Division(s): N/A

AUDIT & GOVERNANCE COMMITTEE – 18 November 2015

TREASURY MANAGEMENT MID-TERM REVIEW 2015/16

Report by Chief Finance Officer

Introduction

1. The Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice on Treasury Management (Revised) 2011 recommends that members are informed of Treasury Management activities at least twice a year. This report ensures this authority is embracing Best Practice in accordance with CIPFA's recommendations.

2. The following annexes are attached

Annex 1	Lending List Changes
Annex 2	Debt Financing 2015/16
Annex 3	PWLB Debt Maturing
Annex 4	Prudential Indicator Monitoring
Annex 5	Arlingclose Quarter 2 Benchmarking

Strategy 2015/16

3. The approved Treasury Management Strategy for 2015/16 was based on an average base rate forecast of 0.625%.

4. The Strategy for borrowing continued to provide the option to fund new or replacement borrowing up to the value of 25% of the portfolio through internal borrowing.

5. The Strategy included the continued use of pooled fund vehicles with variable net asset value.

External Context – Provided by Arlingclose

6. As the year began, economic data was largely overshadowed by events in Greece. Markets' attention centred on the never-ending Greek issue, which stumbled from turmoil to crisis, running the serious risk of a disorderly exit from the Euro. The country's politicians and the representatives of the 'Troika' of its creditors - the European Commission (EC), the European Central Bank (ECB) and the International Monetary Fund (IMF) – barely saw eye to eye. Greece failed to make a scheduled repayment to the IMF on 30th June, in itself not a default until the IMF's Managing Director declares it so. Prime Minister Tsipras blindsided Greece's creditors by calling a referendum on 5th July on reform proposals which by then were off the table anyway. The European Central Bank froze liquidity assistance provided to Greek banks and capital controls within the country severely restricted individuals' and corporates' access to cash.

7. On 12th July, following a weekend European Union Summit, it was announced that the terms for a third bailout of Greece had been reached. The deal amounting to €86 billion was agreed under the terms that Greece would see tax increases, pension reforms and privatisations; the very reforms Tsipras had vowed to resist. This U-turn saw a revolt within the ruling Syriza party and on 27th August, Alexis Tsipras resigned from his post as Prime Minster of Greece after just eight months in office by calling a snap election, held on 20th September. This gamble paid off as Tsipras led his party to victory once again, although a coalition with the Independent Greeks was needed for a slim parliamentary majority. That government must now continue with the unenviable task of guiding Greece through the continuing economic crisis – the Greek saga is far from over.

8. The summer also saw attention shift towards China as the Shanghai composite index (representing China's main stock market), which had risen a staggering 50%+ since the beginning of 2015, dropped by 43% in less than three months with a reported $3.2 trillion loss to investors, on the back of concerns over growth and after regulators clamped down on margin lending activity in an effort to stop investors borrowing to invest and feeding the stock market bubble. Chinese authorities intensified their intervention in the markets by halting trading in many stocks in an attempt to maintain market confidence. They surprised global markets in August as the People's Bank of China changed the way the yuan is fixed each day against the US dollar and allowed an aggressive devaluation of the currency. This sent jitters through Asian, European and US markets impacting currencies, equities, commodities, oil and metals. On 24th August, Chinese stocks suffered their steepest one-day fall on record, driving down other equity markets around the world and soon becoming known as another 'Black Monday'. Chinese stocks have recovered marginally since and are trading around the same level as the start of the year. Concerns remain about slowing growth and potential deflationary effects.

9. **UK Economy:** The economy has remained resilient over the last six months. Although economic growth slowed in Q1 2015 to 0.4%, year/year growth to March 2015 was a relatively healthy 2.7%. Q2 2015 GDP growth bounced back and was confirmed at 0.7%, with year/year growth showing slight signs of slowing, decreasing to 2.4%. GDP has now increased for ten consecutive quarters, breaking a pattern of slow and erratic growth from 2009. The annual rate for consumer price inflation (CPI) briefly turned negative in April, falling to -0.1%, before fluctuating between 0.0% and 0.1% over the next few months. In the August Quarterly Inflation Report, the Bank of England projected that GDP growth will continue around its average rate since 2013. The Bank of England's projections for inflation remained largely unchanged from the May report with them expecting inflation to gradually increase to around 2% over the next 18 months and then remain there in the near future. Further improvement in the labour market saw the ILO unemployment rate for the three months to July fall to 5.5%. In the September report, average earnings excluding bonuses for the three months to July rose 2.9% year/year.

