STRATEGY AND RESOURCES COMMITTEE
24 JUNE 2015

TREASURY MANAGEMENT PERFORMANCE 2014/15

Report of the:	Head of Financial Services
Contact:	Lee Duffy
Urgent Decision?(yes/no)	No
If yes, reason urgent decision required:	N/A
Annexes/Appendices (attached):	Annexe 1 - Treasury Management Review 2014/15 Annexe 2 - Prudential indicators 2014/15
Other available papers (not attached):	Fund Manager Performance Report 2014/15 and Final Accounts Working Papers 2014/15.

REPORT SUMMARY

This report reviews the performance of the council's treasury management function in 2014/15 and seeks changes to the treasury management strategy

	Notes
RECOMMENDATIONS **That the Committee:-** **(1) receives the report on the Council's treasury management performance 2014/15;** **(2) approves the actual 2014/15 prudential indicators as set out in Annexe 2;** **(3) approves changes to the treasury management strategy as set out in paragraph 11.2 to the report.**	

1 Implications for Community Strategy and Council's Key Priorities

1.1 Income earned from investments is used to help finance Council's services. The Treasury Management Statement sets out the strategy and procedures that are adopted by the Council to manage the investment of reserves and 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 Policy Statement and Procedures approved by this Committee.

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 and provisions and has also generated income from the disposal of property (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, Scottish Widows Investment Partnership (SWIP) and at the end of March 2015 the Council had £19.8 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 2015 the Council had £800,000 held in short term deposits of less than one year duration remaining.

3.3 The Council has no external debt. In accordance with the approved financial strategy no borrowings are undertaken except to meet temporary in year requirements.

3.4 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.

3.5 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 2014/15 is attached to this report at Annexe 1.

4.2 No temporary borrowings were required in 2014/15 except use of the Council's bank overdraft facility.

4.3 The average return achieved for 2014/15 of 0.85% compares favourably with the benchmark seven day London Interbank Bid (LIBID) rate of 0.35%. This amounted to total income for the year of £222,000, generated on reserves, working balances and cash flow.

4.4 The final outturn position shows an increase in income by £18,000 on what was reported in the half year report which went to Financial Policy Panel in December 2014, at this stage where it was anticipated that income from investments would be £204,000 at the end of the year.

4.5 The performance for 2014/15 on the Council's investments were as follows;

	Average Investment	Interest Received	Average Rate of Return
Internally Managed Funds	**£'m**	**£'000**	**%**
Money Market Funds	2.2	12	0.54
Interest Bearing Account	0.3	2	0.56
Externally Managed Funds			
Scottish Widows	23.7	208	0.88
Total	**26.2**	**222**	**0.85**

4.6 Returns on investments for 2014/15 were £15,000 more than the budgeted income for the year and the average annualised return on investments was 0.85%.

4.7 Epsom and Ewell Borough Council has achieved this performance by following the strategy of investing its long to medium term funds with its external fund manager, Scottish Widows and keeping its 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 0.54% compared favourably to the benchmark of 0.35%. 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 0.56% again compared favourably to the benchmark of 0.35%. However, it should be noted that NatWest has significantly reduced the interest receivable on their account in the last year.

6 Externally Managed Funds

6.1 In continuingly difficult market conditions our external fund manager delivered returns of 0.88% for 2014/15 which compares to 0.83% for 2013/14. Returns have remained at historically low levels since October 2009 as opportunities for delivering significant returns have become very limited.

6.2 The Council has adopted a policy of investing the majority of our 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 it minimises 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 Financial and Manpower Implications

7.1 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	184	Used to maintain low Council Tax and finance services
Hospital Cluster Interest Reserve	2	Contingency for funding Hospital Cluster works
Repair and Renewals Fund	6	Used to fund the replacement of equipment
Insurance Reserve	4	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	2	Used to fund backlog property repairs
Corporate Project Reserve	8	Provision for any high priority projects
Community Safety Partnership Fund	1	Used to finance community safety projects
Other Reserves/Accounts	10	Nonsuch Park Joint Management Committee and Epsom, Walton Downs Conservators, trust funds and bonds held
Total Interest Applied	**256**	
<u>Funded by</u>: Interest from investments	(222)	
Interest Equalisation Reserve	(34)	
Total Funding	**(256)**	

8 Interest Equalisation Reserve

8.1 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.

8.2 With base rates and investment returns at historically low levels and with no immediate sign of these increasing, the funds in this reserve are under increasing pressure.

8.3 A contribution to general fund of £59,000 from this reserve was included in the budget for 2014/15 but due to higher levels of funds being available during the year for investment than anticipated the required contribution from this reserve has reduced to £34,000.

8.4 The balance on this reserve at 31 March 2015 after drawing out the £34,000 is £631,000. The Panel have agreed in 2013/14 that up to £200,000 can be transferred to the property maintenance reserve, subject to an assessment of works required. Therefore, as at the end of 2014/15 the uncommitted balance on this reserve is currently £431,000.

