

NORTH WEST LEICESTERSHIRE DISTRICT COUNCIL

AUDIT AND GOVERNANCE COMMITTEE – WEDNESDAY,
21 OCTOBER 2020



Title of Report	TREASURY MANAGEMENT ACTIVITY REPORT APRIL 2020 TO SEPTEMBER 2020	
Presented by	Anna Wright Finance Team Manager and Deputy S151 Officer	
Background Papers	Treasury Management Strategy Statement 2020/21 Council 25 February 2020	Public Report: Yes
Purpose of Report	To inform Members of the Council's Treasury Management activity undertaken during the period April 2020 – September 2020	
Recommendations	THAT MEMBERS APPROVE THIS REPORT AND COMMENT AS APPROPRIATE.	

1.0 BACKGROUND

- 1.1 Treasury Management activity is underpinned by CIPFA's Code of Practice on Treasury Management ("the code"), which requires local authorities to produce Prudential Indicators and a Treasury Management Strategy Statement annually on the likely financing and investment activity.
- 1.2 As a minimum, the code requires that the council reports on the performance of the Treasury Management function at least twice yearly (mid-year and at year end). This is the first of three reports to be presented in 2020/21, to inform Members of the council's treasury activity and enable scrutiny of activity and performance.
- 1.3 The council's current Treasury Management Strategy Statement which includes the Borrowing Strategy; Debt Rescheduling Strategy; Annual Investment Strategy; Apportionment of Interest Strategy; Prudential Indicators and Annual Minimum Revenue Provision was approved by Council on 25 February 2020.
- 1.4 Investing or borrowing activities expose the council to financial risks including the loss of invested funds and revenue effects of changing interest rates. The successful identification, monitoring and control of risks are therefore central to the council's Treasury Management strategy.

2.0 THE UK ECONOMY & OTHER FACTORS

2.1 Economic and interest rate forecasts are provided on a regular basis by our treasury advisors (Arlingclose).

Economic background: Coronavirus continued to dominate the news flow during the period as countries around the world tried to manage the delicate balancing act of containing transmission of the virus while easing lockdown measures and getting their populations and economies working again. After a relatively quiet few months of Brexit news it was back in the headlines towards the end of the period as agreement between the UK and EU on a trade deal was looking difficult and the government came under fire, both at home and abroad, as it tried to pass the Internal Market Bill which could override the agreed Brexit deal, potentially breaking international law.

The Bank of England (BoE) maintained Bank Rate at 0.1% and its Quantitative Easing programme at £745 billion. The potential use of negative interest rates continued to not be ruled in or out by BoE policymakers, but then a comment in the September Monetary Policy Committee meeting minutes took financial markets by surprise highlighting the central bank was having a harder look at its potential impact than was previously suggested.

Government initiatives continued to support the economy throughout the period, with the furlough (Coronavirus Job Retention) scheme keeping almost 10 million workers in jobs and 100 million discounted meals being claimed during the 'Eat Out to Help Out' (EOHO) offer.

GDP growth contracted by a massive 20.4% in Q2 2020 (Apr-Jun) according to the Office for National Statistics, pushing the annual growth rate down to -21.7%. Construction output fell by 35% over the quarter, services output by almost 20% and production by 17%. Recent monthly estimates of GDP have shown growth recovering, with the latest rise of almost 7% in July, but even with the two previous monthly gains this still only makes up half of the lost output.

The headline rate of UK Consumer Price Inflation fell to 0.2% y/y in August, further below the Bank of England's 2% target, with the largest downward contribution coming from restaurants and hotels influenced by the EOHO scheme.

In the three months to July, labour market data showed the unemployment rate increased from 3.9% to 4.1% while wages fell 1% for total pay in nominal terms (0.2% regular pay) and was down 1.8% in real terms (-0.7% regular pay). Despite only a modest rise in unemployment over the period, the rate is expected to pick up sharply in the coming months as the furlough scheme ends in October. On the back of this, the BoE has forecast unemployment could hit a peak of between 8 and 9%.

The US economy contracted at an annualised rate of 31.7% in Q2 2020 (Apr-Jun). The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% but announced a change its inflation targeting regime. The move is to a more flexible form of average targeting which will allow the central bank to maintain interest rates at low levels for an extended period to support the economy even when inflation is 'moderately' above the 2% average target, particularly given it has been below target for most of the last decade.

