

Decision Maker: Resources, Commissioning and Contracts Management
Portfolio Holder

Date: For pre-decision scrutiny by Executive, Resources and Contracts PDS
Committee on 18th November 2021
Council on 6th December 2021

Decision Type: Non-Urgent Executive Non-Key

Title: TREASURY MANAGEMENT - QUARTER 2 PERFORMANCE
2021/22 & MID-YEAR REVIEW

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Ward: All

1. Reason for report

- 1.1. This report summarises treasury management activity during the second quarter of 2021/22. The report also includes a Mid-Year Review of the Treasury Management Strategy Statement and Annual Investment Strategy (Appendix 4). The report ensures that the Council is implementing best practice in accordance with the CIPFA Code of Practice for Treasury Management. Investments as at 30th September 2021 totalled £427.6m (£373.3m at 30th September 2020) and there was no outstanding external borrowing.
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2. RECOMMENDATION(S)

- 2.1. The Resources, Commissioning and Contracts Management Portfolio Holder is requested to:

- (a) note the Treasury Management performance for the second quarter of 2021/22;
- (b) agree the amendment to the Council's Treasury Management Strategy Statement allowing investment in Sovereign Bonds (Sterling denominated only and subject a maximum duration of three years with a total exposure of no more than £25m);
- (c) recommend that Council approve the 2021/22 prudential indicators as set out in Appendix 4

- 2.2. Council is requested to note the report and approve the changes to the prudential indicators and the proposed amendment to the Treasury Management Strategy.

Impact on Vulnerable Adults and Children

1. Summary of Impact: None
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Corporate Policy

1. Policy Status: Existing policy. To maintain appropriate levels of risk, particularly security and liquidity, whilst seeking to achieve the highest rate of return on investments.
 2. BBB Priority: Excellent Council.
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Financial

1. Cost of proposal: N/A
 2. Ongoing costs: N/A
 3. Budget head/performance centre: Interest on balances
 4. Total current budget for this head: £3,591k surplus currently projected for 2021/22
 5. Source of funding: Net investment income
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Personnel

1. Number of staff (current and additional): 0.25 fte
 2. If from existing staff resources, number of staff hours: 9 hours per week
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Legal

1. Legal Requirement: Non-statutory - Government guidance.
 2. Call-in: Call-in is applicable
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Procurement

1. Summary of Procurement Implications: N/A
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Customer Impact

1. Estimated number of users/beneficiaries (current and projected): N/A
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Ward Councillor Views

1. Have Ward Councillors been asked for comments? N/A
2. Summary of Ward Councillors comments: N/A

3. COMMENTARY

- 3.1 Under the requirements of the CIPFA Code of Practice on Treasury Management, the Council is required, as a minimum, to approve an annual treasury strategy in advance of the year, a mid-year review report and an annual report following the year comparing actual activity to the strategy. This effectively means that in-year monitoring is incorporated into the three reports required by the Code of Practice and that Quarter 1 monitoring will no longer be reported unless there are any matters that officers feel should come before the Committee sooner.
- 3.2 This report includes details of investment performance in the second quarter of 2021/22. The 2021/22 annual treasury strategy, including the MRP (Minimum Revenue Provision) Policy Statement and prudential indicators, was originally submitted to the Executive, Resources and Contracts PDS Committee on 3rd February and Council on 1st March 2021.
- 3.3 Changes in the regulatory environment have placed a much greater onus on Members to undertake the review and scrutiny of treasury management policy and activities. This report is important in that respect as it provides details of the actual position for treasury activities and highlights compliance with the Council's policies previously approved by Members.
- 3.4 The Council has monies available for Treasury Management investment as a result of the following:
- Positive cash flow;
 - Receipts (mainly from Government) received in advance of payments being made;
 - Capital receipts not yet utilised to fund capital expenditure;
 - Provisions made in the accounts for liabilities e.g. provision for outstanding legal cases which have not yet materialised;
 - General and earmarked reserves retained by the Council.
- 3.5 Some of the monies identified above are short term and investment of these needs to be highly 'liquid', particularly if it relates to a positive cash flow position which can change in the future. Future monies available for Treasury Management investment will depend on the budget position of the Council and whether the Council will need to substantially run-down capital receipts and reserves. Against a backdrop of unprecedented cuts in Government funding, which will require the Council to make revenue savings to balance the budget in future years, there is a likelihood that such actions may be required in the medium term which will reduce the monies available for investment.
- 3.6 The Council has also identified an alternative investment strategy relating to property investment. To date, this has resulted in actual and planned acquisitions which generated £4.6m in 2016/17, £5.6m in 2017/18, £5.5m in 2018/19, £5.4m in 2019/20, £5.3m in 2020/21 and is budgeted to achieve £5.2m in 2021/22. This is based on a longer-term investment timeframe of at least 3 to 5 years and ensures that the monies available can attract higher yields over the longer term.
- 3.7 A combination of lower risk investment relating to Treasury Management and a separate investment strategy in the form of property acquisitions (generating higher yields and risks) provides a balanced investment strategy. Any investment decisions will also need to consider the likelihood that interest rates will increase at some point. The available resources for the medium term, given the ongoing reductions in Government funding, will need to be regularly reviewed.

