NORTH WEST LEICESTERSHIRE DISTRICT COUNCIL

AUDIT AND GOVERNANCE COMMITTEE – WEDNESDAY, 20 OCTOBER 2021

Title of Report	**TREASURY MANAGEMENT ACTIVITY REPORT APRIL 2021 –SEPTEMBER 2021**	
Presented by	Anna Wright Finance Team Manager and Deputy S151 Officer	
Background Papers	Treasury Management Strategy Statement 2021/22 Council 23 February 2021	**Public Report:** Yes
Purpose of Report	To inform Members of the Council's Treasury Management activity undertaken during the period April 2021 to September 2021.	
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 second report to be presented in 2021/22 designed 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 23 February 2021.

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: The economic recovery from the coronavirus pandemic continued to dominate the first half of the financial year. By the end of the period over 48 million people in the UK had received their first dose of a COVID-19 vaccine and almost 45 million their second dose.

The Bank of England (BoE) held Bank Rate at 0.1% throughout the period and maintained its Quantitative Easing programme at £895 billion, unchanged since the November 2020 meeting. In its September 2021 policy announcement, the BoE noted it now expected the UK economy to grow at a slower pace than was predicted in August, as the pace of the global recovery had shown signs of slowing and there were concerns inflationary pressures may be more persistent. Within the announcement, Bank expectations for GDP growth for the third (calendar) quarter were revised down to 2.1% (from 2.9%), in part reflecting tighter supply conditions. The path of CPI inflation is now expected to rise slightly above 4% in the last three months of 2021, due to higher energy prices and core goods inflation. While the Monetary Policy Committee meeting ended with policy rates unchanged, the tone was more hawkish.

Government initiatives continued to support the economy over the quarter but came to an end on 30th September 2021, with businesses required to either take back the 1.6 million workers on the furlough scheme or make them redundant.

The latest labour market data showed that in the three months to July 2021 the unemployment rate fell to 4.6%. The employment rate increased, and economic activity rates decreased, suggesting an improving labour market picture. Latest data showed growth in average total pay (including bonuses) and regular pay (excluding bonuses) among employees was 8.3% and 6.3% respectively over the period. However, part of the robust growth figures is due to bases effect from a decline in average pay in the spring of last year associated with the furlough scheme.

Annual CPI inflation rose to 3.2% in August, exceeding expectations for 2.9%, with the largest upward contribution coming from restaurants and hotels. The Bank of England now expects inflation to exceed 4% by the end of the calendar year owing largely to developments in energy and goods prices. The ONS' preferred measure of CPIH which includes owner-occupied housing was 3.0% year/year, marginally higher than expectations for 2.7%.

The easing of restrictions boosted activity in the second quarter of calendar year, helping push GDP up by 5.5% q/q (final estimate vs 4.8% q/q initial estimate). Household consumption was the largest contributor. Within the sector breakdown production contributed 1.0% q/q, construction 3.8% q/q and services 6.5% q/q, taking all of these close to their pre-pandemic levels.

The US economy grew by 6.3% in Q1 2021 (Jan-Mar) and then by an even stronger 6.6% in Q2 as the recovery continued. The Federal Reserve maintained its main interest rate at between 0% and 0.25% over the period but in its most recent meeting made suggestion that monetary policy may start to be tightened soon.

The European Central Bank maintained its base rate at 0%, deposit rate at -0.5%, and asset purchase scheme at €1.85 trillion.

Financial markets: Monetary and fiscal stimulus together with rising economic growth and the ongoing vaccine rollout programmes continued to support equity markets over most of the period, albeit with a bumpy ride towards the end. The Dow Jones hit another record high while the UK-focused FTSE 250 index continued making gains over pre-pandemic levels. The more internationally focused FTSE 100 saw more modest gains over the period and remains below its pre-crisis peak.

Inflation worries continued during the period. Declines in bond yields in the first quarter of the financial year suggested bond markets were expecting any general price increases to be less severe, or more transitory, that was previously thought. However, an increase in gas prices in the UK and EU, supply shortages and a dearth of HGV and lorry drivers with companies willing to pay more to secure their services, has caused problems for a range of industries and, in some instance, leading to higher prices.

