

TREASURY MANAGEMENT – INTERIM REPORT

<u>Report of the:</u>	Director of Finance & Resources
<u>Contact:</u>	Lee Duffy, Head of Financial Services
<u>Annexes/Appendices (attached):</u>	None
<u>Other available papers (not attached):</u>	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 five months of 2016/17.

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 2016/17;**
- (3) Notes the current investment decisions being made within the terms sets out in the Treasury Management Strategy.**

Notes

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.
- 1.2 The Treasury Management Strategy for 2016/17 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 2016 to 30th September 2016.
- 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 3 to 6 months or less) or to cover precept dates for the remainder of the year
 - 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 2016/17 was anticipated at 1.25%. This amounted to total budgeted income for the year of £178,000, generated on reserves, working balances and cash flow.
- 5.2 The performance for the first five months of 2016/17 on the Council's investments were as follows:

	Average Investment (Apr-Sept) £'m	Interest Received (Apr-Sept) £'000	Average Rate of Return %
Internally Managed Funds			
Money Market Funds	3.5	6.5	0.38
Fixed Rate Deposits	15.0	79.3	1.06
Interest Bearing Account	0.3	0.3	0.16
Total Internally Managed	18.8	86.1	0.92
Externally Managed Funds			
Aberdeen Asset Management	14.0	92.8	1.32
Grand Total	32.8	178.9	1.09

- 5.3 Returns on investments for the first six months met the profiled budgeted income for the same period, with an average annualised return on investments of 1.09%.
- 5.4 The average return achieved for the first six months of 2016/17 of 1.09% compares favourably with the benchmark seven day London Interbank Bid (LIBID) rate of 0.12%.
- 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 1 percent. Short term funds have been invested in money market funds or in an interest bearing instant access account.

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 0.38% is higher than the benchmark of 0.12%. 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 currently had six fixed term deposits of £2,500,000, these investments are 1 year fixed rate deposits, invested at rates of 1.10% and 0.80% with maturity dates between October 2016 and August 2017.
- 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 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 0.16% compared to the benchmark of 0.12%.

7 Externally Managed Funds

- 7.1 Aberdeen Asset Management plc, previously Scottish Widows, has been the Council's external fund manager since 31st October 2007. During this period they have consistently performed above the benchmark.

	Aberdeen Asset Management Actual Return - EEBC	LIBID 7 Day Rate
2008/09	5.60%	3.68%
2009/10	3.62%	0.42%
2010/11	1.23%	0.43%

	Aberdeen Asset Management Actual Return - EEBC	LIBID 7 Day Rate
2011/12	1.49%	0.48%
2012/13	1.38%	0.39%
2013/14	0.83%	0.35%
2014/15	0.88%	0.36%
2015/16	0.76%	0.36%

- 7.2 Initially the external fund manager produced some exceptional returns for the Council. Since October 2009 returns have dropped of significantly as opportunities to deliver significant returns have become very limited due to difficult market conditions. However the fund manager has still consistently produced returns above the benchmark.
- 7.3 The fund manager has advised of an anticipated overall return on the fund of around 0.8% by the end of the year.
- 7.4 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.
- 7.5 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 currently being maintained over the short term.
- 8.2 Officers have entered into a number of fixed rate 1 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.
- 8.4 Aberdeen Asset Management plc commented the following;
- 8.5 That after Brexit, markets immediately reacted adversely with risky asset prices and yields on gilts falling aggressively. Following a brief leadership campaign Theresa May was installed as leader of the Conservative party and Prime Minister.
- 8.6 Sterling also declined precipitously as markets fretted about the UK's future trading relationships and ability to fund its large current account deficit
- 8.7 The FTSE 100 quickly reversed course as soothing words and a strong hint at policy actions to come calmed market fear
- 8.8 Then at the MPC's August meeting those hints became actions as the MPC voted to cut interest rates to 0.25%, re-start the QE programme (GBP 60bn) and engage in a programme of corporate bond buying (GBP 10bn)
- 8.9 Initial survey data weakness indicated a hit to UK economic confidence. However, this recovered sharply and data released subsequently shows that as yet there does not appear to have been a major shock to the economy.
- 8.10 A further interest rate cut is anticipated, however the timing is very subjective. We believe this is very much data dependent, earliest market opinion appears to be November, Aberdeen believe Q2, erring on a possible cut in late Q1.

9 Financial and Staffing Implications

- 9.1 The Council's budget anticipates the equivalent of £178,000 of interest to help fund services in 2016/17 calculated as follows:

	Budgeted £	Forecast £
Interest earned in year	178,000	295,000
Contribution from Interest Equalisation Reserve	42,000	0
Total Interest Available	220,000	295,000
Less Interest credited to specific provisions	73,000	73,000
Interest used to fund General Fund services	147,000	222,000

- 9.2 The forecast interest at the end of 2016/17 is anticipated to be at £295,000 compared to £178,000 assumed within the budget. Interest credited to specific provisions will remain close to budget at £73,000. It is therefore anticipated that no 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 is currently at the start of 2016/17 was £630,000, however, £70,000 of this balance has been earmarked to be transferred to the Property Maintenance Reserve. The budgeted position shows that the balance will reduce to £518,000 at the end of this financial year. The forecast position means that the year-end balance on this reserve will be around £560,000.
- 10.4 The level of this reserve will be re-assessed in the 2017/18 budget report in February 2017.

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.

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.

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- 13.3 Both internal and external investments for the first 6 months of 2016/17 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