Treasury Performance in the quarter ended 30th September 2021

3.8 Borrowing: The Council's healthy cashflow position continues and, other than some short-term borrowing at the end of 2015/16, no borrowing has been required for a number of years.

3.9 Investments: The following table sets out details of investment activity during the second quarter and year to date:

	Qtr Ended 30/09/21		2021/22 Year to Date		Paragraph
	Deposits £m	Ave Rate %	Deposits £m	Ave Rate %	
Balance of "core" investments b/f	280.00	0.74	265.00	0.97	
New investments made in period	70.00	0.51	130.00	0.40	
Investments redeemed in period	-60.00	0.83	-105.00	1.11	
"Core" investments at end of period	290.00	0.67	290.00	0.67	
Money Market Funds	35.00	0.01	35.00	0.00	3.16
CCLA Property Fund*	40.00	13.87	40.00	0.16	3.25
Multi-Asset Income Funds*	40.00	-0.11	40.00	0.06	3.27
Schroders Diversified Growth Fund	20.00	0.24	20.00	5.43	3.29
Project Beckenham Loan	2.60	6.00	2.60	6.00	3.20
"Alternative" investments at end of period	137.60	4.15	137.60	0.97	
Total Investments at end of Period	427.60	1.79	427.60	0.76	

* The rates shown in here are the total return (ie. the dividend income plus the change in capital value)
A more detailed breakdown of the rates for these investments is shown in the relevant paragraphs

3.10 Details of the outstanding investments at 30th September 2021 are shown in maturity date order in Appendix 2 and by individual counterparty in Appendix 3. The return on the new "core" investments placed during the second quarter of 2021/22 was 0.51%.

3.11 Reports to previous meetings have highlighted the fact that options with regards to the reinvestment of maturing deposits have become seriously limited in recent years following bank credit rating downgrades. Changes to lending limits and eligibility criteria, as well as the introduction of pooled funds and housing associations have alleviated this to some extent, but there are still not many investment options available other than placing money with instant access accounts at relatively low interest rates.

3.12 Despite this, the Council's treasury management performance compares very favourably with that of other authorities. The Council was in the top decile nationally for 2014/15, 2015/16, 2016/17 and 2017/18 (the most recent CIPFA treasury management statistics available) and officers continue to look for alternative investment opportunities, both within the current strategy and outside, for consideration as part of the ongoing review of the strategy.

3.13 Active UK banks and building societies on the Council's list now comprise only Lloyds, National Westminster Bank, Santander UK, Goldman Sachs International Bank, Close Brothers, and Yorkshire, Principality, Nottingham & Skipton Building Societies, and all of these have reduced their interest rates significantly in recent years. The Director of Finance will

continue to monitor rates and counterparty quality and take account of external advice prior to any investment decisions.