The 5-year UK benchmark gilt yield began the financial year at 0.36% before declining to 0.33% by the end of June 2021 and then climbing to 0.64% on 30th September. Over the same period the 10-year gilt yield fell from 0.80% to 0.71% before rising to 1.02% and the 20-year yield declined from 1.31% to 1.21% and then increased to 1.36%.

The Sterling Overnight Rate (SONIA) averaged 0.05% over the quarter.

Credit review: Credit default swap spreads were flat over the most of period and are broadly in line with their pre-pandemic levels. In late September spreads rose by a few basis points due to concerns around Chinese property developer Evergrande defaulting but are now falling back. The gap in spreads between UK ringfenced and non-ringfenced entities continued to narrow, but Santander UK remained an outlier compared to the other ringfenced/retail banks. At the end of the period Santander UK was trading the highest at 53bps and Lloyds Banks Plc the lowest at 32bps. The other ringfenced banks were trading between 37-39bps and Nationwide Building Society was 39bps.

Over the period Fitch and Moody's upwardly revised to stable the outlook on a number of UK banks and building societies on our counterparty list, recognising their improved capital positions compared to last year and better economic growth prospects in the UK.

Fitch also revised the outlooks for Nordea, Svenska Handelsbanken and Handelsbanken plc to stable from negative. The rating agency considered the improved economic prospects in the Nordic region to have reduced the baseline downside risks it previously assigned to the lenders.

The successful vaccine rollout programme is credit positive for the financial services sector in general and the improved economic outlook has meant some institutions have been able to reduce provisions for bad loans. While there is still uncertainty around the full extent of the losses banks and building societies will suffer due to the pandemic-related economic slowdown, the sector is in a generally better position now compared to earlier this year and 2020.

At the end of the period Arlingclose had completed its full review of its credit advice on unsecured deposits. The outcome of this review included the addition of NatWest Markets plc to the counterparty list together with the removal of the suspension of Handelsbanken plc. In addition, the maximum duration for all recommended counterparties was extended to 100 days.

As ever, the institutions and durations on the Authority's counterparty list recommended by treasury management advisors Arlingclose remain under constant review.

3.0 THE COUNCIL'S TREASURY POSITION

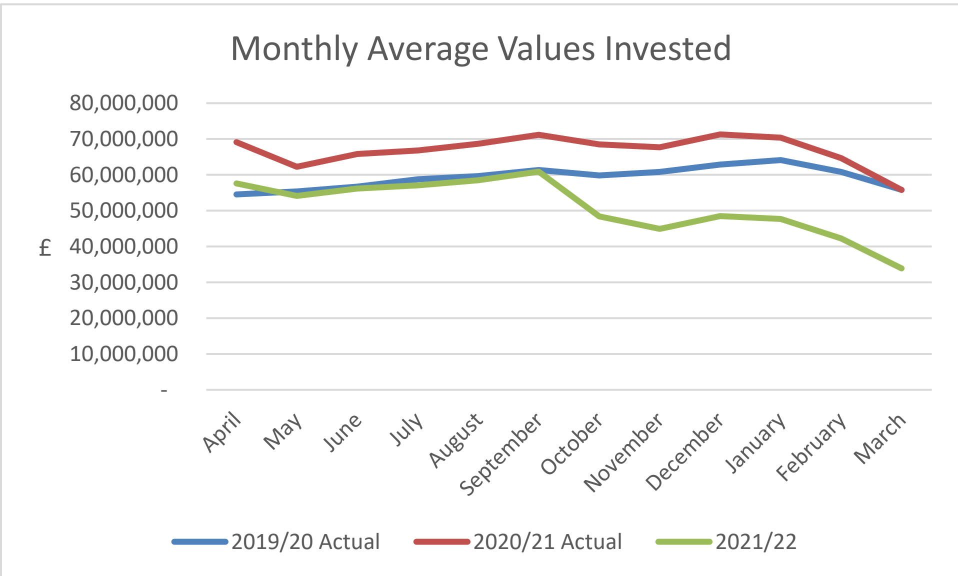
3.1 The council's current strategy is to use internal borrowing to reduce risk and keep interest costs low. The treasury management current position and the change over the reporting period is shown below.