10. The outcome of the UK general election, largely fought over the parties' approach to dealing with the consequences of the structural deficit and the pace of its removal, saw some very big shifts in the political landscape and put the key issue of the UK's relationship with the EU at the heart of future politics.

11. The US economy slowed to 0.6% in Q1 2015 due to bad weather, spending cuts by energy firms and the effects of a strong dollar. However, Q2 GDP showed a large improvement at a twice-revised 3.9% (annualised). This was largely due to a broad recovery in corporate investment alongside a stronger performance from consumer and government spending and

construction and exports. With the Fed's decision on US interest rate dependent upon data, GDP is clearly supportive. However it is not as simple as that and the Fed are keen to see inflation rise alongside its headline economic growth and also its labour markets. The Committee decided not to act at its September meeting as many had been anticipating but have signalled rates rising before the end of the year.

12. **Market reaction:** Equity markets initially reacted positively to the pickup in the expectations of global economic conditions, but were tempered by the breakdown of creditor negotiations in Greece. China led stock market turmoil around the globe in August, with the FTSE 100 falling by around 8% overnight on 'Black Monday'. Indices have not recovered to their previous levels but some improvement has been seen. Government bond markets were quite volatile with yields rising (i.e. prices falling) initially as the risks of deflation seemingly abated. Thereafter yields fell on the outcome of the UK general election and assisted by reappraisal of deflationary factors, before rising again. Concerns around China saw bond yields dropping again through August and September. Bond markets were also distorted by the size of the European Central Bank's QE programme, so large that it created illiquidity in the very markets in which it needed to acquire these bonds, notably German government bonds (bunds) where yields were in negative territory.

Treasury Management Activity

Debt Financing

13. Oxfordshire County Council's debt financing to date for 2015/16 is analysed in Annex 2.

14. The Council's cumulative total external debt has decreased from £399.38m on 1 April 2015 to £394.38m by 30 September 2015, a net decrease of £5m. No new debt financing has been arranged during the year. The total forecast external debt as at 31 March 2016, after repayment of loans maturing during the year, is £393.38m. The forecast debt financing position for 31 March 2016 is shown in Annex 2.

15. At 30 September 2015, the authority had 66 PWLB[1] loans totalling £344.38m and 10 LOBO[2] loans totalling £50m. The combined weighted average interest rate for external debt as at 30 September 2015 was 4.50%.

Maturing Debt

16. The Council repaid £5m of maturing PWLB loans during the first half of the year. The details are set out in Annex 3.

Debt Restructuring

17. There has been no restructuring of Long Term Debt during the year to date.

[1] PWLB (Public Works Loans Board) is a Government agency operating within the United Kingdom Debt Management Office and is responsible for lending money to Local Authorities.
[2] LOBO (Lender's Option/Borrower's Option) Loans are long-term loans which include a re-pricing option for the bank at predetermined intervals.

Investment Strategy

18. The security and liquidity of cash was prioritised above the requirement to maximise returns. The Council continued to adopt a cautious approach to lending to financial institutions and continuously monitored credit quality information relating to counterparties.

19. During the first half of the financial year short term fixed deposits of up to 12 months have been placed with banks and building societies. Deposits over twelve months have been made with other local authorities, the primary purpose of which was to provide diversification away from bank and building society deposits.

20. The Treasury Management Strategy Statement and Annual Investment Strategy for 2015/16 included the use of external fund managers and pooled funds to diversify the investment portfolio through the use of different investment instruments, investment in different markets, and exposure to a range of counterparties. It is expected that these funds should outperform the Council's in-house investment performance over a rolling three year period. The strategy permitted up to 50% of the total portfolio to be invested with external fund managers and pooled funds (excluding Money Market Funds).

21. The performance of the pooled funds will continue to be monitored by the Treasury Management Strategy Team (TMST) throughout the year against respective benchmarks and the in-house portfolio. The TMST will keep pooled funds under review, including ensuring appropriate diversification and the consideration of alternative investment and fund structures, to manage overall portfolio risk.

The Council's Lending List

22. The Council's in-house cash balances were deposited with institutions that meet the Council's approved credit rating criteria. The approved Lending List was updated during the period to incorporate additional counterparties. Changes were reported to Cabinet on a bi-monthly basis. Annex 1 shows the amendments incorporated into the Lending List during the first half of 2015/16, in accordance with the approved credit rating criteria.

23. All three credit ratings agencies have reviewed their ratings in the first six months of the year to reflect the loss of government support for most financial institutions and the potential for varying loss given default as a result of new bail-in regimes in many countries. Despite reductions in government support many institutions have seen upgrades due to an improvement in their underlying strength and an assessment that that the level of loss given default is low.