- 3.14 The chart in Appendix 1 shows total investments at quarter-end dates back to 1st April 2004 and shows how available funds have increased steadily over the years. This has been a significant contributor to the over-achievement of investment income against budgeted income in recent years.

Interest Rate Forecast (provided by Link Asset Services)

- 3.15 The current Bank of England base rate is 0.1%, which was maintained at the September meeting of the Monetary Policy Committee. However, the market believes that the next movement is likely to be a rise, especially in the light of inflationary pressures in the economy. Link has stated that it believes that the rate will stay at 0.1% in the near future, with an increase to come in June 2022 – its detailed forecast is shown in the table below.

Link Group Interest Rate View												
	Now	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24
Bank Rate	0.10%	0.10%	0.10%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.50%	0.75%	-
3 month ave. earnings	-	0.10%	0.10%	0.10%	0.20%	0.20%	0.30%	0.40%	0.50%	0.50%	0.60%	0.70%
6 month ave. earnings	-	0.10%	0.20%	0.20%	0.30%	0.30%	0.40%	0.50%	0.60%	0.60%	0.70%	0.80%
12 month ave. earnings	-	0.20%	0.30%	0.40%	0.50%	0.50%	0.50%	0.60%	0.70%	0.80%	0.90%	1.00%

Money Market Funds

- 3.16 The Council currently has 6 AAA-rated Money Market Fund accounts, with Federated Prime Rate, Aberdeen Standard (formerly known as Ignis), Insight, Blackrock, Fidelity and Legal & General, all of which have a maximum investment limit of £15m. In common with market rates for fixed-term investments, interest rates on money market funds have fallen considerably in recent years. The Aberdeen Standard, Fidelity and Federated Funds currently offer the best rate at around 0.01%.
- 3.17 The total balance held in Money Market Funds has varied during the year to date moving from £23m as at 31st March 2021 to £35m as at 30th September 2021. The Money Market Funds currently offer the lowest interest of all eligible investment vehicles with the exception of the Government Debt Management Account Deposit Facility; however, they are the most liquid, with funds able to be redeemed up until midday for same day settlement.
- 3.18 Daily balances in the Money Market Funds will vary considerably and have been higher than usual over the previous six months owing to the receipt of Covid related grant funding by the Council. Additionally, balances tend to be higher during February and March to provide a cashflow buffer when the Council's income from Council Tax and Business Rates is significantly lower than the rest of the year. Occasionally, these balances are also inflated to ensure that the Council has sufficient liquidity to cover any 'non-standard' expenditure such as investment property purchases.

Housing Associations

- 3.19 Deposit with Housing Associations have recently attracted favourable rates and most recently the Council's Treasury Management Strategy Statement was amended to increase the overall limit for investments with Housing Associations to £80m. Current investments in Housing Associations total £45m, with rates varying from 0.6% to 2.15%.

Loan to Project Beckenham

- 3.20 On 26th June 2017 Council approved the inclusion in the strategy of a secured loan to Project Beckenham relating to the provision of temporary accommodation for the homeless that had previously been agreed to be advanced from the Investment Fund. A loan of £2.3m was made in June 2017, at a rate of 6%, although that may increase to 7.5% if the loan to value ratio exceeds a specified value. £1m of this loan was re-paid during 2019/20 leaving a balance of £1.3m as at the end of March 2020. Two further loans advances totalling £500,000 have been made during 2021/22, and the balance as at 30th September was £2.6m

