Kirklees COUNCIL

Name of meeting: Cabinet 17 November 2015

Corporate Governance and Audit 20 November 2015

Council 9 December 2015

Title of report: Half yearly monitoring report on Treasury Management activities 2015/16

Is it likely to result in spending or saving £250k or more, or to have a significant effect on two or more electoral wards?	No
Is it in the Council's Forward Plan?	No
Is it eligible for "call in" by Scrutiny?	No
Date signed off by Director **Is it signed off by the Director of Resources?** **Is it signed off by the Assistant Director – Legal and Governance?**	David Smith, Director of Resources 14 October 2015 Yes 14 October 2015 No legal implications
Cabinet member portfolio	Corporate and Finance

Electoral wards affected and ward councillors consulted: All

Public or private: **Public**

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1. Purpose of report

1.1 The Council has adopted the CIPFA Code of Practice on Treasury Management. It is a requirement of the Code that regular reports be submitted to Members detailing treasury management operational activity. This report is the mid-year for 2015/16 covering the period 1 April to 30 September.

2. Key points

2.1 Background

2.1.1 The Council has adopted the CIPFA Code of Practice on Treasury Management and operates its treasury management service in compliance with this Code and various statutory requirements. The

Code recommends monitoring reports on treasury management be submitted to Council. Under Financial Procedure Rules, Cabinet is responsible for the implementation and monitoring of the treasury management policies. Corporate Governance and Audit Committee undertake a scrutiny role with regard to treasury management. The Council's treasury advisors gave training to members of that committee in March 2015.

2.1.2 The report covers the period 1 April to 30 September, and reports on interest rates, investment and borrowing activities, budget monitoring, prudential indicators, and risk/compliance issues. Reference will be made to the Treasury Management Strategy Report approved by Council 18 February 2015.

2.2 The Treasury Management Strategy 2015/16 approved by Council on 18 February 2015

2.2.1 The over-riding policy continues to be one of ensuring the security of the Council's balances. The Council will aim to invest externally balances of around £30 million, largely for the purpose of managing day-to-day cash flow requirements, with any remaining balances invested "internally", offsetting borrowing requirements. The investment strategy is designed to minimise risk, investments being made primarily in instant access accounts or short-term deposits, with the major British owned banks and building societies, or Money Market Funds. Diversification amongst counterparties is key.

2.2.2 It was not expected that the Council would have any external borrowing requirement.

2.3 Economic Context and Interest Rates

2.3.1 Events at the beginning of the year were dominated by Greece and their possible default and exit from the Eurozone. The issue was finally resolved (for the time being) with agreement on 12 July on a third bailout. The summer saw attention shifting towards China with signs of a significant slowdown in their economy. The UK economy has remained resilient over the last six months. GDP has shown growth in ten consecutive quarters and there has been further improvement in the labour market.

2.3.2 Base rate has remained at 0.5% for the period, whilst long term borrowing rates continue at historically low levels – 3.11% at the beginning of April, 3.40% at the end of June and 3.19% at the end of September (50 year maturity loan – PWLB – Certainty Rate). Our advisors expect the first rise in Base Rate to be mid 2016, with the pace of increases being gradual thereafter.

2.4 Investment Performance

2.4.1 The Council invested an average balance of £60.9 million externally during the period (£58.8 million in the first six months of 2014/15), generating £0.13 million in investment income. The Council is cash rich at the beginning of the year due to profiles of Revenue Support Grant being weighted towards earlier payments and it is not expected that the “target” investment balance of £30 million will be achieved until January.

2.4.2 Most balances were invested in instant access accounts or short term deposits. Appendix 1 shows where investments were held at the start of April, the end of June and September by counterparty, by sector and by country.

2.4.3 The Council’s investment performance was monitored during the period, with the average lending rate of 0.43%. This is slightly higher than the average for 2014/15 of 0.42%.