	Balance at 01/04/21 £m	Net Movement £m	Balance at 30/09/2021 £m
Long term borrowing - HRA	70.52	-0.58	69.94
Long term borrowing – General Fund	8.44	0.00	8.44
Other long-term liabilities - HBBC	0.08	0.00	0.08
Total Borrowing	**79.04**	**-0.58**	**78.46**
Long term investments – greater than 1 year	0.00	0.00	0.00
Short term investments – less than 1 year	38.78	-2.93	35.85
Pooled funds and Money Market Funds	11.50	6.50	18.00
Total Investments	**50.28**	**3.57**	**53.85**
Net debt	**28.76**	**-4.15**	**24.61**

3.2 In the period April 2021 to September 2021, the capacity for investment has increased by £3.57m. 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.
- Normally, Capital expenditure is heavily weighted towards the latter part of the financial year due to the time required to schedule programmes of work or award contracts. This was further impacted by COVID due to difficulty in sourcing resource and materials.
- There was also some influence on the timing difference between receipt of grants and expenditure.

3.3 The average value of investments per month are represented in the graph below, illustrating the cash flow trends throughout the year. The current pattern up to September 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 2021/22 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 2021/22 shows that the council may need to borrow short term in March 2022, this will be monitored closely up until the period. Borrowing may also be required later in 2022/23 should the council wish to maintain its MIFID status which requires an investment balance of £10m at any one time.

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 four PWLB loan repayments due this year. The first two are annuity loans that require part of the principal to be paid each year. The first payment totalling £0.59m was made on 28 September and the second of the same amount will be made in March 2022. The remaining two loans, totalling £13m, relate to the repayment of two maturity loans that will be paid in March 2022. All these loans were taken out in 2012 as part of the self-financing of the Housing Revenue Account.

4.5 During the reporting period of April 2021 to September 2021, the council's cash flow remained positive and therefore no temporary loans were required.

5.0 DEBT RESCHEDULING ACTIVITY

5.1 The council's Debt Rescheduling Strategy 2021/22 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 that 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. Two of the PWLB loans will be repaid this financial year as outlined in section 4.4.

6.0 INVESTMENT ACTIVITY

6.1 The main objective of the council's Investment Policy and Strategy 2021/22 is to invest its surplus funds prudently.

6.2 The council's investment priorities are:

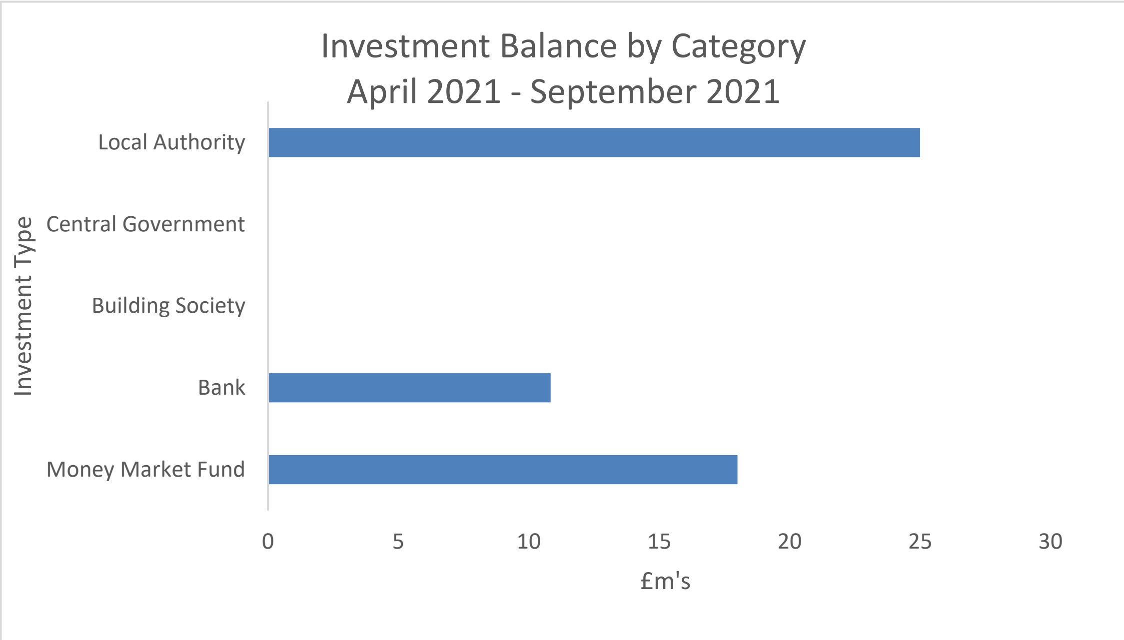
- security of the invested capital;
- sufficient liquidity to permit investments; and,
- Optimum yield which is commensurate with security and liquidity.