Pooled Investment Schemes

- 3.21 In September 2013, the Portfolio Holder and subsequently Council approved the inclusion of collective (pooled) investment schemes as eligible investment vehicles in the Council's Investment Strategy with an overall limit of £25m and a maximum duration of 5 years. The limit was subsequently increased to £40m by Council in October 2015, £80m in June 2017 and £100m in December 2017. Such investments would require the approval of the Director of Finance in consultation with the Resources Portfolio Holder.
- 3.22 Until March 2018, accounting rules required that the change in capital value of these investments be held in the Available for Sale Financial Assets Reserve, and only recognised in revenue on the sale of the investment. In year projections for interest on balances therefore only reflected the dividends from these investments.
- 3.23 However, from 2018/19 onwards, local authorities have been required to account for financial instruments in accordance with IFRS9. One of the results of this is that changes in the capital value of pooled fund investments are recognised in revenue in-year. MHCLG has since issued regulations providing a statutory override to reverse the impact of IFRS9 on the Council's General Fund, which came into force in December 2018. The regulations are currently only applicable for a period of five years to March 2023, when it is intended for movements in value to be recognised in year.
- 3.24 Due to the regulations being time limited and the potentially volatile nature of these investments, interest/dividend earnings above 2.5% (£1,509k in 2018/19, £1,196k in 2019/20 and £1,520k in 2020/21) relating to the CCLA Property Fund and Fidelity Multi-Asset Income Fund have been set aside in an Income Equalisation earmarked reserve. This will protect the Council against unexpected variations in the capital value of these investments and any timing issues arising from the expiry of the statutory override.

CCLA Property Fund

- 3.25 Following consultation between the Director of Finance and the Resources Portfolio Holder, an account was opened in January 2014 with the CCLA Local Authorities' Property Fund and an initial deposit of £5m was made, followed by further deposits of £5m in July 2014, £5m in March 2015, £10m in October 2015, £5m in October 2016 and £10m in October 2017. The investment in the CCLA Fund is viewed as a medium to long-term investment and dividends are paid quarterly. A breakdown of the dividends earned and capital growth is provided in the table below.

Annualised Net Return	Dividend %	Capital Growth %	Total Return
01/02/14 – 31/3/14	4.29	-29.64	-25.35
01/04/14 – 31/03/15	5.03	3.44	8.47
01/04/15 – 31/03/15	5.02	1.63	6.65

01/04/16 – 31/03/16	4.55	-2.50	2.05
01/04/17 – 31/03/17	4.59	2.41	7.00
01/04/18 – 31/03/18	4.46	1.57	6.03
01/04/19 – 31/03/19	4.45	-3.68	0.77
01/04/20 – 31/03/20	4.30	-0.71	3.59
01/04/21 – 30/09/21	1.95	13.7	15.65
Cumulative Return	4.31	0.93	5.24

- 3.26 The annualised fund return for the year to 30th September 2021 was capital growth of 13.7% and dividends paid of 1.95% resulting in a total return of 15.65%. Since inception, dividends paid have averaged 4.31% per annum and the capital value has increased by 0.93% per annum resulting in a net annual return of 5.24%.

Multi-asset Income Fund

- 3.27 Following approval by Council in June 2017, the limit for pooled investment schemes was increased to £80m and an investment of £30m was made on 12th July 2017 in the Fidelity Multi-Asset Income Fund following the agreement of the Resources, Commissioning and Contracts Management Portfolio Holder. A subsequent investment of £10m was made on December 30th 2019. The annualised fund return for the year to 30th September 2021 was capital growth of 2.76% and dividends paid of 3.66% resulting in a total return of 6.42%.

- 3.28 Since inception, dividends paid have averaged 4.23% per annum and the capital value has declined by -0.36% per annum resulting in a net annual return of 3.87%.

Annualised Net Return	Dividend %	Capital Gain/Loss %	Total Return %
12/07/17 – 31/03/18	4.42	-6.27	-1.85
01/04/18 – 31/03/19	4.26	1.45	5.71
01/04/19 – 31/03/20	4.37	-11.81	-7.44
01/04/20 – 31/03/21	4.38	9.52	13.90
01/04/21 – 30/09/21	3.66	2.76	6.42
Cumulative Return	4.23	-0.36	3.87

Global Diversified Income Fund

- 3.29 During 2020/21 a new investment was made in the Global Diversified Income Fund managed by Schroders. The aim of this fund is to provide long-term capital growth and income of 3-5% per annum. An initial investment of £10m was made in March 2021, followed by a further £10m in April 2021. A breakdown of the dividends earned and capital growth is provided in the table below.