The European Central Bank maintained its base rate at 0% and deposit rate at -0.5%.

Financial markets: Equity markets continued their recovery, with the Dow Jones climbing to not far off its pre-crisis peak, albeit that performance being driven by a handful of technology stocks including Apple and Microsoft, with the former up 75% in 2020. The FTSE 100 and 250 have made up around half of their pre-crisis losses. Central bank and government stimulus packages continue to support asset prices, but volatility remains.

Ultra-low interest rates and the flight to quality continued, keeping gilts yields low over the period with the yield on some short-dated UK government bonds remaining negative. The 5-year UK benchmark gilt yield fell further from -0.06% on 30th June to -0.18% on 18th September. The 10-year yield was 0.17% at the start and end of the same period (with much volatility in between, peaking at 0.34% towards the end of August), while the 20-year rose from 0.56% to 0.69%. 1-month, 3-month and 12-month bid rates averaged 0.02%, 0.06% and 0.25% respectively over the quarter.

Over the same period, the yield on 2-year US treasuries slipped from 0.15% to 0.13% while the yield on 10-year treasuries rose slightly from 0.66% to 0.69%. German bund yields remain negative across most maturities.

Credit review: Credit default swap spreads continued to ease over the period to slightly above their pre-crisis levels. In the UK, the spreads between ringfenced and non-ringfenced entities remains, except for retail bank Santander UK whose CDS spread remains elevated. NatWest Markets Plc (non-ringfenced) remains the highest at 74bps while Standard Chartered the lowest at 42bps. The ringfenced banks are currently trading between 42 and 49bps.

After a busy second quarter of the calendar year, the subsequent period has been relatively quiet for credit changes for the names on our counterparty list. Fitch assigned a AA- deposit rating to Netherlands lender Rabobank with a negative outlook and prior to that, while not related to our counterparty list but quite significant, revised the outlook on the US economy to Negative from Stable while also affirming its AAA rating.

There continues to remain much uncertainty around the extent of the losses banks and building societies will suffer due to the impact from the coronavirus pandemic and for the UK institutions on our list there is the added complication of Brexit and what a trade deal may or may not look like. The institutions on Arlingclose's counterparty list and recommended duration remain under constant review, but at the end of the period no changes had been made to the names on the list or the recommended maximum duration of 35 days.

Borrowing Update: On 9th October 2019 the PWLB raised the cost of certainty rate borrowing to 1.8% above UK gilt yields making it relatively expensive. Market alternatives are available, however the financial strength of individual authorities will be scrutinised by investors and commercial lenders.

The Chancellor's March 2020 Budget statement included significant changes to Public Works Loan Board (PWLB) policy and launched a wide-ranging consultation on the PWLB's future direction. Announcements included a reduction in the margin on new Housing Revenue Account (HRA) loans to 0.80% above equivalent gilt yields (if the Authority has an HRA, then include: the value of this discount is 1% below the rate at which the authority usually borrows from the PWLB). £1.15bn of additional "infrastructure rate" funding at gilt yields plus 0.60% has been made available to support specific local authority infrastructure projects for England, Scotland and Wales for which there is a bidding process.

The consultation titled "Future Lending Terms" allows stakeholders to contribute to developing a system whereby PWLB loans can be made available at improved margins to support qualifying projects. It contains proposals to allow authorities that are not involved in "debt for yield" activity to borrow at lower rates as well as stopping local authorities using PWLB loans to buy commercial assets primarily for yield. The consultation also broaches the possibility of slowing, or stopping, individual authorities from borrowing large sums in specific circumstances.

The consultation closed on 31st July 2020 with the announcement and implementation of the revised lending terms expected in the latter part of this calendar year or early next year. The council responded to this consultation.

3.0 THE COUNCIL'S TREASURY POSITION

- 3.1 The council's current strategy is to use internal borrowing to reduce risk and keep interest costs low. The treasury management current position and the change over the reporting period is shown below.

