Leicestershire County Council

CORPORATE GOVERNANCE COMMITTEE – 22ND SEPTEMBER 2017

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 June 2017.

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 snap UK General Election, which was announced on 18th April and took place on 8th June 2017, was by far the most meaningful event in the UK over the quarter. The outcome of the loss of an overall Conservative majority but a continuing Conservative government with the support of the Democratic Unionist Party was unexpected and may well lead to a period of uncertainty for both individuals and business. Estimates for UK economic growth in the second quarter were 0.3% and although this was a marginal increase from the final figure produced for the previous quarter (0.2%, revised down from an initial estimate of 0.3%) there are clear signs of a slowdown in the UK economy. Brexit negotiations continue to be difficult and this also brings risks, to the extent that most commentators have now discounted the possibility of a base rate increase in 2017 – many saw this as inevitable at the beginning of the year.

5. Inflation in the UK (as measured by the Consumer Price Index) reached 2.6% in June and stayed at this level in July, before increasing to 2.9% in August. Given the impact onto import prices from the reduction in the value of sterling since the Brexit vote in June 2016 it is perhaps surprising that inflation has not increased to higher levels, and this may be partly linked to the relatively weak economic growth currently being experienced.

6. In the US, economic growth remains strong but the President has not yet been able to push through many of the policies that were expected would move growth even higher. The impact of this may be for a slower trajectory towards the normalisation of interest rates to neutral levels, although rises are still expected to happen. The

consensus view of the level of future neutral interest rates (the point at which real economic growth is at trend levels and inflation is stable) is now materially below the level of this indicator before the Global Financial Crisis. Or, put another way, low interest rates are here to stay – albeit probably not as low as they currently are.

7. Within the Eurozone there has been a meaningful acceleration of economic growth in recent months, and the estimated figure for the June quarter is 0.6%. Whilst there is currently no suggestion that the European Central Bank's negative interest rate policy is about to change, there are signs that the Eurozone is past the worst and is beginning to grow in a sustainable manner.

Action Taken during June Quarter

8. The balance of the investment portfolio decreased to £202.7m from £204.8m over the quarter. Most activity during the quarter related 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. 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.

9. During the quarter £100m of loans that were originally for periods of 6 months or more matured, and the average rate of these loans was 0.76%. Some of these loans were rolled over with the same counterparty, whilst others were reinvested with alternative counterparties, but the average rate of all new loans placed during the June quarter for 6 months or more (excluding the Danske Bank loan referred to below) was 0.60%. Whilst this rate is still very attractive compared to the expected average base rate over the loan periods, it does highlight the lower interest rate environment that existed relative to the period in which the maturing loans were placed.

10. In late June a loan was agreed with Danske Bank that was 'set-off' against borrowing that had been taken from them in 2004 as part of the funding of the capital programme. The loan to them is for a little over 10 years and has the legal right of offset in various scenarios, and because of this there is no counterparty risk involved. The terms of the loan are, in summary, that there will be 20 consecutive 6 month loan periods and the interest rate payable by Danske Bank shall be the 6 month LIBOR rate on the date of each period plus 0.45%. This rate is highly likely to be significantly above those available elsewhere in the market, and the lack of counterparty risk and the mitigation of interest rate risk (the rate payable will be regularly reset to an above-market rate) makes the deal extremely attractive to the authority.

11. The impact of all of the above action was to reduce the average rate of interest earned on loans from 0.68% to 0.57% and the portfolio continues to benefit from the policy of lending to acceptable counterparties that are paying attractive rates, and to maximise the loan period.

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

	£m
Money Market Funds	12.7
Lloyds Banking Group/Bank of Scotland	20.0
Royal Bank of Scotland	40.0
Santander UK	20.0
Nationwide	20.0
Landesbank Hessen Thuringen	15.0
Credit Industriel et Commercial	10.0
Goldman Sachs International	20.0
Close Brothers	10.0
Danske Bank	10.0
Local Authorities	25.0
	202.7

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 first of these LAMS loans matured in early September 2017 and was repaid. The interest earned over the period of the loan was £272,000 and this is considerably above the interest amount of c.£50,000 that would have been earned if the cash had remained within the loan portfolio.

15. The interest payable on the LAMS deposits is 0.70% above the equivalent 5 year loan rate at the time that the deposit was placed. For a £2m loan this means that £70,000 was generated over the five year loan period as an 'insurance premium' to help offset the potential cost of indemnity down to 75% of the purchase price; given that the minimum deposit required was 5% of the purchase price the maximum indemnity from the authority was for 20% of the purchase price and in some cases it was less.

16. LAMS was a scheme that preceded the government's 'Help to Buy' scheme, whereby the deposit placed by the authority acted as security against default and allowed first time buyers to obtain mortgage rates that were based on a 25% deposit amount, despite having to only put down a minimum of a 5% deposit themselves. This was exceptionally beneficial to the mortgagees and came at a time when the property market was stagnant due to a lack of buyers. The enhanced rate paid on the deposit was considered highly likely to more-than-offset any cost of default. Crucially the indemnity offered by the authority did not impact on the criteria that decided whether a mortgage was offered, it merely reduced the interest rate payable by successful applicants.

17. In total LAMS helped 400 first time buyers to secure mortgages, and the total cost of the properties purchased was approximately £50m. It is impossible to estimate how much this helped the local economy, but there is little doubt that it had a positive impact.

18. There have been very few arrears (classed by Lloyds as 3 months or more) across LAMS. By coincidence one property in the first tranche of LAMS fell into arrears in the last 6 months of the five year term and as a result the indemnity will be extended by a further two years, which is line with the scheme documentation. A worst case scenario is that the authority will have to pay an amount of £21,740 back to Lloyds, but this assumes repossession and subsequent resale at a price of below £86,250 for a property that was purchased in October 2012 for £115,000. Even in this worst case scenario the particular tranche of LAMS where the deposit has now been repaid can be judged a financial success, as well as being economically beneficial.

19. There are currently no other arrears within the other LAMS tranches.

Loans to counterparties that breached authorised lending list

20. There were no loans active during the period that breached the authorised counterparty list at the time that the loan was made, and also none that had already been placed to a counterparty that subsequently fell below the threshold that would have been acceptable for the remaining period of the loan following a credit-rating downgrade.

Resource Implications

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

Equality and Human Rights Implications

22. There are no discernible equality and human rights implications.

Recommendation

23. The Committee is asked to note this report;

Background Papers

None

Circulation under the Local Issues Alert Procedure

None

Officers to Contact

Declan Keegan - Head of Service - Finance
- Telephone 0116 3057668, email declan.keegan@leics.gov.uk

Colin Pratt – Investments Manager
- Telephone 0116 3057656, email colin.pratt@leics.gov.uk