Leicestershire County Council

CORPORATE GOVERNANCE COMMITTEE – 13TH MAY 2016

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

QUARTERLY TREASURY MANAGEMENT REPORT

Purpose of the Report

1. To update the Corporate Governance Committee about the actions taken in respect of treasury management in the quarter ended 31st March 2016.

Background

2. Treasury Management is defined as:

   "The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

3. A quarterly report is produced for the Corporate Governance Committee to provide an update on any significant events in the area of treasury management.

Economic Background

4. UK economic growth for the December 2015 quarter was upgraded from the estimated 0.5% to a figure of 0.6%, and over the whole of 2015 the growth was 2.1%. Preliminary estimates for the March 2016 quarter are for a 0.4% level of growth, and weakness in other economies does not suggest that growth will accelerate quickly in the near future. Inflation remained low but picked up from the ultra-low levels of previous quarters, largely as a result of previous significant falls in the oil price 'falling out' of the annual figure. Consumer Price Inflation – the Bank of England's target measure – stood at 0.5% in the year to March 2016 and although this is expected to rise further, there does not appear to be any realistic threat of interest rate rises being required to control inflation anytime soon.

5. The US economy continues to outperform most others but the slowdown in China is exerting downward pressure on global growth, with global central banks interest rates continuing to trend downwards. In a number of countries interest rates are negative, a policy measure that is intended to try to force the spending of cash balances. There is no obvious sign that this policy measure is having any significant impact.

6. The EU Referendum in the UK, and the threat of 'Brexit', brings significant uncertainties around the future of the UK economy. Markets dislike uncertainty and as a result volatility within markets should be expected over the coming months, and so far this has manifested itself most obviously in the foreign exchange market. The level of volatility will probably depend on how clear cut the outcome of the Referendum looks.

Action Taken during March Quarter

7. The balance of the investment portfolio increased from £165.2m to £171.9m over the quarter, despite the investment of a further £7.5m into a second pooled property fund. This level of variance in cash balances is quite normal.

8. Activity during the quarter related mainly to the reinvestment of maturing loans with acceptable counterparties, which became difficult to do at reasonable rates of interest following the removal of Lloyds Banking Group from the counterparty list. This removal came as a result of an increase in the cost of buying Credit Default Swaps (CDS) on their loans (in effect a market assessment on the cost of insuring against default), which is one of the overlays used in assessing counterparty risk. Since the year end, Lloyds have returned to the list, but at a lower maximum maturity period (6 months) and maximum outstanding loan amount (£20m) than has been the case historically. These lower levels are a reflection of the lower level of State-ownership than was previously the case, and hence the lower possibility of government support in the event of financial difficulties, and not a reflection of the CDS issue.

9. Lloyds Banking Group has a maximum loan period of one year and a maximum sum outstanding of £50m when there was a higher level of Government share ownership, and £40m of loans with them matured during the quarter. As they were not an acceptable counterparty, none of these loans could be reinvested with them. One loan of £5m, for one year at a rate of 1.05%, was placed with Landesbank Hessen Thuringen (generally known in the market as Helaba) and £20m was lent to Nationwide Building Society for six months at a rate of 0.73%. In the absence of other acceptable counterparties offering attractive rates, there was a sizeable (£21.7m) increase in monies held in Money Market Funds over the quarter.

10. The impact of the action taken during the quarter was to decrease the average rate of interest from 0.93% to 0.86%. This reduction was as a result of the Lloyds loans maturing at an average rate of 0.96%, and the fact that the large increase in Money Market Fund investment being at an average rate of 0.53%. How much money is held in Money Market Funds is a function of cash flows, availability of counterparties at attractive rates of interest and views on how future interest rates will change.

11. The loan portfolio at the end of March was invested with the counterparties shown in the list below.

	£m
Lloyds Banking Group/Bank of Scotland	5.0
Royal Bank of Scotland	50.0
Santander UK	20.0
Nationwide	20.0
Landesbank Baden-Wuerttemberg	10.0
Landesbank Hessen Thuringen	15.0
Close Brothers	10.0
Toronto Dominion Bank	10.0
Money Market Funds	31.9
	171.9

12. There are also five further loans with Lloyds Banking Group which are classified as 'service investments' for the Local Authority Mortgage Scheme (LAMS), and all of these loans had original maturities of five years. These do not form part of the treasury management portfolio, but are listed below for completeness:

5 year loan for £2m, commenced 5th September 2012 at 2.72%
5 year loan for £1.4m, commenced 27th November 2012 at 2.19%
5 year loan for £2m, commenced 12th February 2013 at 2.24%
5 year loan for £2m, commenced 1st August 2013 at 2.31%
5 year loan for £1m, commenced 31st December 2013 at 3.08%

13. The Leicestershire Local Enterprise Fund has been making financing available to small and medium sized Leicestershire companies, via an association with Funding Circle, since December 2013. There are a number of hurdles that companies must clear before being able to access this funding, and any loans made will be classed as 'service investments'. As such, these loans are not covered within the Treasury Management Policy but at the end of March 2016 there had been 50 loans made totalling £492,400, and the average interest rate on these loans was 8.5%. There were no new loans made during the quarter and the average interest rate was also static.

Resource Implications

14. The interest earned on revenue balances and the interest paid on external debt will impact directly on the resources available to the Council.

Equal Opportunities Implications

15. There are no discernable equal opportunity implications.

Recommendation

16. The Committee is asked to note this report.

Background Papers

None

Circulation under the Local Issues Alert Procedure

None

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