6.3 During the period April 2021 to September 2021 the deposit rates on the Debt Management Account Deposit Facility (DMADF) have remained stable at 0.01%.

6.4 The return on Money Market Funds net of fees remained very low between 0.00% and 0.02%. In many instances, the fund management companies have temporarily lowered or waived fees to maintain a positive net return.

6.5 To lower the inherent investment risk, the council has minimised the use of banks and continues to use other Local Authorities as investment counterparties. A range of lengths of investment, from overnight investments to short term up to 9 months have been utilised to ensure that the principles of security, liquidity and yield are followed.

6.6 The graph below shows the type of counterparties used by the council and the values currently invested.



6.7 The counterparties that the council currently use all meet the criteria set out in the Treasury Management Strategy Statement 2021/22 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**.

6.8 The average rate of return on the council's investment balances during the period was 0.05%, for comparison purposes, the benchmark return at the end of September 2021 for the average 7 day London Interbank Offered Rate (LIBOR) was 0.04%. This rating system will be being phased out at the end of the year and replaced with the 7-day Sterling Over Night Rate (SONIA), which was at 0.05%.

6.9 The council's Treasury Management Advisors produce investment-benchmarking information quarterly. The latest available benchmarking data is at the 30 June 2021. The total rate of return achieved by the council takes into account the full year effect to date and is compared to 46 other district councils and the average of 128 local authorities, the yield is itemised by types of investments. At the time, the current internal investment return for the council of 0.06% is significantly lower than the 0.12% achieved by 46 district councils and 0.11% achieved by the average of 128 local councils. This is in part due to a number of higher yield investments maturing and being reinvested at a lower rate due to the current investment environment. The full benchmarking summary can be seen in **Appendix B.**

6.10 Short and long term interest rates continue to decline with the base rate by the Bank of England stuck at 0.10% and reduced local authorities' cash demand with grants received from central government. Our treasury advisors expect the rate to remain at this level, until at least 2022.

6.11 There were 39 investments made during the period April 2021 to September 2021 totalling £137.5m and 31 maturities totalling £136m. The average balance held for the period was

£57,382,219.

6.12 The fixed term investments for the period were for amounts ranging between £1m and £5m.

6.13 The budget for investment income for 2021/2022 for General Fund and Housing Revenue Account is £14,000. Investment activity from April to September 2021 has generated £15,500 in interest for the financial year. The current outturn forecast is estimated to be £19,742.

6.14 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 £1,700 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.

6.15 Estimated interest for the year of £19,774 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 2021/22	**Projected**
General Fund	£8,905.95	£9,682.61
Housing Revenue Account	£5,129.90	£5,577.61
Sub-Total	**£14,035.85**	**£15,260.22**
External Balances		£4,482.20
Total	**£14,035.85**	**£19,742.41**

6.16 There was a breach of the Treasury Management Strategy Statement (TMSS) on 20 July 2021. A local authority failed to pay back our investment on the agreed date despite every effort made to remind them. This caused our bank account to be £4.7m overdrawn for one day. The Local Authority in question was charged our bank overdraft charges and one day interest.

7.0 Treasury Advisor's Commentary – Arlingclose Ltd

7.1 NWLDC is currently taking a relatively low credit and liquidity risk approach to its investment strategy by investing mainly in Money Market Funds (MMFs), local authorities and the UK central government for short terms (up to 12 months). These options avoid the direct bail-in risk associated with bank deposits (although indirect exposure is held via the MMFs, this is highly diversified).

7.2 The council's focus is on security and liquidity and this approach combined with the current interest rate environment means investment returns are at low levels. Given these low returns, the council's level of real return (i.e. adjusting for inflation) is negative. The latest client investment benchmarking exercise that NWLDC took part in (June 2021) showed the council's credit risk (as measured by credit ratings) and return in line with the average for other local authorities on internally managed investments.

7.3 Other investment options that may 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).

7.4 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).

7.5 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.

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 2021 to September 2021. 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 2021, 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, there has been one breach as outlined in section 6.16 of this report. Outside of that it can be confirmed that the Treasury Management Strategy Statement and Treasury Management practices have been complied with.

