Leicestershire County Council

CORPORATE GOVERNANCE COMMITTEE – 25TH NOVEMBER 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 30th September 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. The unexpected decision by the UK electorate to support leaving the European Union, which came at the end of the previous quarter, was expected to impact significantly onto economic growth but early estimates are for growth to have continued at broadly the same level as before the vote. There was also an upward revision to growth for the previous quarter, to 0.7%, which surprised most economists who had expected a significant slowdown in economic activity in the run-up to the Referendum.

5. Given the uncertainties surrounding the Brexit vote, the Bank of England cut UK base rates in August from 0.5% (where they had been since March 2009) to 0.25% in a pre-emptive move against a likely economic slowdown. At the time of the cut it was widely expected that there would be a further future rate cut (probably to 0.1%) although the Governor of the Bank of England gave clear guidance that negative base rates were not considered a useful policy tool. Given the apparent resilience of the UK economy since the base rate cut, a further cut currently looks unlikely. Further quantitative easing was also announced at the time of the interest rate cut.

6. In the US there was no further tightening of monetary policy following the increase that had occurred late in 2015. At the time of that increase there was an expectation that it was the first increase on the path towards normalisation of interest rates, and that further small increases would follow in the not-too-distant future. Slightly disappointing growth figures in the US, the expectation that the UK's Brexit vote would have a dampening effect on growth around the world and the close-run and

hostile Presidential campaign combined to persuade the Federal Reserve to take no action. It is currently unclear how the unexpected Trump victory will impact onto future interest rate activity in the US, although it does seem highly likely that there will be a new Chair of the Federal Reserve in February 2018 when Janet Yellen's current term expires.

7. Europe continued to show modest economic growth, although this growth was not consistent across the continent. The market has no expectation of any increase in interest rates in the foreseeable future, and the European Central Bank also appears willing to undertake significant further quantitative easing if this proves necessary. There are a number of important elections across Europe in 2017 – most notably in Germany, France and the Netherlands – and these will be crucial in shaping future economic and political outlook.

Action Taken during September Quarter

8. The balance of the investment portfolio increased from £180.0m to £187.6m over the quarter. This level of variance in balances is entirely normal.

9. Activity during the quarter related entirely to attempting to maintain as long a maturity profile as possible, subject to the availability of acceptable counterparties that were paying attractive rates of interest. The reduction in the UK base rates led to a fall in the rates available, but there remained a meaningful premium for being willing to lend for longer periods even though there appeared no realistic possibility of base rate rises in the near term.

10. During the quarter £30m of loans that were originally for periods of 6 months or more matured. All of these loans were rolled-over with the same counterparties at lower interest rates (on average falling from 0.81% to 0.60%). £10m was lent to Royal Bank of Scotland for 1 year at a rate of 0.72%, and this loan had matured late in the June quarter and was not re-invested until early August as the bank were not paying attractive rates until this time. A further one year loan of £10m placed with the French bank Credit Industriel et Commercial in July at a rate of 0.595%. On 1st September Santander UK reduced the interest rate payable on their 6 month notice account, but at 0.90% it remained the most attractive home for the money.

11. The action taken saw the average rate decrease from 0.87% to 0.81%, and the average rate is likely to fall sharply in the coming quarters. Whilst the portfolio has been protected from lower interest rates as far as was possible, there is little else that can be done to combat lower base rates.

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

	£m
Lloyds Banking Group/Bank of Scotland	20.0
Royal Bank of Scotland	40.0
Santander UK	20.0
Nationwide	20.0
Toronto Dominion Bank	15.0
Landesbank Hessen Thuringen	15.0
Norddeutsche Landesbank	10.0
Credit Industriel et Commercial	10.0
Goldman Sachs International	20.0
Commonwealth Bank of Australia	15.0
Money Market Funds	2.6
	187.6

13. 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%

14. The Leicestershire Local Enterprise Fund (LLEF) has been making financing available to small and medium-sized Leicestershire companies, via an association with Funding Circle, since December 2013. For the last year Funding Circle has been able to match the financing requirements of Leicestershire's small and medium sized enterprises to capital made available by private investors. It is clear that LLEF has met its primary objective of ensuring that loan capital is available to appropriate Leicestershire businesses, and Leicestershire will start to divest from the scheme. The released funding will be targeted at priority scheme to increase economic growth in Leicestershire.

15. These loans are not covered within the Treasury Management Policy and are classed as 'service loans', but have been historically included in this report for completeness. Given that the loans outstanding amount is small (£258,000 at 31st August 2016) and will reduce as loans are repaid, it is my intention to not report on this matter in the future unless there are any meaningful issues that arise.

<u>Loans to counterparties that breached authorised lending list</u>

16. As reported last quarter, on 13th May 2016 a loan of £10m was placed with Norddeutsche Landesbank for a period of 6 months. On 2nd June 2016 one of the credit rating agencies changed the outlook on the Long Term and Short Term Ratings for the counterparty to 'Negative Outlook', which moved them from a 6 month maximum period on the standard counterparty list of Capita Asset Services to a 100 day month maximum period. As the Leicestershire policy is to exclude all counterparties that fall within the Capita 100 day period, this meant that Norddeutsche were removed from our list. Norddeutche have not actually been downgraded and the loan was repaid in November 2016, but this breach is being reported for completeness.

<u>Resource Implications</u>

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

<u>Equality and Human Rights Implications</u>

18. There are no discernable equality and human rights implications.

Recommendation

19. The Committee is asked:

(a) To note this report;
(b) To agree that only loans which breach the authorised lending list as set out in paragraph 20 to this report, be reported to the Committee on a quarterly basis.

Background Papers

None

Circulation under the Local Issues Alert Procedure

None

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