24. Fitch reviewed the credit ratings of multiple institutions in May. Most UK banks had their support rating revised from 1 (denoting an extremely high probability of support) to 5 (denoting external support cannot be relied upon). Despite this, Lloyds Banking Group received a one notch upgrade.

25. Moody's concluded its review in June and upgraded the long-term ratings of Close Brothers, Standard Chartered Bank, Goldman Sachs International, HSBC, Coventry Building Society, Nationwide Building Society, Svenska Handelsbanken and Landesbank Hessen-Thuringen.

26. Standard & Poor's (S&P) reviewed UK and German banks in June downgrading Barclays' long-term rating to A- from A. S&P has also revised the outlook of the UK as a whole to negative from stable, citing concerns around a planned referendum on EU membership and its effect on the economy.

27. At the end of July, the council's treasury advisors Arlingclose advised an extension of recommended durations for unsecured investments in certain UK and European institutions following improvements in the global economic situation and the receding threat of another Eurozone crisis. A similar extension was advised for some non-European banks in September, with the Danish Danske Bank also being included as a new recommended counterparty.

28. In the six months to 30 September 2015 there were no instances of breaches in policy in relation to the Council's Lending List. Any breaches in policy will be reported to Cabinet as part of the bi-monthly financial monitoring.

Investment Performance

29. Security of capital has remained the Authority's main investment objective. This has been maintained by following the Authority's counterparty policy as set out in its Treasury Management Strategy Statement and Annual Investment Strategy for 2015/16.

30. The average daily balance of temporary surplus cash invested in-house in the six months to 30 September was £331.75m. The Council achieved an average in-house return for that period of 0.76%, exceeding the budgeted rate of 0.70% set in the strategy. This has produced gross interest receivable of £1.25m.

31. Temporary surplus cash includes; developer contributions; council reserves and balances; trust fund balances; and various other funds to which the Council pays interest at each financial year end, based on the average three month London Interbank Bid (LIBID) rate.

32. The Council uses the three month inter-bank sterling bid rate as its benchmark to measure its own in-house investment performance. During the first half of 2015/16 the average three month inter-bank sterling rate was 0.45%. The Council's average in-house return of 0.76% exceeded the benchmark by 0.31%. The Council operates a number of call accounts and instant access Money Market Funds to deposit short-term cash surpluses. The average balance held on overnight deposit in money market funds or call accounts in the 6 months to 30 September was £57.5m or 17.3% of the total in house portfolio.

External Fund Managers and Pooled Funds

33. The Council continued to use pooled funds with variable net asset value. Weighted by value pooled fund investments produced an overall annualised return of 0.74% for the period. These investments are held with a long-term view and performance is assessed accordingly.

34. Gross distributions from pooled funds have totalled £0.14m in the six months to 30 September. This brings total income, including gross interest receivable to £1.39m for the period.

35. In September 2015 the TMST approved the decision to sell approximately one quarter of the Council's £20m initial investment in the Threadneedle Strategic Bond Fund, due to a decrease in the size of the fund. The sale resulted in a realisable gain of £0.26m, which represents an annualised return of 3.29% since the initial investment.

36. Having reviewed further investment options the TMST approved the decision to invest a further £5m in the CCLA Local Authorities' Property Fund in September 2015.

Prudential Indicators for Treasury Management

37. The position as at 30 September 2015 for the Prudential Indicators is shown in Annex 4.

38. As at 30 September 2015 the Council exceeded the prudential indicator for the upper limit on fixed interest rate exposure for net debt. Actual fixed interest rate exposure was 153.63%, exceeding the 150% limit set out in the 2015/16 Treasury Management Strategy.

39. The indicator is calculated using the following formula:

$$\frac{\text{Fixed debt – Fixed deposits}}{\text{Total debt – Total deposits and investments}}$$

40. The reason for exceeding the limit lies predominantly with an increase in the proportion of the Council's investment portfolio held in investments and deposits with variable interest rates, which has subsequently reduced the proportion of deposits with fixed interest rates. This was a deliberate decision taken by the Treasury Management Strategy Team in order to further diversify the Council's investment portfolio.

41. At 30 September 2015, 32.5% of total investments and deposits held were at variable interest rates. The Treasury Management Strategy Team are comfortable with this level of variable rate investments and deposits and do not believe that exceeding the fixed interest rate exposure limit poses a risk to the Council.