2.4.4 The change in regulations on bank bail-ins has now been reflected in movements in credit ratings, along with other factors. Some institution’s ratings have improved whilst others have suffered, notably in terms of the Council’s investment activity –

- Coventry Building Society improving its ratings such that it has moved into the Council’s specified category, thus increasing potential investment limits (up to £10 million)
- Nottingham and Yorkshire Building Societies improving their ratings such that they move into the Council’s non-specified category, thus increasing potential counterparties (up to £3 million)
- Barclays’ ratings falling such that it moves into the Council’s non-specified category from specified, thus reducing potential investment limits (down from £10 million to £3 million)

2.4.5 In an attempt to further diversify the Council’s investments in light of the changes in regulations on bail-in, the strategy approved in February was changed to allow fixed deposits for up to two months with some unrated building societies (as approved by our treasury management advisors) and highly rated foreign banks, particularly when the Council was cash rich. Unfortunately, this opportunity has not really materialised –

- Many of the building societies suggested are not or rarely in the market for taking local authority money, or want investments for longer periods than the Council is prepared to place monies.
- Due to the uncertainty over the Greek economic position over the last few months, the Director of Resources has decided not to increase exposure to foreign banks as this point in time.

2.5 Borrowing Performance

2.5.1 In terms of borrowing, long-term loans at the end September totalled £413.1 million (£422.6 million 31 March 2015) and short-term loans £12.6 million (£21.1 million 31 March 2015). There has been no new external borrowing so far this year. The updated borrowing requirement for the year is around £20 million. This builds in borrowing rolled over from 2014/15 capital underspend but also allows for slippage in 2015/16.

2.5.2 Any borrowing undertaken is likely to be fairly short-term, partly to take advantage of very low borrowing rates but also because as the Council may be cash rich again in April 2016, it will give the opportunity to repay at least some of the borrowing rather than have high investment balances increasing the exposure to risk.

2.5.3 The Local Capital Finance Company, established in 2014 by the LGA as an alternative source of local authority finance, is still not operational. Officers will continue to monitor developments.

2.5.4 Fixed rate loans account for around 80% of total long-term debt giving the Council stability in its interest costs. The maturity profile for fixed rate long-term loans is shown in Appendix 2 and shows that no more than 10% of fixed rate debt is due to be repaid in any one year. This is good practice as it reduces the Council's exposure to a substantial borrowing requirement in future years when interest rates might be at a relatively high level.

2.5.5 The Council has not had any temporary borrowing from the Money Market, apart from in the first few days of April. This was borrowed from another local authority at a rate of 0.28%.

2.6 Revenue Budget Monitoring

2.6.1 The treasury management budget for 2015/16 currently stands at £34.7 million. The latest budget monitoring shows an under-spend of £1.75 million. The under-spend is due to savings on principal and interest arising from capital slippage and the net effect of £10.5 million capital receipt/revenue contribution/capital grant applied to service debt in 2014/15.

2.7 Prudential Indicators

2.7.1 The Council is able to undertake borrowing without central government approval under a code of practice called the Prudential Code. Under this Code, certain indicators have to be set at the beginning of the financial year as part of the treasury management strategy. The purpose of the indicators is to contain the treasury function within certain limits, thereby reducing the risk or likelihood of an adverse movement in interest rates or borrowing decision impacting negatively on the Council's overall financial position. Other prudential indicators are reported as part of the monitoring of capital.

2.7.2 Appendix 3 provides a schedule of the indicators set for treasury management and the latest position.

2.8 Risk and Compliance Issues

2.8.1 The Council moved its current account banking arrangements from the Co-Operative to Barclays on 1 July 2015, on an initial five year contract. The changeover was extensively planned by officers and went reasonably smoothly. There have been issues with income coding and loading statements into SAP for bank reconciliation purposes, and officers are currently working to get these items up-to-date.

2.8.2 There has been some adverse publicity recently, including a Channel 4 documentary on 6 July, about LOBO (Lender's Option, Borrower's Option) loans, claiming that these loans are offering poor value for money for local authorities. The publicity has resulted in a DCLG Select Committee taking evidence from the participants of the documentary on 20 July.

2.8.3 The principle of a LOBO is that the opening rate is usually cheaper than borrowing from the Government's Public Works Loans Board. However, at pre-determined future dates, such as every 5 years, the lender has the option to propose or impose a new fixed rate for the remaining term of the facility and the borrower has the option to either accept the new imposed fixed rate or repay the loan facility.

2.8.4 The Council currently has eleven LOBOs with various UK and foreign banks, totalling £105 million. They were all taken between 1997 and 2008, and their average interest rate equates to 4.4% compared to the Council's PWLB loan average interest rate of 5.1%. All the LOBOs are on their original terms – in one case, where a bank proposed to increase an interest rate from 3.36% to 4.20%, the Council decided to immediately repay that loan. The Council has no "inverse floating" LOBOs, of which the Channel 4 documentary was particularly critical.