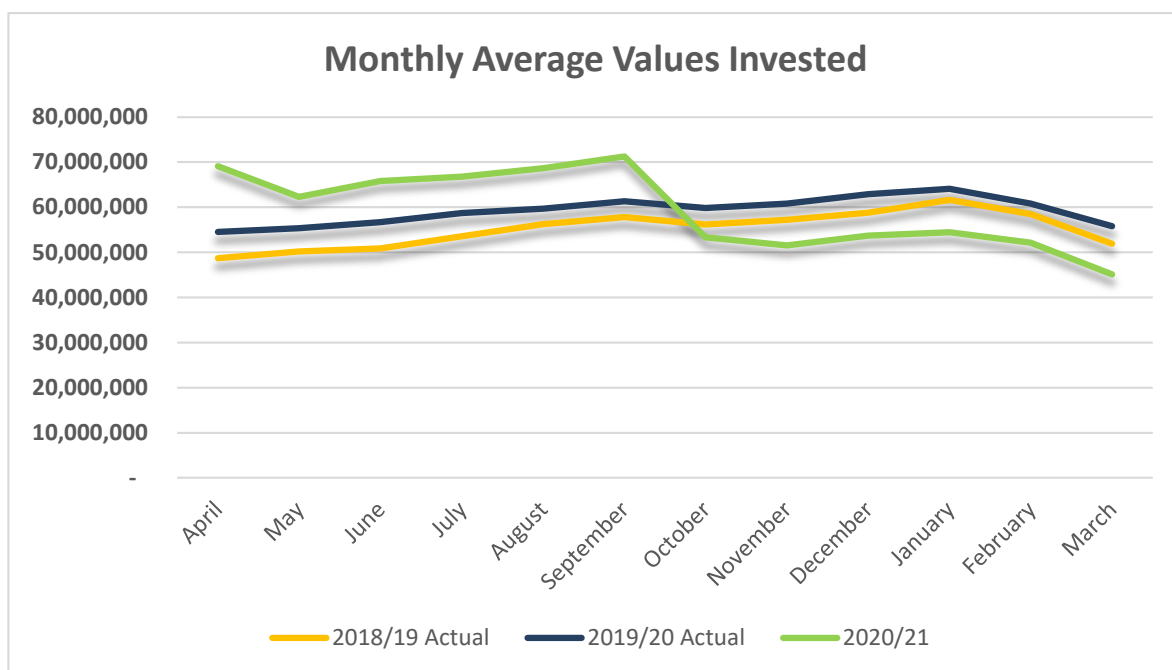
	Balance at 01/04/20 £m	Net Movement £m	Balance at 27/09/2020 £m
Long term borrowing - HRA	71.67	-0.6	71.11
Long term borrowing – General Fund	8.44	0.0	8.44
Other long-term liabilities - HBBC	0.09	0.0	0.09
Total Borrowing	80.20	-0.6	79.64
Long term investments – greater than 1 year	3.00	-3.0	0.00
Short term investments – less than 1 year	39.00	16.2	55.24
Pooled funds and Money Market Funds	8.70	0.8	9.50
Total Investments	50.70	14.0	64.74
Net debt	29.50	14.6	14.90

3.2 The investment position will vary throughout the year as it is dependent upon cash flow. Examples of significant areas that can impact on cash flow are collection of Council Tax, Business Rates, grants, and capital receipts, payments to other precepting authorities or central government, capital programme and interest on treasury activity.

3.3 In the period April 2020 to September 2020, the capacity for investment has increased by £14m. The volatility of balances is normal throughout the year and a number of factors contribute to this during the financial year:

- The council (as it typically does) has benefit from the receipt of Council Tax and Business Rates during the first ten months of the financial year whilst revenue expenditure is more evenly weighted throughout the financial year.
- Capital expenditure can be heavily weighted towards the latter part of the financial year due to the time required to schedule programmes of work or award contracts.

3.4 The average value of investments per month are represented in the graph below, illustrating the cash flow trends throughout the year. The current pattern is in line with previous years. The council’s cash flow projections are monitored and revised daily as part of the treasury management process:



4.0 BORROWING ACTIVITY

- 4.1** The council's Borrowing Strategy 2020/21, incorporates a prudent and pragmatic approach to borrowing to minimise borrowing costs without compromising the longer-term stability of the portfolio, consistent with the council's Prudential Indicators.
- 4.2** The council's updated borrowing strategy for 2020/21 shows that the council does not need to borrow in 2020/21. Borrowing may be required by 2021/22 should the council wish to maintain its MIFID status which requires an investment balance of £10m at any one time, and further assessments are being undertaken.
- 4.3** The council has not undertaken any new long-term borrowing during the period as the levels of cash balances held have meant that we are currently able to use internal borrowing.
- 4.4** The council has two PWLB annuity loans as part of the self-financing of the HRA. The repayment element for these in 2020/21 is £1.154m.
- 4.5** During the reporting period of April 2020 to September 2020, the council's cash flow remained positive and did not require any temporary loans.

