# QUARTERLY TREASURY MANAGEMENT REPORT – QUARTER 3

## 1. Borrowing Requirement and Debt Management

As at the 31 December 2015, the council's overall outstanding long term borrowing was £244M, at an average rate of 3.33% and an average maturity of 23 years, this has fallen by £9M since 1 April due to maturing debt which has not yet been replaced. The total long term debt portfolio is made up of loans from the Public Works Loan Board (PWLB) of £235M and market loans of £9M.

Included within the PWLB portfolio is £35M of variable rate loans, which are estimated to average 0.70% for the year and are helping to keep overall borrowing costs down. Whilst in the current climate of low interest rates this remains a sound strategy, the Council need to review these regularly and if appropriate switching into fixed rate loans if interest rates start to rise rapidly.

The Council does not have any temporary borrowing at present having repaid outstanding balances during 2014/15 and whilst these have remained affordable and attractive, due to our continued high level of cash (and subsequent investments) no need has arisen.

As at the 31 March 2015 the Council used £92M of internal resources in lieu of borrowing which has been the most cost effective means of funding past capital expenditure to date. This has lowered overall treasury risk by reducing both external debt and temporary investments. However, this position will not be sustainable over the medium to long term and the Council will need to borrow to cover this amount as balances fall.

Based on the latest Capital update the Council is expected to have a borrowing need up to £107.1M between 2015/16 and 2018/19. Of this £57.1M relates to new HRA capital spend, £28.4M for new capital spend on the GF, the remainder relates to the refinancing of existing debt and externalising internal debt to cover the expected fall in balances.

No new borrowing has been taken to date and none is expected to be taken until the end of the year and will be assessed in conjunction with the development of the capital programme, cash balances and advice from the Council's treasury advisor.

### Budgeted Expenditure

The interest cost of financing the Authority's long term and short term loan debt is charged corporately to the Income and Expenditure account. The interest cost in 2015/16 of financing the Authority's loan debt is currently expected to give a saving to the general fund of £2.30M.. This is mainly due to variable interest rates being lower than those estimated, no new long term borrowing being taken in either 2013/14 or 2014/15, slippage on the HRA capital programme and deferring any new borrowing to later in the year.

## 2. Investment Activity

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves.

The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles. Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its TM Strategy Statement for 2015/16.

Counterparty credit quality is assessed and monitored with reference to: Credit Ratings; credit default swaps; financial statements, information on potential government support and reports in the quality financial press.

**Internal investments**

There has been an increase in balances since the beginning of the year (£92M), peaking at £125M in mid- April, currently £102M, current cash flow forecast indicate that balances are expected to fall during February and March due to the reduction and change in profiling of RSG.

As reported previously, following advice from our advisors Arlingclose, we have invested in bonds to optimise investment income. Including corporate bonds as an alternative to fixed term deposits with banks as although the risk of insolvency remains, there is no risk of pre-emptive bail-in by the regulator and corporates are far less geared than banks. These deals will generate around £600K for the year.

Included within the corporate bond investments is a £1.5M bond for Volkswagen Financial Services which has recently been down rated to BBB+. The downgrade factors in further financial implications the group will face following the problems the company is currently having regarding emissions, however the rating agencies continues to believe that Volkswagen's credit metrics remain solid and has the capacity to absorb losses arising, which it believes will be spread over the next few years. Our Advisors still remain comfortable with us holding these investments until maturity (May 2016).

The Authority has internal investments amounting to £94.7M, with an average rate of return of 1.30% as detailed in Table 1 below:

**Table 1: Quarter 3 Internal Investments**

| Investments | At 31 December 2015<br>£000 | Date of Maturity | Yield<br>% | Rating |
|---|---|---|---|---|
| **Cash** | | | | |
| Barclays Bank PLC | 5,000 | Call | 0.50 | A |
| Santander UK Plc | 600 | Call | 0.40 | A |
| Aberdeen MMF | 10,000 | MMF | 0.50 | A+ |
| Blackrock MMF | 55 | MMF | 0.45 | AA- |
| Deutche MMF | 3,038 | MMF | 0.43 | AA- |
| Federated Prime MMF | 9,830 | MMF | 0.52 | AA- |
| Goldman Sachs MMF | 26 | MMF | 0.45 | AA |
| Insight MMF | 200 | MMF | 0.42 | A+ |
| Invesco MMF | 3,670 | MMF | 0.45 | AA- |
| J P Morgan MMF | 3,954 | MMF | 0.46 | AA- |

