

## **Treasury Management Performance to December 2015**

*Assistant Director: Donna Parham – Finance and Corporate Services*  
*Service Manager: Donna Parham – Finance and Corporate Services*  
*Lead Officer: Karen Gubbins, Principal Accountant - Exchequer*  
*Contact Details: Karen.gubbins@southsomerset.gov.uk or (01935) 462456*

### **Purpose of Report**

1. To review the treasury management activity and the performance against the Prudential Indicators for the nine months ended 31<sup>st</sup> December 2015.

### **Recommendations**

2. The Audit Committee are asked to:
  - Note the Treasury Management Activity for the nine-month period ended 31<sup>st</sup> December 2015.
  - Note the position of the individual prudential indicators for the nine-month period ended 31<sup>st</sup> December 2015.

### **The Investment Strategy for 2015/16**

3. 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. The Council reports six monthly to Full Council against the strategy approved for the year. The scrutiny of treasury management policy, strategy and activity is delegated to the Audit Committee.
4. Treasury management in this context is defined as:

"The management of the local authority's cash flows, its borrowings and its investments, the management of the associated risks, and the pursuit of the optimum performance or return consistent with those risks".
5. The Authority has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.
6. 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.
7. In order to diversify the authority's investment portfolio which is largely invested in cash, investments will be placed with a range of approved investment counterparties in order to achieve a diversified portfolio of prudent counterparties, investment periods and rates of return. Given the increasing risk and continued low returns from short-term unsecured bank investments, the Authority aims to further diversify into more secure

and higher yielding asset classes during 2015/16. Maximum investment levels with each counterparty will be set to ensure prudent diversification is achieved

## Interest Rates 2015/16

8. Base rate began the financial year and remains at 0.5%.
9. Arlingclose is now projecting the first rise in Bank Rate in Q3 of 2016, with the risks weighted to the downside. When interest rates do rise they are expected to do so gradually. The Bank Rate is forecast to peak at a lower level than the previous norm, currently estimated to be between 2% and 3%:

	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Average
Official Bank Rate														
Upside risk	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.31
Arlingclose Central Case	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.50	1.50	1.50	1.12
Downside risk			-0.25	-0.25	-0.50	-0.50	-0.75	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-0.73

## Investment Portfolio

10. The table below shows the Council's overall investments as at 31<sup>st</sup> December 2015:

	Value of Investments at 01.04.15 £	Value of Investments at 31.12.15 £	Fixed/ Variable Rate
<b>Investments advised by Arlingclose</b>			
Money Market Fund (Variable Net Asset Value)	1,001,247	1,001,247	Variable
Property Fund	3,363,303	4,363,303	Variable
<b>Total</b>	<b>4,364,550</b>	<b>5,364,550</b>	
<b>Internal Investments</b>			
Certificates of Deposit	4,512,371	6,500,858	Fixed
Corporate Bonds	11,271,639	8,632,150	Fixed
Floating Rate Notes (FRNs)	9,972,584	10,059,504	Variable
Short Term Deposits (Banks)	7,500,000	17,400,000	Variable
Short Term Deposits (Other LAs)	8,000,000	10,000,000	Variable
Money Market Funds (Constant Net Asset Value) & Business Reserve Accounts	3,720,000	2,240,000	Variable
<b>Total</b>	<b>44,976,594</b>	<b>54,832,512</b>	
<b>TOTAL INVESTMENTS</b>	<b>49,341,144</b>	<b>60,197,062</b>	

## Returns for 2015/16

11. The returns to 31<sup>st</sup> December 2015 are shown in the table below:

<b>Investments advised by Arlingclose</b>		£'000	
Payden Money Market Fund (VNAV)		7	
Property Fund (CCLA)		127	
<b>Total</b>		<b>134</b>	<b>4.43%</b>
<b>Internal Investments</b>			
Certificates of Deposit (CD's)/T Bills		31	
Corporate Bonds		111	
Floating Rate Notes (FRNs)		54	
Fixed Term Deposits		93	
Money Market Funds (CNAV) & Business		17	
Reserve Accounts			
<b>Total</b>		<b>306</b>	<b>0.82%</b>
<b>Other Interest</b>			
Miscellaneous Loans		3	
<b>Total</b>		<b>3</b>	
<b>TOTAL INCOME TO 31<sup>ST</sup> DECEMBER 2015</b>		<b>443</b>	
<b>PROFILED BUDGETED INCOME</b>		<b>346</b>	
<b>FORECAST SURPLUS FOR YEAR END</b>			

12. The table above shows investment income for the year to date compared to the profiled budget. The annual budget is set at £461,320. We currently estimate that the position at the end of the financial year will be an overall favourable variance in the order of £106,548. This is assuming SSDC receive a dividend of 3p per unit each quarter for its investment in the property fund, however if there is a dip in the economy this could affect the forecasted return.