5.0 DEBT RESCHEDULING ACTIVITY

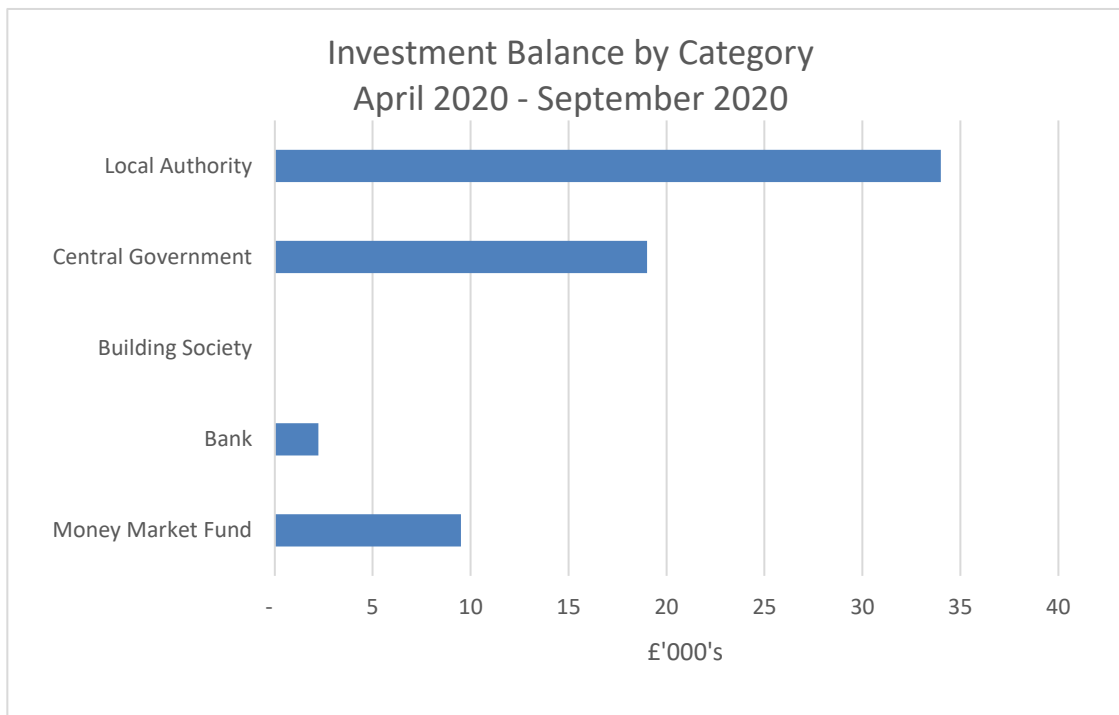
- 5.1** The council's Debt Rescheduling Strategy 2020/20 establishes a flexible approach where the rationale for rescheduling could be one or more of the following:
- Savings in interest costs with minimal risk.
 - Balancing the volatility profile (i.e. the ratio of fixed to variable rate debt) of the debt portfolio.
 - Amending the profile of maturing debt to reduce any inherent refinancing risks.
- 5.2** No opportunities for debt rescheduling were identified which conformed to the above rationale. Accordingly, the council has undertaken no debt rescheduling activity during the period.
- 5.3** The council's portfolio of thirteen loans, ten PWLB loans and three market loans, will continue to be monitored for debt rescheduling opportunities.

6.0 INVESTMENT ACTIVITY

- 6.1** The main objective of the council's Investment Policy and Strategy 2020/21 is to invest its surplus funds prudently.
- 6.2** The council's investment priorities are:
- security of the invested capital;
 - sufficient liquidity to permit investments; and,
 - Optimum yield which is commensurate with security and liquidity.
- 6.3** During this period, the Authority received central government funding to support small and medium businesses during the coronavirus pandemic through grant schemes. £20.2m was received and temporarily invested in short-dated, liquid instruments such as call accounts and Money Market Funds. The majority of the funds were disbursed by the end

of September.