2.8.5 The Council is aware of the risks of passive management of the treasury portfolio and, with the support of the Council's consultants, Arlingclose, has proactively managed the debt and investments over the period.

2.9 <u>Fossil Fuel Divestment</u>

2.9.1 Council on 7th October 2015 passed a motion that:-

"This Council recognises;
(i) the challenge and threat of climate change to residents and global community.
(ii) that to keep global warming below 2oC we must operate within a global carbon budget. 80% of existing fossil fuel reserves cannot be burned if we are to keep below the internationally agreed climate change goal of keeping below 2 degrees
(iii) the growing movement to divest from fossil fuels in order to, in the words of Desmond Tutu, "break their ties with corporations financing the injustice of climate change."
(iv) that there is also a strong financial case for divestment ,with recent concerns raised by the Bank of England about 'unburnable carbon' and significant financial risks posed by fossil fuel equities.
(v) that governments are increasingly controlling carbon emissions to meet international targets; a large proportion of fossil-fuel reserves which companies expect to extract will become stranded assets: a "carbon bubble". Funds which are exposed to fossil-fuel equities when this bubble bursts can expect to suffer considerable losses.
(vi) that Pension Fund Trustees owe fiduciary duties to scheme employers and scheme members, and must act in the best long-term interests of fund members.

This Council believes that;

The Director of Resources is requested to review the existing Treasury Management Strategy, and present a report to Corporate Governance and Audit Committee, Cabinet and Council to giving consideration to an additional principle of avoiding direct investment in institutions with material links to fossil fuel extraction as defined by the Carbon Underground 200 – the top 200 companies with the largest known carbon reserves (oil, gas and coal) by June 2016.

Kirklees Council will encourage other local authorities to similarly reviewing their Fossil Fuel industry investments, by sharing this decision through the Local Government Association and the West Yorkshire Combined Authority.

Kirklees Council will use its influence to call on West Yorkshire Pension Fund and other Funds where the Council appoints Trustees to review investments in the fossil fuel industry (as defined by the Carbon Underground 200). Specifically Kirklees will ask our representatives on the West Yorkshire Pension Fund - Investment Advisory Panel to call on all Pension Trustees to exercise their fiduciary duty and to call for a review of WYPF fossil fuel investments in the light of climate risk posed by fossil fuel equities.

Kirklees Council request that WYPF makes a commitment to wind down exposure to the carbon underground top 200 fossil fuel companies over a 5 year period."

2.9.2 In addition the Council has received a petition of some 350 signatures requesting that "Kirklees Council should immediately freeze any new investments in fossil fuels, and divest from direct public ownership and any commingled funds that include fossil fuel public equities and corporate bonds."

2.9.3 The Director of Resources therefore will review our existing investment policy and report back to Cabinet and Council as part of the 2016/17 budget process. The Council currently has no direct investments in fossil fuel companies. However, further checks need to run on the money market funds the Council invests with to determine whether they hold corporate bonds of such companies. Consideration also needs to be given where the Council is acting as Trustee for Charitable Funds.

3. Implications for the Council

3.1 The underspending on the treasury management function has been taken into account in the consolidated budget monitoring reported to Cabinet.

4. Consultees and their opinions

None.

5. Next steps

None.

6. Officer recommendations and reasons

Cabinet and Corporate Governance and Audit Committee are asked to recommend to Council that the report be noted.

7. Cabinet portfolio holder recommendation

The report be noted.

8. Contact officer and relevant papers

Tim Mitchell
Finance Manager
01484 221000

CIPFA's Code of Practice on Treasury Management in the Public Services.
CIPFA's Prudential Code for Capital Finance in Local Authorities.
Local Government Act 2003.
The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008.
Public Works Loan Board Website.