13. The outturn position is affected by both the amount of cash we have available to invest and the interest base rate set by the Bank of England. Balances are affected by the timing of capital expenditure and the collection of council tax and business rates.

## Investments

14. Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2014/15. New investments can be made with the following institutions:

- Other Local Authorities;
- AAA-rated Money Market Funds;
- Certificates of Deposit (CDs) and Term Deposits with UK Banks and Building Societies systemically important to the UK banking system and deposits with select non-UK Banks (Australian, Canadian and American);
- T-Bills and DMADF (Debt Management Office);
- Bonds issued by Multilateral Development Banks, such as the European Investment Bank;

- Commercial Paper
- Other Money Market Funds and Collective Investment Schemes meeting the criteria in SI 2004 No 534, SI 2007 No 573 and subsequent amendments.

15. The graph shown in Appendix A shows the performance of the in-house Treasury team in respect of all investments for the quarter ending 31<sup>st</sup> December 2015 in comparison to all other clients of Arlingclose.

16. The graph shows that SSDC is in a satisfactory position in terms of the risk taken against the return on investments.

### **Borrowing**

17. An actual overall borrowing requirement (CFR) of £9.7 million was identified at the beginning of 2015/16. As interest rates on borrowing exceed those on investments the Council has used its capital receipts to fund capital expenditure. As at 31<sup>st</sup> December 2015 the Council had no external borrowing.

### **Breakdown of investments as at 31<sup>st</sup> December 2015**

<b>Date Lent</b>	<b>Counterparty</b>	<b>Amount</b>	<b>Rate</b>	<b>Maturity Date</b>
5 Nov 15	Lancashire County Council	1,000,000	0.60	26 Sep 16
11 Dec 15	Barclays Bank Plc	1,000,000	0.54	18 Mar 16
11 Sep 15	IPA SCB TD Incoming (Santander)	1,000,000	0.65	11 Mar 16
9 Sep 15	United Overseas Bank Ltd	2,000,000	0.60	9 Mar 16
9 Oct 15	Barclays Bank Plc	1,000,000	0.53	11 Jan 16
23 Oct 15	Bank of Scotland	1,000,000	0.64	21 Mar 16
5 Nov 15	DBS Bank Ltd	2,000,000	0.56	7 Mar 16
26 Nov 15	Rabobank International	1,000,000	0.45	17 Feb 16
28 Aug 15	Bank of Scotland	1,000,000	1.00	30 Aug 16
30 Sep 15	Nationwide Building Society	1,000,000	0.65	21 Mar 16
15 Jul 15	Toronto Dominion Bank	2,000,000	0.54	15 Jan 16
19 Oct 15	Nationwide Building Society	1,000,000	0.59	18 Mar 16
28 Aug 15	Commonwealth Bank of Australia	1,400,000	0.65	29 Feb 16
7 Oct 15	Coventry Building Society	2,000,000	0.57	18 Mar 16
29 Oct 15	Eastleigh Borough Council	2,000,000	0.50	29 Jun 16
15 Oct 15	Lancashire County Council	1,000,000	0.60	6 Oct 16
2 Nov 15	Conwy County Borough Council	2,000,000	0.50	2 Jun 16
15 Dec 15	North Tyneside Council	2,000,000	0.65	13 Dec 16
18 Dec 15	London Borough of Waltham Forest	2,000,000	0.45	15 Jan 16
	<b>Corporate Bonds/Eurobonds</b>			
10 Dec 13	GE Capital UK Funding	1,038,020	1.42	18 Jan 16
17 Jan 14	Places for People Capital Markets	603,877	2.67	27 Dec 16
17 Jan 14	Places for People Capital Markets	459,287	2.67	27 Dec 16
4 Aug 14	Leeds Building Society (Covered)	560,713	2.13	17 Dec 18
22 Oct 14	Yorkshire Building Society (Covered)	1,729,543	1.56	12 Apr 18
17 Apr 15	Heathrow Funding Ltd	1,109,810	0.85	31 Mar 16
5 Jun 15	European Investment Bank	2,105,188	0.66	7 Sep 16
3 Aug 15	Bank Nederlandse Gemeenten	1,025,712	0.68	26 Feb 16

