Gravesham Borough Council

Public Document Pack

Finance and Audit Committee

Tuesday, 12 July 2016

Dear Councillor

You are advised that the attached documents form part of the main agenda papers for this meeting.

Please ensure you bring them with you to the meeting.

Yours faithfully

S Kilkie
Assistant Director (Communities)

List of documents attached

Civic Centre, Windmill Street, Gravesend Kent DA12 1AU

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Implications of Brexit on TMSS

In light of the EU Referendum result we wanted to take the opportunity to brief Members on the emerging implications for the Treasury Management Strategy Statement and Treasury Management activity.

There are two main areas to highlight

- The downgrading of the UK's sovereignty rating and
- The implications for our recent purchase of units in three Managed Property Funds.

UK Sovereignty

Following the UK's vote to leave the European Union, two of the main ratings agency Fitch and Standard & Poors took action to downgrade the UK's sovereignty rating to AA, Moody's affirmed their rating of AA1 following a previous downgrade. All three changed the forecast for the outlook from Stable to Negative. These changes are in response to the uncertainty that surrounds the result, the likelihood of an abrupt slowdown in short-term growth as businesses defer investment and consider changes to the legal and regulatory environment. Medium term growth is also likely to be weaker due to less favourable terms of exports to the EU, lower immigration and a reduction in foreign direct investment.

In terms of the TMSS, we apply a sovereignty rating overlay to our investment decisions and the Council only uses approved counterparties from countries with a minimum sovereign rating of AAA as determined by at least two of the three ratings. Within the TMSS there is an exemption for the use of counterparties within the UK, whereby officers can continue placing investment with counterparties within the UK provided that the sovereign rating stays above AA-.

Taking into account the recent downgrades, investments can continue to be placed with UK counterparties. Currently the authority has £6m invested in UK counterparties.

Advice from Capita is that we are unlikely to see any more action in terms of downgrades to the UK rating in the near term as it would be difficult for the ratings agencies to take further action until the dust settles.

They have suggested it is worthwhile reviewing the sovereignty overlay for the UK and actually removing it in a future TMSS update. The rationale behind this is that:

- regulatory changes have looked to break the link between sovereignty's and their banks ie the UK entities do not receive any form of uplift for the sovereign
- Our knowledge and understanding should be best for the UK

- Applying a sovereign overlay is more useful to overseas entities where our knowledge and understanding is more limited.

Capita's view is that whilst the sovereign overlay is of use, the reliance on it going forwards is far less than seen through the financial crisis. Sovereignties may provide support but the real focus should be on the banking entity itself and not one which assumes support will be received from outside parties.

Property Funds

Members will be aware from the most recent F&A committee meeting that deposits in three property funds CCLA, Hermes and Lothbury had been agreed. As of 1st July investments had been made in all three funds.

Members will also have been aware in recent media reports that a number of Property Funds have been suspended. The purpose of suspending a fund can be seen as prudent and responsible management as a mechanism to prevent significant outflows from a fund in order to stop the need from selling assets at a significantly reduced price in order to release cash to meet demand and allow the dust to settle. Dividend payments will continue to be paid even if a fund is suspended. As yet the funds that Gravesham BC has invested in have not been suspended as yet and we have not received any indication that this is likely to happen.

We have carried out some analysis on the capital values invested within the three property funds to establish the impact on those sums had we invested the amounts prior to 2008 for a period of 8 years. Whilst it must be remembered that past performance is not an indication of future performance, this analysis has shown that despite the capital values dropping between 30-40% during the period, by the end of the 8 year period the total capital value across the three funds showed an increase in value of 10%.

There are other reasons to remain positive about the property market given the lack of supply that will compensate for any reduction in demand. The weakness in the pound will increase the "cheapness" of UK assets for international investors and businesses. Even in the event of a net loss of 70,000 jobs in London, the response by developers to weaker demand should meant that the vacancy rate rises only to around 8%, and that level can be seen as consistent with stable rents. The Brexit result has adversely affected sentiment, and this has driven outflows from property funds and assets, however if occupier and investment markets come through the period of uncertainty as reported it is anticipated that fears of a repeat of 2009 are overdone.

Whilst we are likely to see some falls in the capital values invested within the Managed Property Funds during the period of uncertainty the analysis carried out and the future economic forecasts widely reported in the media should provide some comfort. We continue to reiterate the need to view the deposit as a long term investment.