8.5 The budget for 2015/16 agreed a drawdown of £5,000 from this reserve to fund services.

9 2015/16 Treasury Management Strategy

9.1 The Treasury Management Strategy agreed at Strategy & Resources Committee on 24 March 2015, sets out the criteria for assessing investment counterparties including Viability/Financial Strength ratings (Fitch/Moody's) and Support ratings (Fitch only).

9.2 These ratings reflected the implied level of sovereign support during the financial crisis of recent years and in response to subsequent regulatory changes the credit agencies are reducing or removing them to reflect this. Our Treasury Management Advisors suggest that we no longer include the Viability / Financial Strength and Support ratings when monitoring counterparties and use only the Short and Long Term ratings.

9.3 We are also advised to remove reference to the lowest common denominator when assessing suitability as it is anticipated that further methodology changes by the agencies could otherwise restrict our choice of counterparties so severely as to exclude even large institutions such as Santander, Barclays and, now that it is deemed no longer part nationalised, Lloyds.

9.4 Investments with Building Societies offering returns of around 1% have recently become available but our current strategy will not allow this without amendment to the table at page 12 of the Strategy as follows:

9.5 "Unrated Building Societies with assets in excess of £1billion: £2.5million maximum investment limit. 1 year maximum duration."

9.6 Officers request permission to make the changes set out above to the Treasury Management Strategy in order to maintain the ability to make investments in line with the Council's overall investment priorities of low risk, liquidity and returns.

9.7 These changes would not affect the Strategy's compliance with the CIPFA Code of Practice on Treasury Management.

10 Treasury Management Policy

10.1 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. Currently, the majority of the funds are currently being maintained over the short term.

10.2 Officers are in the process of exploring other types of investments that potentially can increase yields without significantly increasing the risk to the capital invested. Areas include the use of property funds, peer to peer lending and potential lending to local Housing Associations.

10.3 Confidence in the banking industry continues to remain low and the Council's approach of restricting the period of investments has to date been effective in limiting exposure to capital loss. It will however continue to result in lower returns.

10.4 The UK General Election yielded a major surprise, with the Conservatives winning a small majority. However, given that they have pledged to follow similar fiscal rules to those adopted by the coalition, the outcome doesn't materially alter Aberdeen's thinking on the economic outlook. After a weak start, the economy should now gain momentum. Aberdeen have maintained their 2015 GDP growth forecast at 2.6% and forecast growth of 2.8% in 2016.

10.5 Dramatic falls in energy prices and its impact on inflation in the final quarter of 2014 delayed the path of possible rate hikes. However with the tighter labour market feeding through into a pick-up in wage growth, consumer spending should now accelerate. In addition, business investment prospects are encouraging and house building is strengthening. CPI inflation turned negative in April, but fading energy price effects and a pick-up in wage growth mean that sustained deflation should not a threat. Aberdeen expect CPI inflation to average 0.4% over 2015 before picking up to 1.7% in 2016. That should allow the Bank of England's Monetary Policy Committee to start hiking rates very gradually from Q1 next year. As a result our external fund manager predicts a return on Investment Cash Fund for 2015/16 in a range of 0.8% to 1%.

11 Risk Assessment and Conclusions

11.1 Investment performance exceeded the benchmark level in 2013/14. The appointed external fund manager, Aberdeen Asset Management, performed well against the benchmark and the industry average.

11.2 The Strategy and Resources Committee approved the Treasury Management Strategy for 2014/15, which includes a risk management approach to investment of funds and returns. An amendment to this Strategy is requested as changes by rating agencies have reduced the number of eligible counterparties, this amendment will allow officers to maintain the ability to make investments in line with the Council's overall investment priorities of low risk, liquidity and returns. The requested changes are as follows:

11.2.1 When assessing suitability of individual counterparties reference to the lowest common denominator is removed;

11.2.2 The Council can invest in unrated building societies with assets in excess of £1 billion to a maximum investment of £2.5 million and for a maximum duration of 1 year.

11.3 Interest rates remain at historically low levels and are not expected to rise until at least next year. The Council is still following a policy of restricting the length of investments, which reduces the risk of loss of capital invested and investments being tied in at lower rates when interest rates start to increase. However, this reduces the level of return that can be achieved on investments.

11.4 The Council's externally managed investments of approximately £19 million are held within a pooled fund, valued at around £1 billion, in contrast to previous holdings in specific institutions. 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 1% for 2015/16; this compares to an anticipated return built into the budget of 1.25%.

11.6 Any Councillors who have any questions on the treasury management performance for 2014/15 are requested to contact the Head of Financial Services prior to the meeting.

<u>WARD(S) AFFECTED</u>: N/A