42. The Treasury Management Strategy Team will review the suitability of existing interest rate exposure indicators as part of the 2016/17 Treasury Management Strategy. A move away from existing indicators towards the use of local indicators where these are more appropriate will be considered, as encouraged in the CIPFA Treasury Management Code of Practice 2011.

External Performance Indicators and Statistics

43. The County Council is a member of the CIPFA Treasury and Debt Management benchmarking club and receives annual reports comparing returns and interest payable against other authorities. The benchmarking results for 2014/15 showed that Oxfordshire County Council had achieved an average investment return of 1.15% compared with an average of 0.77% for their comparative group of 40 members.

44. The average interest rate paid for all debt during 2014/15 was 4.54%, with an average of 4.23% for the comparative group of 40 members. It should be noted that all of Oxfordshire

County Council's debt is long-term, whereas the averages for the comparators include short-term debt which has a lower interest rate and so reduces the averages. Oxfordshire County Council had a higher than average proportion of its debt portfolio in PWLB loans at 87% compared to 74% for the all member group. Oxfordshire County Council had 13% of its debt in LOBO loans at 31 March 2015 compared with an average of 17% for the comparative group.

45. Arlingclose also benchmark the Council's investment performance against its other clients on a quarterly basis. The results of the quarter 2 benchmarking to 30 September 2015 are included in annex 5.

46. The benchmarking results show that the Council was achieving higher than average interest on deposits at 30 September 2015, when compared with a group of 121 other local authorities. This has been achieved by placing deposits over a longer than average duration with institutions that are of higher than average credit quality.

47. Oxfordshire had a higher than average allocation to external funds, fixed and local authority deposits when compared with other local authorities in the benchmarking exercise. Oxfordshire also had a notably lower than average exposure to money market funds, call accounts and certificates of deposit.

Training

48. Individuals within the Treasury Management Team continued to keep up to date with the latest developments and have attended a number of external workshops and conferences.

Financial and Legal Implications

49. Interest payable and receivable in relation to Treasury Management activities are only two parts of the overall Strategic Measures budget.

50. The 2015/16 budget for interest receivable is £2.06m. The forecast outturn for interest receivable and returns on investments is £2.72m, giving net forecast excess income of £0.66m. The increased forecast is due to a combination of higher average cash balances and higher average interest rates than originally forecast. In addition to stronger distributions from pooled funds than originally forecast.

51. Interest payable is currently forecast to be in line with the budgeted figure of £18.2m.

RECOMMENDATION

52. **The Committee is RECOMMENDED to note the report.**

LORNA BAXTER
Chief Finance Officer

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November 2015

Annex 1

Lending List Changes during 2015/16

Counterparties added/reinstated

Counterparty	Lending Limit	Maximum Maturity
Santander 95 day notice a/c	£15m	6 mths
Bank of Scotland	£15m	9 mths
Barclays current a/c	£15m	100 days
Barclays 100 day notice a/c	£15m	100 days
Danske Bank	£15m	100 days

Counterparties suspended

Counterparty
Goldman Sachs International Bank

Lending limits & Maturity limits increased

Counterparty	Lending Limit	Maximum Maturity
Close Brothers Ltd	£15m	6 mths*
Coventry Building Society	£15m	6 mths*
Nationwide Building Society	£15m	6 mths*
Santander UK PLC	£15m	6 mths*
Landesbank Hessen-Thuringen	£20m	6 mths*
Lloyds Bank Plc	£25m	9 mths*
HSBC Bank Plc	£25m	364 days*
Rabobank Group	£25m	364 days*
Svenska Handelsbanken	£25m	364 days*
Bank of Montreal	£25m	364 days*
Bank of Nova Scotia	£25m	364 days*
Canadian Imperial bank of Commerce	£25m	364 days*
Royal Bank of Canada	£25m	364 days*
Toronto-Dominion Bank	£25m	364 days*

*Indicates limit changed.

Lending limits & Maturity limits decreased

No Counterparty limits have been decreased between 1 April 2015 and 30 September 2015.