Appendix A

LIST OF COUNTERPARTIES, CURRENT INVESTMENT AND RATE

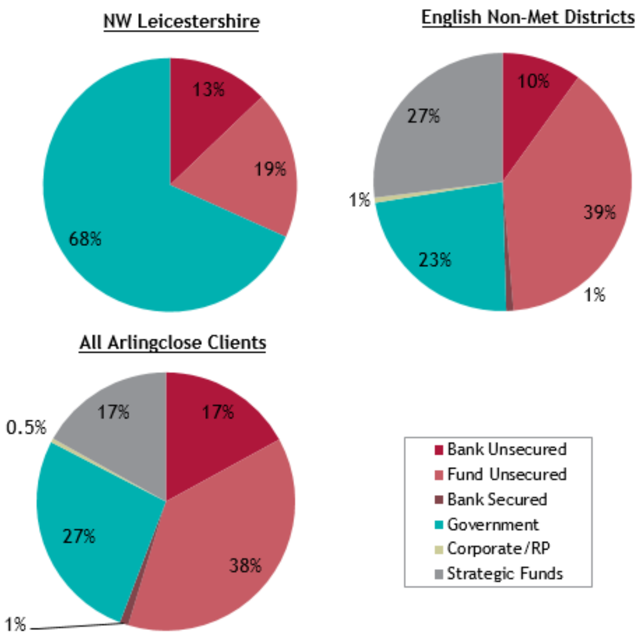
Counterparty	Length	Amount	Rate
Goldman Sachs MMF	Overnight	2,000,000.00	0.00%
Blackrock MMF	Overnight	2,500,000.00	0.01%
Aberdeen Asset Management MMF	Overnight	4,500,000.00	0.01%
Federated Investors MMF	Overnight	3,000,000.00	0.01%
CCLA MMF	Overnight	6,000,000.00	0.02%
Lloyds Main	Overnight	4,835,275.89	0.00%
Lloyds Notice Account	32 days	2,000,000.00	0.03%
Santander Notice Account	35 days	2,000,000.00	0.15%
Lloyds Market Call Account	Overnight	2,000,000.00	0.01%
Isle of Wight	277 days	5,000,000.00	0.09%
Guilford Borough Council	276 days	5,000,000.00	0.09%
Surrey County Council	183 days	5,000,000.00	0.06%
Monmouthshire County Council - Caldicot	183 days	5,000,000.00	0.08%
Surrey Heath Borough Council	184 days	4,000,000.00	0.03%
Hinckley & Bosworth BC	7 days	1,000,000.00	0.40%
Total		**53,835,275.89**	

Appendix B

Investment benchmarking 30th June 2021

Investment Benchmarking
30 June 2021

	NW Leicestershire	47 English Non-Met Districts Avera	124 LAs Average
Internal Investments	£55.6m	£34.2m	£83.4m
Cash Plus & Short Bond Funds	£0.0m	£1.6m	£2.7m
Strategic Pooled Funds	£0.0m	£13.4m	£11.9m
TOTAL INVESTMENTS	**£55.6m**	**£49.2m**	**£98.0m**
Security			
Average Credit Score	4.61	4.60	4.64
Average Credit Rating	A+	A+	A+
Average Credit Score (time-weighted)	4.47	4.61	4.51
Average Credit Rating (time-weighted)	AA-	A+	A+
Number of Counterparties / Funds	14	12	13
Proportion Exposed to Bail-in	32%	68%	67%
Liquidity			
Proportion Available within 7 days	32%	51%	56%
Proportion Available within 100 days	64%	61%	71%
Average Days to Maturity	80	41	12
Market Risks			
Average Days to Next Rate Reset	89	166	50
Strategic Fund Volatility	-	2.9%	3.8%
Yield			
Internal Investment Return	0.06%	0.12%	0.11%
Cash Plus Funds - Income Return	-	0.41%	0.37%
Strategic Funds - Income Return	-	4.21%	4.28%
Total Investments - Income Return	**0.06%**	**1.22%**	**0.82%**
Cash Plus Funds - Capital Gain/Loss	-	0.35%	0.40%
Strategic Funds - Capital Gain/Loss	-	7.47%	7.28%
Total Investments - Total Return	**0.06%**	**3.32%**	**2.13%**



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 2021/22 Council 23 February 2021
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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