- 6.4 On 25th September the overnight, 1 and 2 week deposit rates on the Debt Management Account Deposit Facility (DMADF) deposits dropped below zero percent to -0.03%, the rate was 0% for 3-week deposits and 0.01% for longer maturities.
- 6.5 The return on Money Market Funds net of fees also fell over the six months and for many funds net returns range between 0% and 0.1%. In many instances, the fund management companies have temporarily lowered or waived fees to maintain a positive net return.
- 6.6 To lower the inherent investment risk, the council has minimised the use of banks and increased the use of other Local Authorities as investment counterparties. A range of lengths of investment, from overnight investments to short and long fixed term, from 1 day to 364 days, have been utilised to ensure that the principles of security, liquidity and yield are followed.
- 6.7 With the COVID-19 pandemic situation, the council has taken a prudent approach on investments by limiting new Local Authority investments for a period of no more than 4 months. This has ensured that the council's Cashflow remained liquid throughout the year. A scenario base analysis was also undertaken, taking into account the estimated impact of the pandemic on income and expenditure on a monthly basis – this was monitored weekly.
- 6.8 The graph below shows the type of counterparties used by the council and the values currently invested.



- 6.9 The counterparties that the council currently use all meet the criteria set out in the Treasury Management Strategy Statement 2020/21 and are monitored by the Treasury Management Advisors. A detailed list of the counterparties used and amounts currently invested can be seen in **Appendix A**.

- 6.10** The average rate of return on the council's investment balances during the period was 0.27% for comparison purposes, the benchmark return at the end of September 2020 for the average 7-day London Interbank Bid Rate (LIBID) was - 0.08% and the average 7 day London Interbank Offered Rate (LIBOR) rate was 0.047%. This shows that we are achieving a good rate of return against the benchmark.
- 6.11** The council's Treasury Management Advisors produce investment benchmarking information quarterly. The latest available benchmarking data is at the 30 June 2020. The total rate of return achieved by the council takes into account the full year effect to date and is compared to 47 other district councils and the average of 125 local authorities, the yield is itemised by types of investments. At the time, the current internal investment return for the council of 0.59% is comparable to 0.42% achieved by 47 district councils and 0.38% achieved by the average of 125 of the local councils. The full benchmarking summary can be seen in **Appendix B**.
- 6.12** Short and long term interest rates have significantly declined with the base rate by the Bank of England dropping to 0.10%. Our treasury advisors expect the rate to remain at this level, but further cuts to zero, or perhaps even to negative territory, cannot be completely ruled out. The downside risk is that the rate could drop to -0.10% in December 2020, - 0.20% in March 2021 and -0.50% from June 2021 onwards.
- 6.13** There were 34 investments made during the period totalling £150.3m and 41 maturities totalling £135.9m. The average balance held for the period was £67m.
- 6.14** The fixed term investments for the period were for amounts ranging between £1m and £5m.
- 6.15** The budget for investment income for 2020/2021 for General Fund and Housing Revenue Account is £300,701. Investment activity from April to September 2020 has generated £163,246 in interest for the financial year. The current outturn forecast is estimated to be £195,740.
- 6.16** Of this total forecast, an element is applied to balances held on external income. This external income largely represents balances from S106 contributions that have not yet been spent. The estimated amount forecast to be applied is approximately £22,402 subject to the balances remaining at the end of the financial year. There is no budget applied to this element as S106 contributions are only achieved when specific conditions are met and are anticipated to be spent.
- 6.17** Estimated interest for the year of £173,338 will be apportioned between General Fund and the Housing Revenue Account based on the estimated cash flow position. The current budget and forecast is shown in the table below:

	Budget 2020/21	Projected
General Fund	£190,799	£109,981
Housing Revenue Account	£109,902	£63,357
Sub-Total	£300,701	£173,338
External Balances		£22,402
Total	£300,701	£195,740

- 6.18** During the period there has been two breaches in of the Treasury Management Strategy Statement in relation to investments:

1. The COVID-19 support grants received from the central government were deposited in short term call accounts and money market funds as the council was required to disburse this to local businesses as soon as possible. Individual account limits on money market funds were maintained, but the aggregate money market limit of £20m as per TMSS was breached by an amount of £2m. This occurred on April 1 when the grants were received and was resolved on April 9 when grants were paid out to businesses. The Head of Finance & S151 officer was made aware of this in advance prior to the initial receipt of the grants. This was closely monitored through a weekly update on the council's cashflow and investments.
2. The £5m limit in the Lloyds day to day banking account was breached by £1.2m on the 1 July 2020. This occurred as a result of £5.7m of Council Tax, Business Rates and Rents being received on this date. As the funds were required the next day to make payments to preceptors (Fire, Police and Leicestershire County Council) and the money market funds were already at their approved limits. The Finance Team Manager and Deputy S151 Officer in the absence of the Head of Finance, approved the breach of the TMSS and to leave the funds in the Lloyds account overnight. No further breaches of any other nature were identified during this period.