Annex 2

OXFORDSHIRE COUNTY COUNCIL DEBT FINANCING 2015/16

Debt Profile		£m
1. PWLB	87%	349.38
2. Money Market LOBO loans	17%	50.00
3. Sub-total External Debt		399.38
4. Internal Balances	0%	-27.31
5. Actual Debt at 31 March 2015	**100%**	**372.07**
6. Government Supported Borrowing		0.00
7. Unsupported Borrowing		12.55
8. Borrowing in Advance		0.00
9. Minimum Revenue Provision		-15.60
10. Forecast Debt at 31 March 2016		**369.02**
Maturing Debt		
11. PWLB loans maturing during the year		-6.00
12. PWLB loans repaid prematurely in the course of debt restructuring		0.00
13. Total Maturing Debt		**-6.00**
New External Borrowing		
14. PWLB Normal		0.00
15. PWLB loans raised in the course of debt restructuring		0.00
16. Money Market LOBO loans		0.00
17. Total New External Borrowing		**0.00**
Debt Profile Year End		
18. PWLB	87%	343.38
19. Money Market LOBO loans	13%	50.00
20. Sub-total External Debt		393.38
21. Internal Balances	0%	-24.36
22. Forecast Debt at 31 March 2016	**100%**	**369.02**

Line

1 – 5 This is a breakdown of the Council's debt at the beginning of the financial year (1 April 2015). The PWLB is a government agency operating within the Debt Management Office. LOBO (Lender's Option/ Borrower's Option) loans are long-term loans, with a maturity of up to 60 years, which includes a re-pricing option for the bank at predetermined time intervals. Internal balances include provisions, reserves, revenue balances, capital receipts unapplied, and excess of creditors over debtors.

6 'Government Supported Borrowing' is the amount that the Council can borrow in any one year to finance the capital programme. This is determined by Central Government, and in theory supported through the Revenue Support Grant (RSG) system.

7 'Unsupported Borrowing' reflects Prudential Borrowing taken by the authority whereby the associated borrowing costs are met by savings in the revenue budget.

8 'Borrowing in Advance' is the amount the Council borrowed in advance to fund future capital finance costs.

9 The amount of debt to be repaid from revenue. The sum to be repaid annually is laid down in the Local Government and Housing Act 1989, which stipulates that the repayments must equate to at least 4% of the debt outstanding at 1 April each year.

10 The Council's forecast total debt by the end of the financial year, after taking into account new borrowing, debt repayment and movement in funding by internal balances.

11 The Council's normal maturing PWLB debt.

12 PWLB debt repaid early during the year.

13 Total debt repayable during the year.

14 The normal PWLB borrowing undertaken by the Council during 2015/16.

15 New PWLB loans to replace debt repaid early.

16 The Money Market borrowing undertaken by the Council during 2015/16

17 The total external borrowing undertaken.

18-22 The Council's forecast debt profile at the end of the year.

Annex 3

<u>Long-Term Debt Maturing 2015/16</u>

Public Works Loan Board: Loans Matured during first half of 2015/16

Date	Amount £m	Rate %
30/04/2015	4.000	9.75%
13/07/2015	0.500	2.35%
31/07/2015	0.500	2.35%
Total	**5.000**	

Public Works Loan Board: Loans Due to Mature during second half of 2015/16

Date	Amount £m	Rate %
13/01/2016	0.500	2.35%
29/01/2016	0.500	2.35%
Total	**1.000**	

Annex 4

Prudential Indicators Monitoring at 30 September 2015

Authorised and Operational Limit for External Debt

Authorised limit for External Debt	£490,000,000
Operational Limit for External Debt	£480,000,000
Capital Financing Requirement for year	£406,298,000

	Actual 30/09/2015	Forecast 31/03/2016
Borrowing	£394,382,618	£393,382,618
Other Long-Term Liabilities	£40,000,000	£40,000,000
Total	**£434,382,618**	**£433,382,618**