	<b>Certificates of Deposit (CDs)</b>			
31 Jul 15	Landesbanken Hessen-Thuringen	2,000,298	0.69	29 Jan 16
7 Aug 15	Standard Chartered	1,000,149	0.70	5 Feb 16
1 Oct 15	Nordea Bank AB	1,000,149	0.62	31 Mar 16
23 Oct 15	Credit Suisse AG London	1,000,075	0.55	22 Jan 16
30 Oct 15	Standard Chartered	1,000,149	0.70	29 Apr 16
9 Nov 15	Nordea Bank AB	500,038	0.52	9 Feb 16
	<b>Floating Rate Notes (FRNs)</b>			
25 Nov 13	HSBC Bank PLC	1,004,169	0.82	16 May 16
3 Apr 14	Yorkshire Building Society *Covered*	1,005,441	0.98	23 Mar 16
22 Oct 14	Abbey National Treasury Services *Covered*	1,034,829	0.71	5 Apr 17
21 Nov 14	Barclays Bank Plc *Covered*	1,000,341	0.68	15 Sep 17
25 Mar 15	Lloyds Bank Plc *Covered*	2,006,200	0.64	16 Jan 17
29 Apr 15	Toronto Dominion *Covered*	1,002,572	0.66	20 Nov 17
26 Jun 15	Nationwide Building Society *Covered*	1,001,774	0.68	17 Jul 17
2 Jul 15	National Australia bank Ltd	1,503,339	0.67	12 Aug 16
9 Nov 15	HSBC Bank PLC	500,839	0.66	16 May 16
	<b>Pooled Funds &amp; Money Market Funds</b>			
	Payden Fund VNAV	1,001,247	0.88	
	CCLA Property Fund	4,363,303	5.68	
	Federated Money Market Fund	500,000	0.47	
	Blackrock Money Market Fund	1,100,000	0.44	
	Invesco Aim Money Market Fund	500,000	0.43	
	Handelsbanken Business Reserve	140,000	0.45	
	<b>TOTAL</b>	<b>60,197,062</b>		

\* Note: Money Market Funds are instant access accounts so the rate displayed is a daily rate

## **Prudential Indicators – Quarter 3 monitoring**

### **Background:**

18. In February 2015, Full Council approved the indicators for 2015/16, as required by the Prudential Code for Capital Finance in Local Authorities. The Local Government Act 2003 allowed local authorities to determine their own borrowing limits provided they are affordable and that every local authority complies with the code.

### **Prudential Indicator 1 - Capital Expenditure:**

19. The revised estimates of capital expenditure to be incurred for the current year compared to the original estimates are:

	<b>2015/16 Original Estimate £'000</b>	<b>Expected Outturn £'000</b>	<b>2015/16 Variance £'000</b>	<b>Reason for Variance</b>
Approved capital schemes	5,568	1,866	(3,702)	Re-profiling of the expenditure to future years
Reserves	404	219	(185)	Re-profiling of the reserves from 2015/16 into 2016/17
<b>Total Expenditure</b>	<b>5,972</b>	<b>2,085</b>	<b>(3,887)</b>	

20. The above table shows that the overall estimate for capital expenditure has increased.

### **Prudential Indicator 2 - Ratio of Financing Costs to Net Revenue Stream:**

21. A comparison needs to be made of financing capital costs compared to the revenue income stream to support these costs. This shows how much of the revenue budget is committed to the servicing of finance.

<b>Portfolio</b>	<b>2015/16 Revised Estimate £'000</b>	<b>Expected Outturn £'000</b>	<b>2015/16 Variance £'000</b>	<b>Reason for Variance</b>
Financing Costs*	(338)	(420)	(82)	Better return on the Property fund is expected but this is dependent on the economy
Net Revenue Stream	17,390	17,742	352	Carry forwards approved of £303k, £44k contribution from the Somerset Rivers Authority, £5k contribution from Somerset Growth Board
<b>%*</b>	<b>(1.9)</b>	<b>(2.4)</b>		

\*figures in brackets denote income through receipts and reserves

22. The financing costs include interest payable, notional amounts set aside to repay debt, less, interest on investment income. The figure in brackets is due to investment income

outweighing financing costs significantly for SSDC but is nevertheless relevant since it shows the extent to which the Council is dependent on investment income.