7.0 Treasury Advisor's Commentary – Arlingclose Ltd

- 7.1 NWLDC is currently taking a relatively low credit risk approach to its investment strategy by investing mainly in Money Market Funds (MMFs), local authorities and the UK central government. These options avoid the direct bail-in risk associated with bank deposits (although indirect exposure is held via the MMFs, this is highly diversified). Client investment benchmarking over the past year suggests that the council usually takes lower credit risk compared to other local authorities while maintaining equivalent or higher average returns on internally managed investments. The council usually makes relatively short-term investments (up to 12 months). This is another way of limiting risk but does mean that the rate of return earned is relatively low. The council's investments have always been in the cash markets and this remains the case at the moment (as opposed to other asset classes such as property, bonds or equities). This is generally also a lower risk approach. Overall the council's focus is firmly on security and liquidity.
- 7.2 Other investment options that I think would fit with the council's current risk appetite include longer-term loans to local authorities (the council has done this before), covered bonds and loans to Registered Providers (housing associations), which would also require a longer investment horizon (3 to 5 years).
- 7.3 Going beyond this would be an alternative approach – that a portion of the investment portfolio is invested strategically for income rather than liquidity. This would involve investing in asset classes such as property, bonds and equities (typically via pooled funds). This would carry a different and typically higher set of risks but also generate a higher return. An appropriate risk/return balance is key and these would be long-term investments, the value of which would fluctuate over time.
- 7.4 The council has held reasonably significant investment balances for at least the 10 years that Arlingclose has advised the council. It could be argued that given investment balances have been available for the long term but usually reinvested for the short term then the opportunity to earn a higher level of income from the investments has been missed. Of course a higher risk/higher return approach would require the council to have an appropriate risk appetite.

8.0 SUMMARY


- 8.1** In compliance with the requirements of the CIPFA code of practice, this report provides Members with a summary report of the Treasury Management activity for the period April 2020 to September 2020. A prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.
- 8.2** For the reporting period April to September 2020, the council can confirm that it has complied with its Prudential Indicators, which were approved by Council as part of the Treasury Management Strategy Statement.
- 8.3** For the reporting period, with the exception of the two breaches detailed in section 6.18, the council can confirm that it has complied with its Treasury Management Strategy Statement and Treasury Management practices.