Fixed Interest Rate Exposure

Fixed Interest Net Borrowing limit	150.00%
Actual at 30 September 2015	153.63%

Variable Interest Rate Exposure

Variable Interest Net Borrowing limit	25.00%
Actual at 30 September 2015	-62.74%

Sums Invested over 365 days

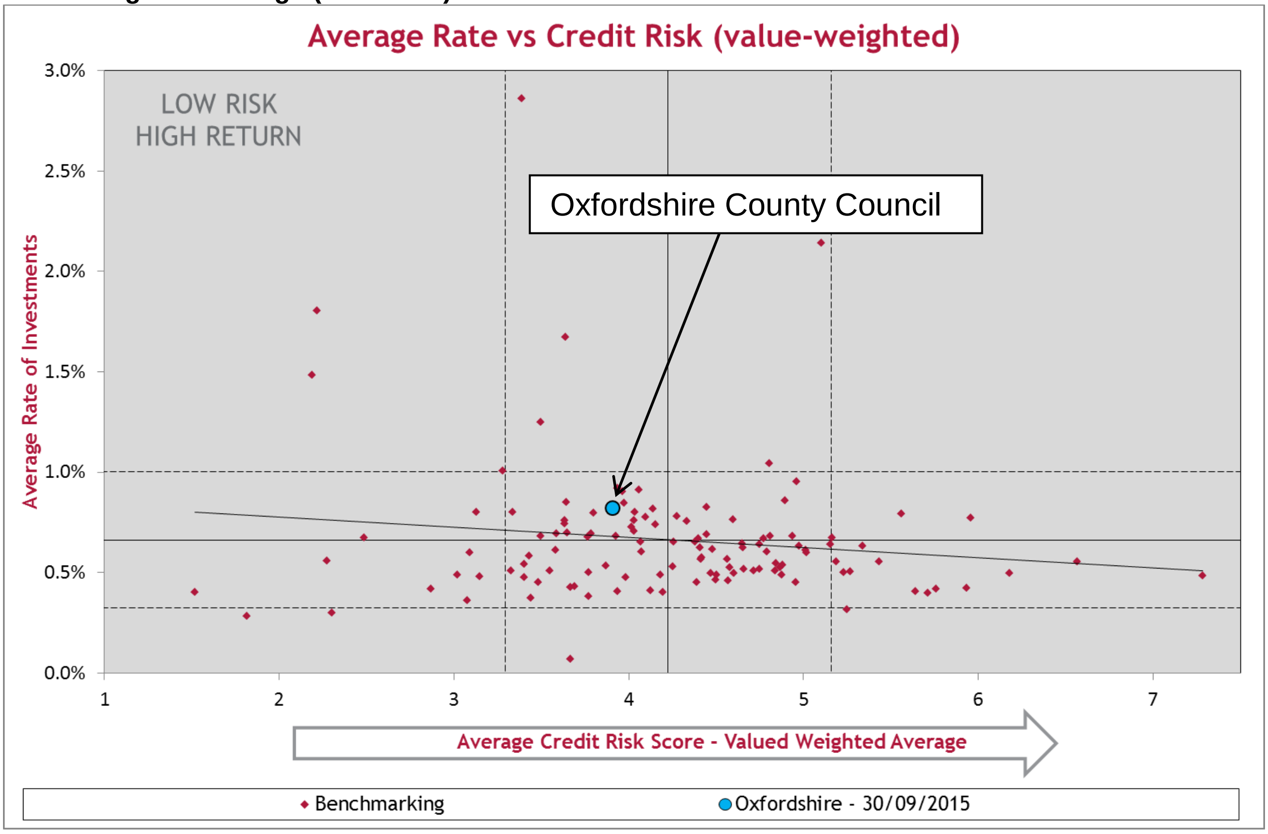
Total sums invested for more than 364 days limit	£150,000,000
Actual sums invested for more than 364 days	£ 59,000,000

Maturity Structure of Borrowing

	Limit %	Actual %
Under 12 months	0 - 20	7.86
12 – 24 months	0 - 25	2.28
24 months – 5 years	0 - 35	17.50
5 years to 10 years	5 - 40	11.66
10 years +	50 - 95	60.70