| | | | | |
|---|---|---|---|---|
| Standard Life MMF | 10,000 | MMF | 0.50 | A+ |
| **Total Cash** | **46,373** | | **0.49** | |
| **Corporate Bonds** | | | | |
| Linde Finance BV | 4,588 | 29/01/2016 | 0.99 | A |
| Heathrow Funding Ltd | 4,915 | 31/03/2016 | 0.96 | A- |
| Volkswagen Financial Service NV | 1,496 | 26/05/2016 | 0.90 | A |
| Rolls Royce PLC | 2,189 | 14/06/2016 | 0.89 | A- |
| Mobility Operations Group Plc | 2,080 | 28/09/2016 | 1.23 | A+ |
| **Total Corporate Bonds** | **15,268** | | **0.98** | |
| **Other Short Term Bonds** | | | | |
| Yorkshire Building Society Covered Bond | 4,016 | 23/03/2016 | 0.77 | AAA |
| Svenkska Handelsbanken AB | 2,197 | 26/05/2016 | 0.95 | AA- |
| Nederlandse Waterschapsbank | 4,828 | 07/09/2016 | 0.77 | AA+ |
| Bank of Scotland PLC Covered Bond | 4,164 | 08/11/2016 | 0.68 | AAA |
| Laneskreditbank Baden-Wuert | 2,010 | 15/12/2016 | 0.72 | AAA |
| **Total Other Bonds** | **17,215** | | **0.77** | |
| **Long Term Bonds** | | | | |
| Lloyds Bank Covered Bond | 2,003 | 16/01/2017 | 0.68 | AAA |
| Nationwide Building Society Covered Bond | 1,484 | 17/07/2017 | 0.68 | AAA |
| Leeds Building Society Covered Bond | 2,002 | 09/02/2018 | 0.82 | AAA |
| Barclays Bank Covered Bond | 1,001 | 12/02/2018 | 0.71 | AAA |
| Yorkshire Building Society Covered Bond | 3,234 | 12/08/2018 | 1.94 | AA+ |
| Leeds Building Society Covered Bond | 3,004 | 01/10/2019 | 0.95 | AAA |

| | | | | |
|---|---|---|---|---|
| European Investment Bank - Bond | 1,069 | 15/04/2025 | 5.27 | AAA |
| European Investment Bank - Bond | 1,054 | 07/06/2025 | 5.16 | AAA |
| European Investment Bank - Bond | 1,039 | 07/06/2025 | 5.49 | AAA |
| **Total Long Term Bonds** | **15,890** | | **1.90** | |
| **Total Investments** | **94,746** | | **1.30** | |

**External Managed investments**

On the 30 April 2014 the Council invested £5M in property funds which offer the potential for enhanced returns over the longer term, but may be more volatile in the shorter term. These funds are managed by professional fund managers which allows the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. This investment returned £0.24M in 2014/15, a yield of 5.21% and the net asset value of the fund at 31st March was £5.3M a notional "gain" of £0.3M against initial investment. Whilst recognising the increased risk (as the value of the fund can also go down) due to the strong performance to date an additional £2M was invested on the 30 April 2015, as at the 31 December the sell price of our total investments were valued at £7.5M a notional "gain" of £0.5M against investments. The current quoted dividend yield on the fund is 4.67% and is expected to return £0.36M for the year.

**Budgeted Income**

The Council does not expect any losses from non-performance in relation to its investments by any of its counterparties. The UK Bank Rate has been maintained at 0.5% since March 2009 and as a consequence short-term money market rates have remained at relatively low levels, investments in Money Market Funds and call accounts currently generated an average rate of 0.49%. Investments in bonds have performed better returning an average of 1.19% for the year to date. The average cash balances during the quarter was £103.7M; these are expected to decline towards the end of the financial year as the incidence of government grant income and council tax income is skewed towards the earlier part of the year.

The Authority's budgeted investment income for the year was estimated at £0.6M, the Authority currently anticipates an investment outturn of £1.2M for the year based on current and committed deals. As reported previously the Authority continues to review investments in suitable longer term financial instruments which will generate a better return, as it is envisaged that there be sufficient cash balances over the medium term.

3. **Compliance with Prudential Indicators**

The Council can confirm that it has complied with its Prudential Indicators for 2015/16, approved by Full Council on 11 February 2015. Table 2 below summarises the Key Prudential Indictors and performance to date:

**Table 2: Compliance with Prudential Indicators**

| Indicator | Limit | Actual at 31 December 2015 |
|---|---|---|
| Authorised Limit for external debt £M | £727M | £326M |
| Operational Limit for external debt £M | £553M | £326M |
| Maximum external borrowing year to date | | £253M |
| Limit of fixed interest debt % | 100% | 82% |
| Limit of variable interest debt % | 50% | 18% |

| | | |
|---|---|---|
| Limit for Non-specified investments £M | £70M | £38M |

4. **Minimum Revenue Provision (MRP)**

The CLG Guidance requires the Authority to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP, the Council's strategy was approved as part of the 2015/16 report. However following a review of the guidance the Council has revised this in order to achieve revenue savings whilst still proving a prudent provision, which we are currently discussing with our Auditors.

We will continue to apply set aside capital receipts to reduce the level of MRP which the council needs to set aside from revenue as a prudent provision, as detailed in paragraphs 45 to 48 in the Review of Prudential Limits and Treasury Management Outturn report submitted to Council on 15 July, item 37
http://www.southampton.gov.uk/modernGov/ieListDocuments.aspx?CId=122&MId=3044&Ver=4

The impact of these changes is an increased MRP of £0.7M which has been reflected in the forecast position.