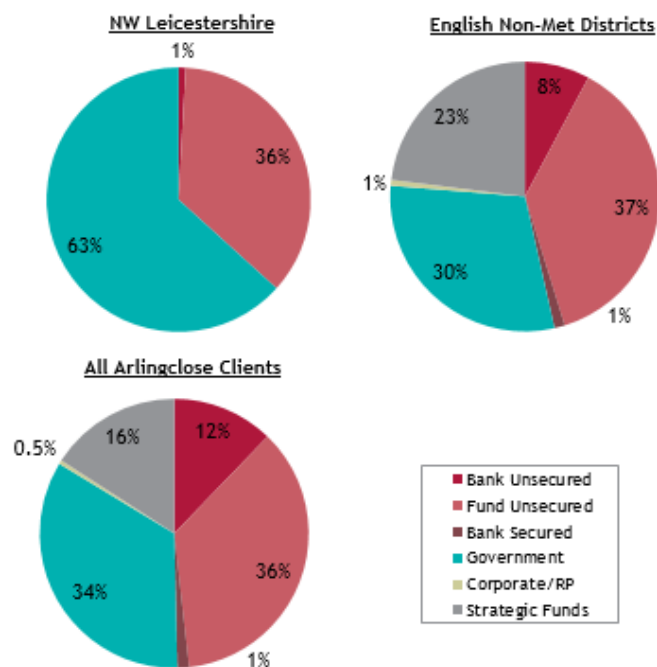
Appendix A

LIST OF COUNTERPARTIES, CURRENT INVESTMENT AND RATE

Counterparty	Length	From	To	Amount	Rate
Aberdeen Asset Management MMF	Overnight	27/09/2020	28/09/2020	5,500,000.00	0.18%
Federated Investors MMF	Overnight	27/09/2020	28/09/2020	3,000,000.00	0.06%
CCLA MMF	Overnight	27/09/2020	28/09/2020	1,000,000.00	0.14%
Lloyds Main	Overnight	27/09/2020	28/09/2020	335,052.17	0.00%
Bank of Scotland	Overnight	27/09/2020	28/09/2020	1,900,000.01	0.00%
Ards and North Down Borough Council	261 days	13/01/2020	30/09/2020	2,000,000.00	0.95%
Blackburn with Darwen Council	276 days	03/04/2020	04/01/2021	2,000,000.00	0.97%
Walsall Metropolitan Borough Council	364 days	09/04/2020	08/04/2021	5,000,000.00	1.00%
Ashford Borough Council	92 days	20/07/2020	20/10/2020	5,000,000.00	0.15%
Dover District Council	92 days	10/08/2020	10/11/2020	5,000,000.00	0.05%
Flintshire County Borough Council	92 days	27/08/2020	27/11/2020	5,000,000.00	0.08%
Kingston-upon-Hull City Council	133 days	14/09/2020	25/01/2021	2,000,000.00	0.08%
Monmouthshire County Council - Caldicot	91 days	18/09/2020	18/12/2020	5,000,000.00	0.05%
Torfaen County Borough Council	68 days	18/09/2020	25/11/2020	3,000,000.00	0.04%
DMADF	31 days, 32 days and 37 days	08/10/2020	09/10/2020	19,000,000.00	0.01%
Total				64,735,052.18	

Appendix B

 Investment Benchmarking 30 June 2020			
	NW Leicestershire	47 English Non-Met Districts Average	125 LA's Average
Internal Investments	£65.6m	£29.8m	£66.2m
Cash Plus & Short Bond Funds	£0.0m	£1.3m	£2.1m
Strategic Pooled Funds	£0.0m	£10.8m	£11.2m
TOTAL INVESTMENTS	£65.6m	£41.8m	£79.5m
Security			
Average Credit Score	3.92	4.10	4.10
Average Credit Rating	AA-	AA-	AA-
Average Credit Score (time-weighted)	3.81	4.09	3.98
Average Credit Rating (time-weighted)	AA-	AA-	AA-
Number of Counterparties / Funds	18	13	13
Proportion Exposed to Bail-in	37%	59%	59%
Liquidity			
Proportion Available within 7 days	37%	50%	54%
Proportion Available within 100 days	89%	65%	72%
Average Days to Maturity	56	51	18
Market Risks			
Average Days to Next Rate Reset	68	66	47
Strategic Fund Volatility	-	5.7%	7.7%
Yield			
Internal Investment Return	0.59%	0.42%	0.38%
Cash Plus & Short Bond Fund - Total Return	-	0.96%	0.97%
Strategic Funds - Total Return	-	-3.95%	-4.12%
Total Investments - Total Return	0.59%	-0.58%	-0.30%
All External Funds - Income Only Return	-	3.52%	3.57%
All External Funds - Capital Gains/Losses	-	-6.86%	-7.05%
Total Investments - Income Only Return	0.59%	1.23%	0.96%



Notes

- Unless otherwise stated, all measures relate to internally managed investments only, i.e. excluding external pooled funds.
- Averages within a portfolio are weighted by size of investment, but averages across authorities are not weighted.
- Credit scores are calculated as AAA = 1, AA+ = 2, etc.
- Volatility is the standard deviation of weekly total returns, annualised.

Policies and other considerations, as appropriate	
Council Priorities:	Value for Money
Policy Considerations:	Treasury Management Strategy Statement 2020/21 Council 25 February 2020
Safeguarding:	Not applicable
Equalities/Diversity:	Not applicable
Customer Impact:	Not applicable
Economic and Social Impact:	Not applicable
Environment and Climate Change:	Not applicable
Consultation/Community Engagement:	Not applicable
Risks:	Borrowing and investment both carry an element of risk. This risk is mitigated through the adoption of the Treasury and Investment Strategies, compliance with the CIPFA code of Treasury Management and the retention of Treasury Management advisors (Arlingclose) to proffer expert advice.
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