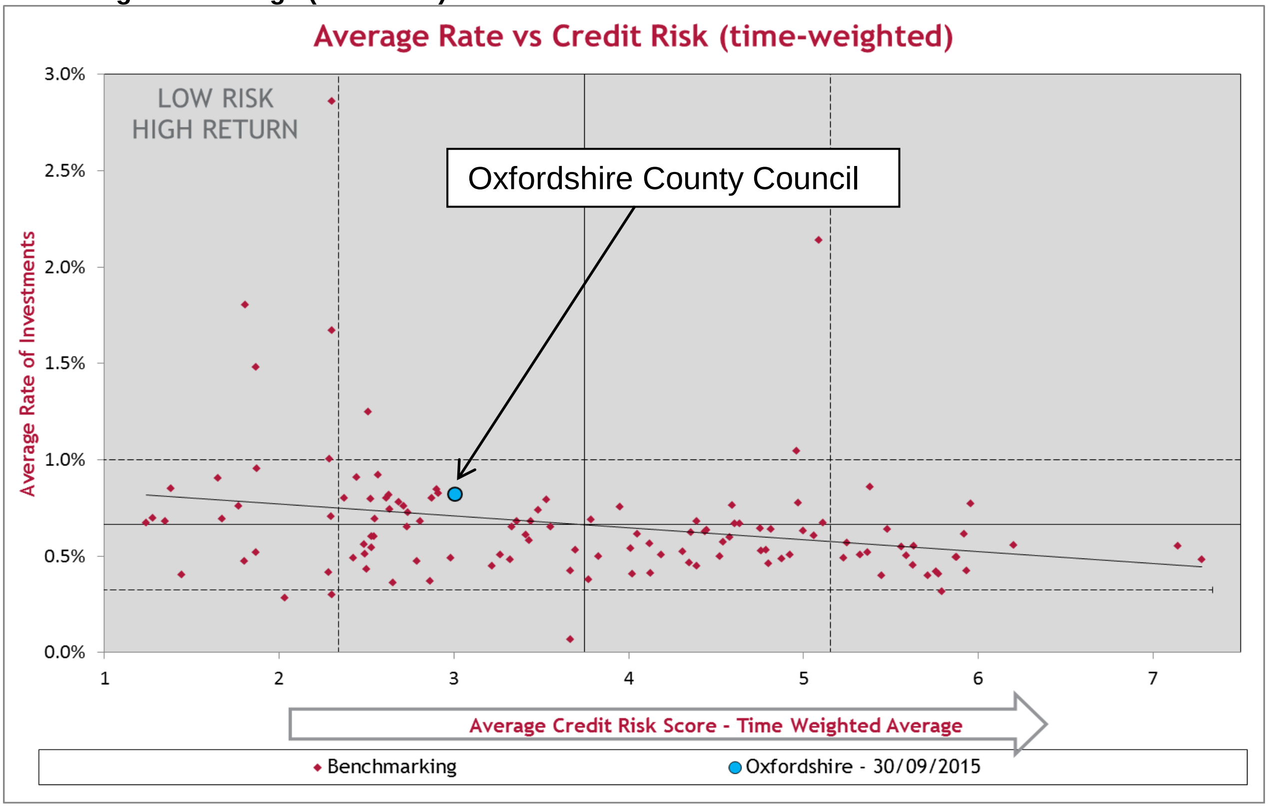
Annex 5

Value weighted average (all clients)



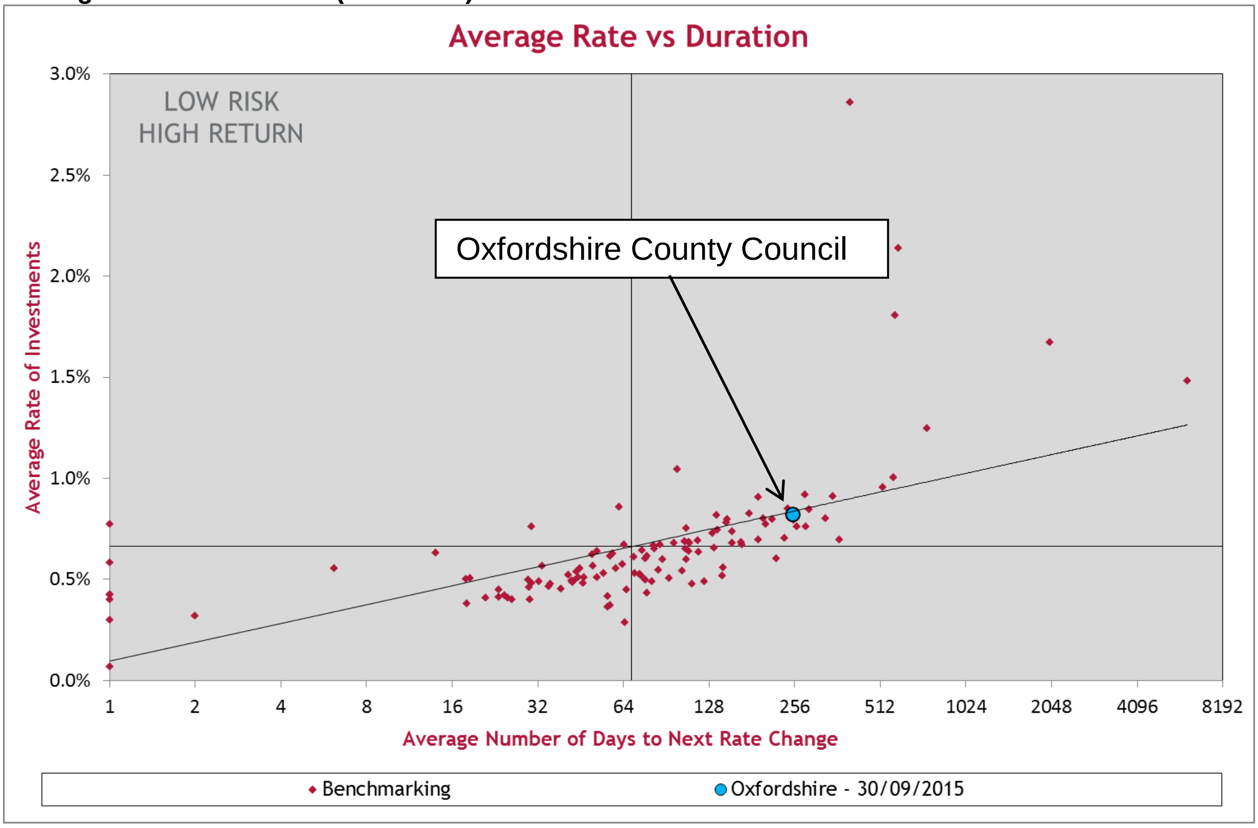
This graph shows that, at 30 September 2015, Oxfordshire achieved a higher than average return for lower than average credit risk, weighted by deposit size.