9. Assistant Director responsible

Debbie Hogg
Assistant Director, Financial Management, Risk & Performance
01484 221000

APPENDIX 1

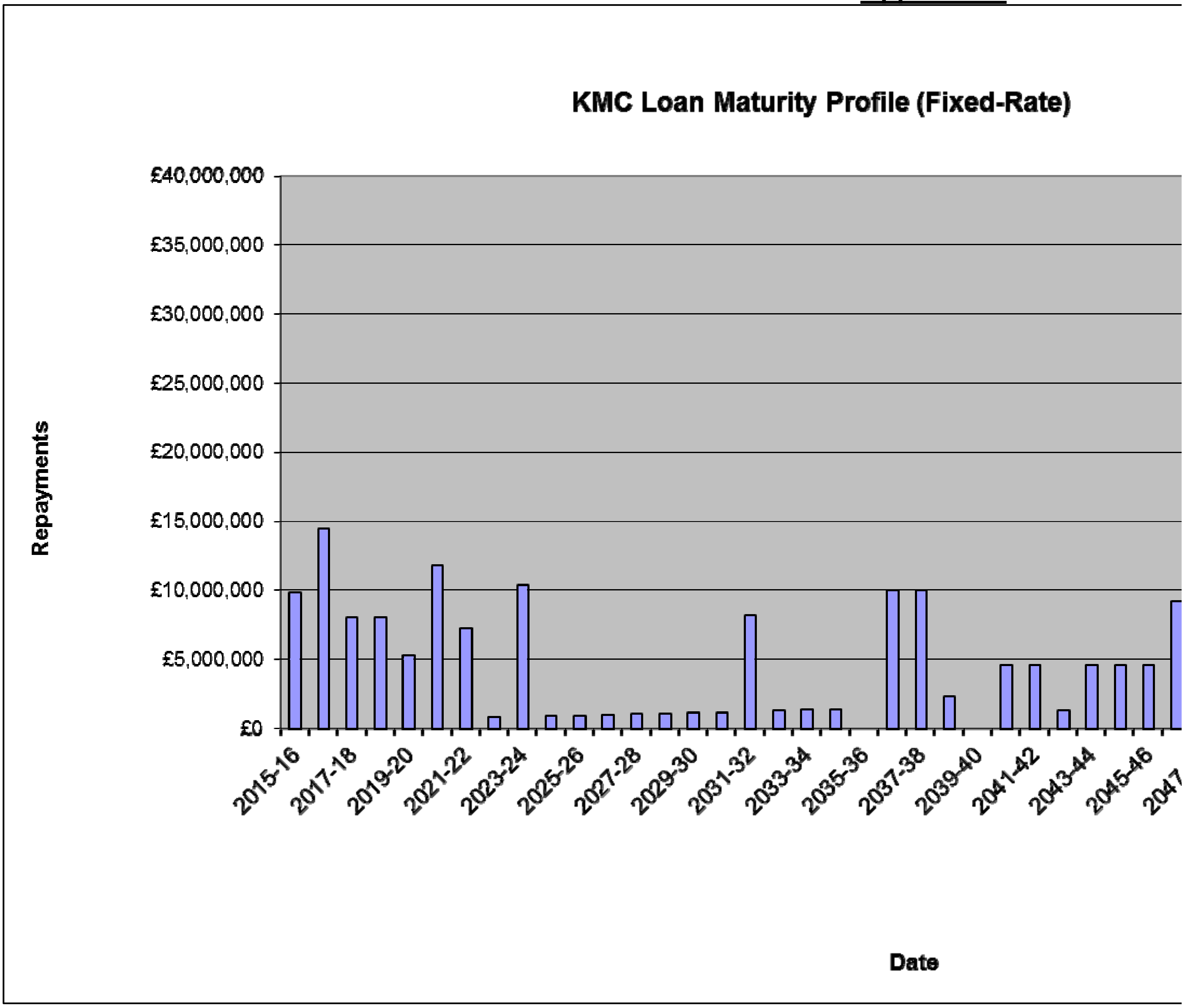
Kirklees Council Investments 2015-16			1 April 2015 (opening)			30 June 2015			30 September 2015		
Counterparty		**Credit Rating Sept 2015***	**£m**	**Interest Rate**	**Type of Investment**	**£m**	**Interest Rate**	**Type of Investment**	**£m**	**Interest Rate**	**Type of Investment**
Specified Investments											
LB Merton	Local Govt		3.2	0.40%	1 mth fixed						
Barclays	Bank					4.0	0.40%	2 mth fixed			
Nationwide	Bldg Soc	F1/A	6.5	0.43%	1 mth fixed	8.0	0.46%	2 mth fixed x 3	8.0	0.43%	1 mth fixed x 3
Bank of Scotland	Bank	F1/A+				4.0	0.40%	Instant Access	2.0	0.40%	Instant Access
Handelsbanken	Bank	F1+/AA-	9.0	0.45%	Instant Access	3.0	0.45%	Instant Access	5.0	0.45%	Instant Access
Handelsbanken	Bank					5.0	0.55%	35 days fixed			
Std Life (Ignis)	MMF**	AAAmmf	10.0	0.47%	MMF-Instant Acc	9.0	0.48%	MMF-Instant Acc	7.6	0.49%	MMF-Instant Acc
Aviva	MMF**	Aaa-mf	5.0	0.39%	MMF-Instant Acc	8.3	0.44%	MMF-Instant Acc	7.6	0.46%	MMF-Instant Acc
Aviva - Govt	MMF**	Aaa-mf				9.6	0.40%	MMF-Instant Acc	10.0	0.39%	MMF-Instant Acc
Deutsche	MMF**	AAAmmf				3.9	0.41%	MMF-Instant Acc	7.5	0.45%	MMF-Instant Acc
Goldman Sachs	MMF**	AAAmmf	5.0	0.41%	MMF-Instant Acc	8.8	0.44%	MMF-Instant Acc	7.1	0.45%	MMF-Instant Acc
Coventry	Bldg Soc	F1/A				3.0	0.41%	1 mth fixed	4.7	0.41%	1 mth fixed x 2
Non-specified investments											
Barclays	Bank	F1/A							2.9	0.10%+0.40%	Instant Access
Nottingham	Bldg Soc	P2/Baa1							3.0	0.40%	1 mth fixed
			38.7			**66.6**			**65.4**		
Sector analysis											
Bank			9.0			16.0			9.9		
Building Society			6.5			11.0			15.7		
MMF**			20.0			39.6			39.8		
Local Authorities/Cent Govt			3.2								
			38.7			**66.6**			**65.4**		
Country analysis											
UK			9.7			19.0			20.6		
Sweden			9			8.0			5.0		
MMF**			20			39.6			39.8		
			38.7			**66.6**			**65.4**		

