the capital invested.
- 8.3 The Council continues to use Money Market Funds for internal investments as they minimise exposure to counterparty risk. Current returns on these funds are slightly lower than that being offered from interest bearing accounts, but these funds also allow for maximising investment of short term cash surpluses during the year and also improve the efficiency of cash flow management.

## **9 Financial and Manpower Implications**

- 9.1 The Council's budget anticipates the equivalent of £168,000 of interest to help fund services in 2017/18 calculated as follows:

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	<b>Budgeted £</b>	<b>Forecast £</b>
Interest earned in year	168,000	179,000
Contribution from Interest Equalisation Reserve	52,000	41,000
<b>Total Interest Available</b>	<b>220,000</b>	<b>220,000</b>
Less Interest credited to specific provisions	63,000	63,000
<b>Interest used to fund General Fund services</b>	<b>157,000</b>	<b>157,000</b>

- 9.2 The forecast interest at the end of 2017/18 is anticipated to be at £179,000 compared to £168,000 assumed within the budget. Interest credited to specific provisions will remain close to budget at £63,000. It is therefore anticipated that no additional contribution will be required from the interest equalisation reserve to fund services.

## 10 Interest Equalisation Reserve

- 10.1 The interest equalisation reserve was set up several years ago 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.
- 10.2 With base rates and investment returns at historically low levels and with no immediate sign of these increasing, the funds in this reserve are needed more than ever.
- 10.3 The balance on this reserve at the start of 2017/18 was £630,000, the budgeted position shows that the balance will reduce to £578,000 at the end of this financial year. The forecast position means that the year-end balance on this reserve will be around £589,000.
- 10.4 The level of this reserve will be re-assessed in the 2018/19 budget report in February 2018.

## 11 Equalities and Other Legal Implications

- 11.1 There are no particular equalities or other legal implications for the purpose of this report.

## 12 Partnerships

- 12.1 There is partnership working with the fund manager and the treasury consultants.
- 12.2 The report seeks approval to continue with the use of Aberdeen Asset Management plc as the Council's fund manager with a further revision in 12 months.

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### **13 Risk Assessment and Conclusions**

- 13.1 Investments with our external fund manager are considered low risk as the money invested in the fund is spread across a range of counterparties, this limits the exposure of a significant sum being invested with a defaulting counterparty.
- 13.2 The Financial Strategy for Treasury Management, sets out that investment decisions must be based first and foremost on security, then liquidity and finally yield.
- 13.3 Both internal and external investments for the first six months of 2017/18 have exceeded the benchmark of 7 day LIBID rate.
- 13.4 Returns and interest rates are expected to stay at a low level both for this year and next year.

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