### Prudential Indicator 3 - Capital Financing Requirement:

23. The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. Estimates of the year-end capital financing requirement for the authority are:

	2015/16 Original Estimate £'000	Expected Outturn £'000	2015/16 Variance £'000	Reason for Variance
Opening CFR	9,484	9,447	(37)	
Capital Expenditure	5,192	2,966	(2,226)	See explanation for Prudential Indicator 1 above
Capital Receipts*	(5,046)	(1,866)	3180	
Grants/Contributions*	(146)	(1,100)	(954)	
Minimum Revenue Position (MRP)	(123)	(148)	(25)	One lease has been amended to be repaid over a shorter period hence an increase in the current years MRP
<b>Closing CFR</b>	<b>9,361</b>	<b>9,299</b>	<b>(62)</b>	

\*Figures in brackets denote income through receipts or reserves.

### Prudential Indicator 4 – Gross Debt and the Capital Financing Requirement:

24. The Council is also required to ensure that any medium term borrowing is only used to finance capital and therefore it has to demonstrate that the gross external borrowing does not, except in the short term exceed the total of capital financing requirements over a three year period. This is a key indicator of prudence.

	2015/16 Original Estimate £'000	2015/16 Qtr 3 Actual £'000	2015/16 Variance £'000	Reason for Variance
Borrowing	0	0	0	
Finance Leases	248	186	(62)	Amendment to the MRP has reduced the amount outstanding on the finance leases
<b>Total Debt</b>	<b>248</b>	<b>186</b>	<b>(62)</b>	

25. Total debt is expected to remain below the CFR.

**Prudential Indicator 5 - Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure:**

26. The Council must set three years of upper limits to its exposure to the effects of changes in interest rates. As a safeguard, it must ensure that its limit would allow it to have up to 100% invested in variable rate investments to cover against market fluctuations. For this purpose, term deposits of less than 365 days are deemed to be variable rate deposits. Fixed rate deposits are investments in Eurobonds, Corporate Bonds and term deposits exceeding 365 days.

	2015/16 % Limit	2015/16 Qtr 3 Actual %	2015/16 Variance %	Reason for Variance
Fixed	80	3.38	(76.62)	Within limit
Variable	100	96.62	(3.38)	Within limit

27. The Council must also set limits to reflect any borrowing we may undertake.

	2015/16 % Limit	2015/16 Qtr 3 Actual %	2015/16 Variance %	Reason for Variance
Fixed	100	0	100	SSDC currently has no borrowing
Variable	100	0	100	SSDC currently has no borrowing

28. The indicator has been set at 100% to maximise opportunities for future debt as they arise.

**Prudential Indicator 6 - Upper Limit for total principal sums invested over 364 days:**

29. SSDC must also set upper limits for any investments of longer than 364 days. The purpose of this indicator is to ensure that SSDC, at any time, has sufficient liquidity to meet all of its financial commitments.

Upper Limit for total principal sums invested over 364 days	2015/16 Maximum Limit £'000	2015/16 Qtr 3 Actual (Principal amount) £'000	Reason for Variance
Between 1-2 years	25,000	6,000	Within limit
Between 2-3 years	20,000	2,000	Within limit
Between 3-4 years	10,000	0	Within limit
Between 4-5 years	10,000	0	Within limit
Over 5 years	5,000	0	Within limit

30. The table above shows that the Council adopts a policy of safeguarding its investments by minimising investments that are redeemable more than five years ahead.

**Prudential Indicator 7 – Credit Risk:**

31. The Council considers security, liquidity and yield, in that order, when making investment decisions.

Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Council’s assessment of counterparty credit risk.