*Fitch short/long term ratings, except Aviva MMF and Nottingham BS (Moody rating). See next page for key. The use of Fitch ratings is illustrative – the Council assesses counterparty suitability using all 3 credit rating agencies, where applicable, and other information on credit quality.
** MMF – Money Market Fund. These funds are domiciled in Ireland for tax reasons, but the funds are made up of numerous diverse investments with highly rated banks and other institutions. The credit risk is therefore spread over numerous countries, including the UK. The exception to this is the Aviva Government Liquidity Fund which invests directly in UK government securities and in short-term deposits secured on those securities.

Key – Fitch's credit ratings:

		Long	Short
Investment Grade	Extremely Strong	AAA	
	Very Strong	AA+	
		AA	F1+
		AA-	
	Strong	A+	
		A	F1
		A-	
	Adequate	BBB+	F2
		BBB	
		BBB-	F3
Speculative Grade	Speculative	BB+	
		BB	
		BB-	
	Very Speculative	B+	B
		B	
		B-	
	Vulnerable	CCC+	
		CCC	
		CCC-	C
		CC	
		C	
	Defaulting	D	D

<u>Appendix 2</u>



<u>APPENDIX 3</u>

Treasury Management Prudential Indicators

<u>Interest Rate Exposures</u>

While fixed rate borrowing can contribute significantly to reducing the uncertainty surrounding future interest rate scenarios, the pursuit of optimum performance justifies retaining a degree of flexibility through the use of variable interest rates on at least part of the treasury management portfolio. The Prudential Code requires the setting of upper limits for both variable rate and fixed interest rate exposure:

	Limit Set 2015 - 16	Estd Actual 2015 - 16
Interest at fixed rates as a percentage of net interest payments	60% - 100%	78.7%
Interest at variable rates as a percentage of net interest payments	0% - 40%	21.3%

The interest payments were within the limits set.

<u>Maturity Structure of Borrowing</u>

This indicator is designed to prevent the Council having large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate	Limit Set 2015 - 16	Estd Actual 2015 - 16
Under 12 months	0% - 20%	3% - 5%
12 months to 2 years	0% - 20%	2% - 4%
2 years to 5 years	0% - 60%	5% - 8%
5 years to 10 years	0% - 80%	6% - 10%
More than 10 years	20% - 100%	76% - 79%

The limits on the proportion of fixed rate debt were adhered to.

<u>Total principal sums invested for periods longer than 364 days</u>
The Council will not invest sums for periods longer than 364 days.