Annualised Net Return	Dividend %	Capital Gain/Loss %	Total Return %
01/03/21 – 31/03/21	2.45	2.43	4.88
01/04/21 – 30/09/21	3.53	1.91	5.44
Cumulative return	3.44	1.95	5.39

- 3.30 Members will be aware from previous updates to the Resources Portfolio Holder and the Executive that the Council had £5m invested with the Heritable Bank, a UK subsidiary of the Icelandic bank, Landsbanki. In October 2008, the bank was placed in administration and the investment was frozen. To date, a total of £5,044k has been received (99% of the total claim of £5,087k) leaving a balance of £43k (<1%).

Mid-Year Review of Treasury Management Strategy Statement and Annual Investment Strategy for 2020/21

- 3.31 The CIPFA Code of Practice on Treasury Management requires the Council to receive a mid-year review report on performance against the approved strategy. The Annual Investment Strategy was originally approved by Council in February 2020. A mid-year review, including comments on the economic background during the first half of 2021/22 and on the outlook, is included at Appendix 4.
- 3.32 The 2021/22 annual treasury strategy, including the MRP (Minimum Revenue Provision) Policy Statement and prudential indicators, was originally submitted to the Executive, Resources and Contracts PDS Committee on 3rd February and Council on 1st March February 2021.
- 3.33 While the Council effectively determines its own eligible counterparties and limits, it also uses Link Asset Services (Link) as an advisor in investment matters. Link uses a modelling approach that combines credit ratings, credit watches, credit outlooks and CDS spreads in a weighted scoring system for which the end product is a measure of the relative creditworthiness of counterparties - these indicate Link's recommendations on the maximum duration for investments. The Council will use its own eligibility criteria for all investment decisions but will also be mindful of Link's advice and information and will not use any counterparty not considered by Link to be a reasonable risk. In line with the requirements of the CIPFA Treasury Management Code of Practice, the Council will always ensure the security of the principal sum and the Council's liquidity position before the interest rate.
- 3.34 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of A- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). Currently the Strategy permits the following type of investments:
- a) Specified Investments: These investments are sterling investments of not more than one-year maturity or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are relatively low risk investments where the possibility of loss of principal or investment income is small and subject to a minimum credit rating. These would include investments with:
1. The UK Government, e.g., a UK Treasury Bill or a Gilt with a maximum of 1 year to maturity
 2. A local authority, parish council or community council
 3. Corporate or supranational bonds
 4. Pooled investment vehicles
 5. Banks and Building Societies.
 6. Certificates of deposit, commercial paper or floating rate notes.
- b) Non-specified Investments: These are any other type of investment and can be for any period over 1 year subject to category and duration limits, namely:
1. Bank Deposits
 2. Building Society Deposits
 3. Deposits with other local authorities

4. Gilt edged securities
5. Non-rated subsidiary of a credit-rated institution
6. Corporate Bonds
7. Collective (pooled) investment schemes
8. Certificates of Deposit, Commercial Paper and Floating Rate Notes
9. Housing Associations

3.35 Although, as indicated above, the strategy allows the Council to make a range of investments, in practical terms the Council has recently utilised only a narrow range of investment types, namely Money Market Deposits, Fixed Interest loans to Banks, Housing Associations and Local Authorities, and Pooled Investment Vehicles. Moreover, the Council's investment decisions have been informed by consideration of maximising the available whilst operating within the parameters set out within the strategy, namely credit-ratings and investment category limits.

3.36 Recent Treasury Management updates have highlighted the fact that options with regards to the reinvestment of maturing fixed-interest deposits have become seriously limited in recent years following bank credit rating downgrades and the low-interest rate environment that has persisted for some time in the UK. Changes to lending limits and eligibility criteria, as well as the inclusion of pooled funds and housing associations within the strategy have alleviated this to some extent, but there are still limited options available other than placing money with instant access accounts at relatively low interest rates.