The Council also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. The following key tools are used to assess credit risk:

- Published credit ratings of the financial institution and its sovereign
- Sovereign support mechanisms
- Credit default swaps (where quoted)
- Share prices (where available)
- Economic Fundamentals, such as a country’s net debt as a percentage of its GDP
- Corporate developments, news articles, markets sentiment and momentum
- Subjective overlay

The only indicators with prescriptive values remain to be credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

**Prudential Indicator 8 - Actual External Debt:**

32. This indicator is obtained directly from the Council’s balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities (this represents our finance leases). This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

<b>Actual External Debt as at 31/03/2015</b>	<b>£’000</b>
Borrowing	0
Liabilities arising from finance leases	334
<b>Total</b>	<b>334</b>

**Prudential Indicator 9 - Authorised Limit for External Debt:**

33. The Council has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy. Borrowing will arise as a consequence of all the financial transactions of the Council not just arising from capital spending.

34. This limit represents the maximum amount that SSDC may borrow at any point in time during the year. If this limit is exceeded the Council will have acted ultra vires. It also gives the Council the responsibility for limiting spend over and above the agreed capital programme. A ceiling of £12 million was set to allow flexibility to support new capital projects over and above the identified borrowing requirement.

	<b>2015/16 Estimate</b>	<b>2015/16 Qtr 3 Actual</b>	<b>2015/16 Variance</b>	<b>Reason for Variance</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	
Borrowing	11,000	0	(11,000)	SSDC currently has no external borrowing
Other Long-term Liabilities (Finance Leases)	1,000	186	(814)	Within limit
<b>Total</b>	<b>12,000</b>	<b>186</b>	<b>(11,814)</b>	

#### Prudential Indicator 10 – Operational Boundary for External Debt:

35. The operational boundary sets the limit for short term borrowing requirements for cash flow and has to be lower than the previous indicator, the authorised limit for external debt. A ceiling of £10 million was set.

	<b>2015/16 Estimate</b>	<b>2015/16 Qtr 3 Actual</b>	<b>2015/16 Variance</b>	<b>Reason for Variance</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	
Borrowing	9,200	0	(9,200)	SSDC currently has no external borrowing
Other Long-term Liabilities (Finance Leases)	800	186	(614)	Within limit
<b>Total</b>	<b>10,000</b>	<b>186</b>	<b>(9,814)</b>	

#### Prudential Indicator 11 - Maturity Structure of Fixed Rate borrowing:

36. This indicator is relevant to highlight the existence of any large concentrations of fixed rated debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest changes in any one period. When we borrow we can take a portfolio approach to borrowing in order to reduce interest rate risk. This indicator is shown as the Council has set limits in anticipation of future borrowing.

<b>Maturity structure of fixed rate borrowing</b>	<b>2014/15 Actual</b>	<b>2015/16 Qtr 3 Actual</b>	<b>Lower Limit</b>	<b>Upper Limit</b>
	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>
Under 12 months	0	0	0	100
12 months and within 24 months	0	0	0	100
24 months and within 5 years	0	0	0	100
5 years and within 10 years	0	0	0	100
10 years and within 20 years	0	0	0	100
20 years and within 30 years	0	0	0	100
30 years and within 40 years	0	0	0	100
40 years and within 50 years	0	0	0	100
50 years and above	0	0	0	100

As the council doesn't have any fixed rate external borrowing at present the above upper and lower limits have been set to allow flexibility.

**Prudential Indicator 12 - Incremental Impact of Capital Investment Decisions:**

37. SSSC must show the effect of its annual capital decisions for new capital schemes on the council taxpayer. Capital spend at SSSC is financed from additional receipts so the figure below actually shows the possible decreases in council tax if all capital receipts were invested rather than used for capital expenditure.

<b>Incremental Impact of Capital Investment Decisions</b>	<b>2015/16 Estimate £</b>	<b>2016/17 Estimate £</b>	<b>2017/18 Estimate £</b>
Decrease in Band D Council Tax	0.07	0.17	0.17

**Prudential Indicator 13 - Adoption of the CIPFA Treasury Management Code:**

38. This indicator demonstrates that the Council has adopted the principles of best practice.

Adoption of the CIPFA Code of Practice in Treasury Management
The Council approved the adoption of the CIPFA Treasury Management Code at its Council meeting on 18 <sup>th</sup> April 2002.

**Conclusion**

39. The council is currently within all of the Prudential Indicators and is not forecast to exceed them.

**Background Papers:** Prudential Indicators Working Paper, Treasury Management Strategy Statement 2015/16, Quarter 3 2015/16 Capital Programme.

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# Appendix A

## Average Rate vs Credit Risk (value-weighted)