Time weighted Average (all clients)



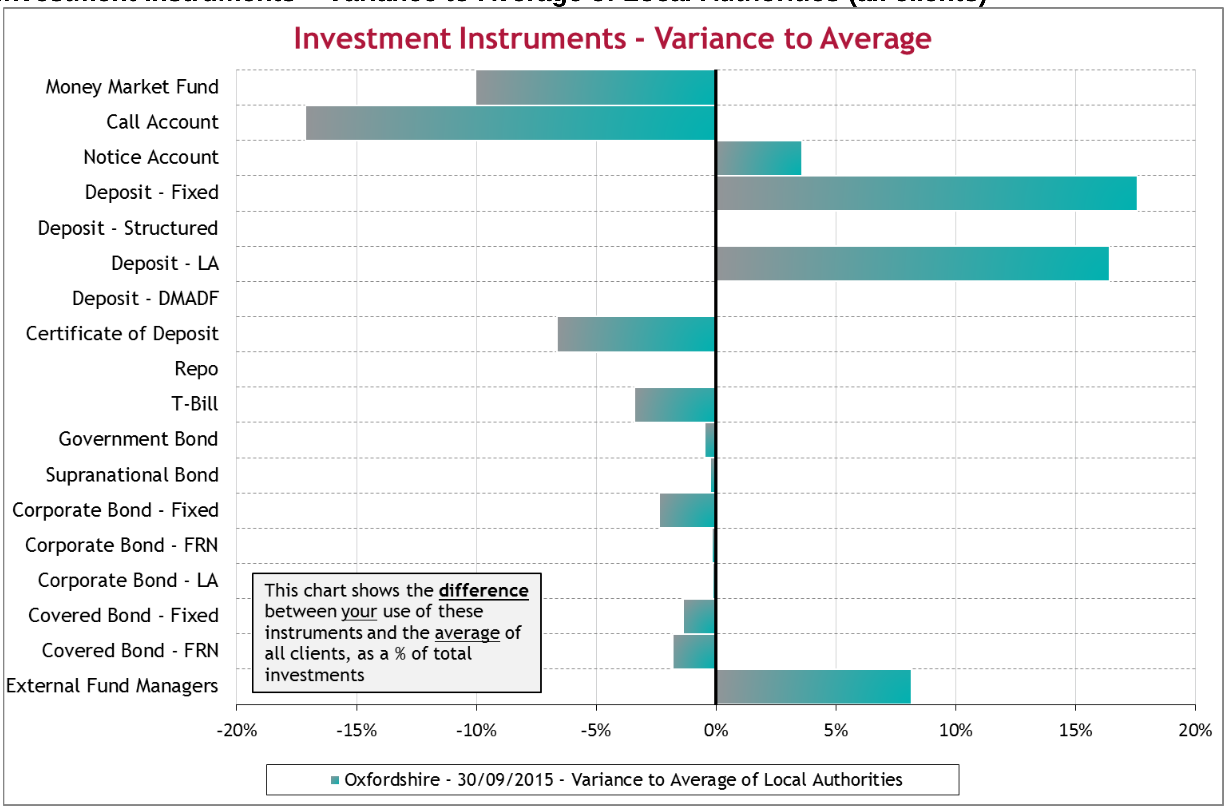
This graph shows that, at 30 September 2015, Oxfordshire achieved higher than average return for lower than average credit risk, weighted by duration.

Average Rate vs Duration (all clients)



This graph shows that, at 30 September 2015, Oxfordshire achieved a higher than average return by placing deposits for longer than average duration.

Investment Instruments – Variance to Average of Local Authorities (all clients)



This graph shows that, at September 2015, Oxfordshire had notably higher than average allocation to external funds, fixed and local authority deposits when compared with other local authorities. Oxfordshire also had notably lower exposures to money market funds, call accounts and certificates of deposit.