3.37 Despite the challenges outlined above, the Council has achieved a significant income stream from interest on balances, as shown below:

Financial Year	Interest on Balances £'000
2017/18	4,049
2018/19	4,951
2019/20	5,133
2020/21	5,140
2021/22	3,591 (projected)

3.38 Whilst permitted investments include Corporate and Supranational Bonds, the Strategy makes no reference to Sovereign Bonds. Sovereign bonds are debt securities issued by a government to raise capital for spending needs, such as on government programs and paying down old debt. They can be issued in the government's domestic currency or in a foreign currency.

3.39 Current indicators show that the return on Sovereign Bonds (i.e., those available with counterparties having a credit rating of at least A-), are in excess of 1% for a duration of one or two years. This compares with the average return on recent investments of below 0.5%.

- 3.40 Initially, it is proposed that investment in Sovereign Bonds be permitted subject to, a minimum credit rating of A-, a maximum total exposure set at £25m, and an investment duration of no more than three years. Additionally, the Council would only invest in sterling-denominated bonds, so as not to be exposed to foreign exchange risk
- 3.41 Any investment decisions as a consequence of this proposed amendment to the Strategy will also need to consider the likelihood that interest rates will increase at some point. Similarly, there will also need to be consideration of the liquidity of the overall investment portfolio, particularly in the light of the Council's financial and budgetary position; this will include consideration of the availability of capital reserves and any planned drawing on reserves to support the revenue budget.

Regulatory Framework, Risk and Performance

- 3.42 The Council's treasury management activities are regulated by a variety of professional codes, statutes and guidance:
- The Local Government Act 2003 (the Act) which provides the powers to borrow and invest as well as providing controls and limits on this activity;
 - The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing that may be undertaken (although no restrictions have been made to date);
 - Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
 - The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
 - The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
 - Under the Act, the MHCLG has issued Investment Guidance to structure and regulate the Council's investment activities;
 - Under section 238(2) of the Local Government and Public Involvement in Health Act 2007, the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007.
- 3.43 The Council has complied with all of the above relevant statutory and regulatory requirements, which limit the levels of risk associated with its treasury management activities. In particular, its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means that its capital expenditure is prudent, affordable and sustainable and its treasury practices demonstrate a low-risk approach.

4 POLICY IMPLICATIONS

- 4.1 In line with government guidance, the Council's policy is to seek to achieve the highest rate of return on investments whilst maintaining appropriate levels of risk, particularly security and liquidity.

5 FINANCIAL IMPLICATIONS

- 5.1 The persistent low interest rate environment in the UK this has led to new core investments being taken out at lower rates, this is expected to lead to a lower rate of return on the portfolio of treasury investments held by the Council.
- 5.2 The treasury management strategy has previously been revised to enable alternative investments of £100m which will generate additional income of around £2m compared with lending to banks.
- 5.3 To further mitigate and offset the risk of diminishing investment returns, this report includes a proposed amendment to the current strategy, under which the Council would have access an additional low-risk investment category, which it would seek to utilise as and when favourable rates become available.

6 LEGAL IMPLICATIONS

- 6.1 Under Section 151 of the Local Government Act 1972, the Section 151 Officer has statutory duties in relation to the financial administration and stewardship of the authority, including securing effective arrangements for treasury management.
- 6.2 This report fulfils the requirements of the Chartered Institute of Public Finance & Accountancy's Treasury Management and Prudential Codes of Practice 2017 and the 2018 Statutory Guidance on Local Government Investments.

Non-Applicable Sections:	Impact on Vulnerable Adults and Children, Personnel, Legal and Procurement Implications
Background Documents: (Access via Contact Officer)	CIPFA Code of Practice on Treasury Management CIPFA Prudential Code for Capital Finance in Local Authorities CLG Guidance on Investments External advice from Link Asset Services