NORTH WEST LEICESTERSHIRE DISTRICT COUNCIL

AUDIT AND GOVERNANCE COMMITTEE – WEDNESDAY, 19 JANUARY 2022

Title of Report	**TREASURY MANAGEMENT ACTIVITY REPORT APRIL 2021 –DECEMBER 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 December 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 third 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). The last update was provided on 17 December 2021

Economic background: The ongoing impact on the UK from coronavirus, together with higher inflation, higher interest rates, and the country's trade position post-Brexit, will be major influences on the Authority's treasury management strategy for 2022/23.

The Bank of England (BoE) increased Bank Rate to 0.25% in December 2021 while maintaining its Quantitative Easing programme at £895 billion. The Monetary Policy Committee (MPC) voted 8-1 in favour of raising rates, and unanimously to maintain the asset purchase programme.

Within the announcement the MPC noted that the pace of the global recovery was broadly in line with its November Monetary Policy Report. Prior to the emergence of the Omicron coronavirus variant, the Bank also considered the UK economy to be evolving in line with expectations, however the increased uncertainty and risk to activity the new variant presents, the Bank revised down its estimates for Q4 GDP growth to 0.6% from 1.0%. Inflation was projected to be higher than previously forecast, with CPI likely to remain above 5% throughout the winter and peak at 6% in April 2022. The labour market was generally performing better than previously forecast and the BoE now expects the unemployment rate to fall to 4% compared to 4.5% forecast previously, but notes that Omicron could weaken the demand for labour.

UK CPI for November 2021 registered 5.1% year on year, up from 4.2% in the previous month. Core inflation, which excludes the more volatile components, rose to 4.0% y/y from 3.4%. The most recent labour market data for the three months to October 2021 showed the unemployment rate fell to 4.2% while the employment rate rose to 75.5%.

In October 2021, the headline 3-month average annual growth rate for wages were 4.9% for total pay and 4.3% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 1.7% while regular pay was up 1.0%. The change in pay growth has been affected by a change in composition of employee jobs, where there has been a fall in the number and proportion of lower paid jobs.

Gross domestic product (GDP) grew by 1.3% in the third calendar quarter of 2021 according to the initial estimate, compared to a gain of 5.5% q/q in the previous quarter, with the annual rate slowing to 6.6% from 23.6%. The Q3 gain was modestly below the consensus forecast of a 1.5% q/q rise. During the quarter activity measures were boosted by sectors that reopened following pandemic restrictions, suggesting that wider spending was flat. Looking ahead, while monthly GDP readings suggest there had been some increase in momentum in the latter part of Q3, Q4 growth is expected to be soft.

GDP growth in the euro zone increased by 2.2% in calendar Q3 2021 following a gain of 2.1% in the second quarter and a decline of -0.3% in the first. Headline inflation has been strong, with CPI registering 4.9% year-on-year in November, the fifth successive month of inflation. Core CPI inflation was 2.6% y/y in November, the fourth month of successive increases from July's 0.7% y/y. At these levels, inflation is above the European Central Bank's target of 'below, but close to 2%', putting some pressure on its long-term stance of holding its main interest rate of 0%.

The US economy expanded at an annualised rate of 2.1% in Q3 2021, slowing sharply from gains of 6.7% and 6.3% in the previous two quarters. In its December 2021 interest rate announcement, the Federal Reserve continue to maintain the Fed Funds rate at between 0% and 0.25% but outlined its plan to reduce its asset purchase programme earlier than previously stated and signalled they are in favour of tightening interest rates at a faster pace in 2022, with three 0.25% movements now expected.

Credit outlook: Since the start of 2021, relatively benign credit conditions have led to credit default swap (CDS) prices for the larger UK banks to remain low and had steadily edged down throughout the year up until mid-November when the emergence of Omicron has caused them to rise modestly. However, the generally improved economic outlook during 2021 helped bank profitability and reduced the level of impairments many had made as provisions for bad loans. However, the relatively recent removal of coronavirus-related business support measures by the government means the full impact on bank balance sheets may not be known for some time.

The improved economic picture during 2021 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several financial institutions, revising them from negative to stable and even making a handful of rating upgrades.

Looking ahead, while there is still the chance of bank losses from bad loans as government and central bank support is removed, the institutions on the Authority's counterparty list are well-capitalised and general credit conditions across the sector are expected to remain benign. Duration limits for counterparties on the Authority's lending list are under regular review and will continue to reflect economic conditions and the credit outlook.

Interest rate forecast: The Authority's treasury management adviser Arlingclose is forecasting that Bank Rate will continue to rise in calendar Q1 2022 to subdue inflationary pressures and the perceived desire by the BoE to move away from emergency levels of interest rates.

Investors continue to price in multiple rises in Bank Rate over the next forecast horizon, and Arlingclose believes that although interest rates will rise again, the increases will not be to the extent predicted by financial markets. In the near-term, the risks around Arlingclose's central case are to the upside while over the medium-term the risks become more balanced.

Yields are expected to remain broadly at current levels over the medium-term, with the 5, 10 and 20 year gilt yields expected to average around 0.65%, 0.90%, and 1.15% respectively. The risks around for short and medium-term yields are initially to the upside but shifts lower later, while for long-term yields the risk is to the upside. However, as ever there will almost certainly be short-term volatility due to economic and political uncertainty and events.

3.0 THE COUNCIL'S TREASURY POSITION

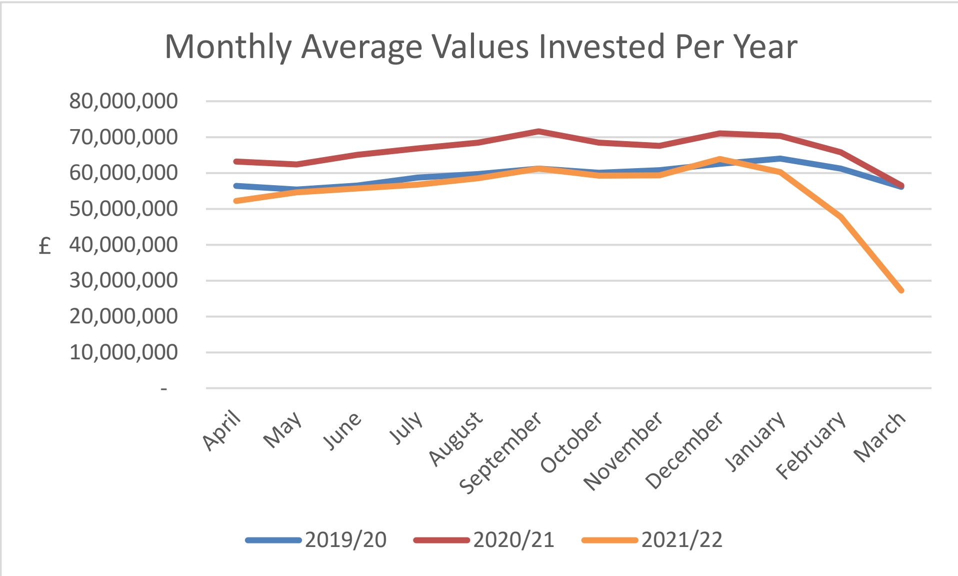
3.1 The Council's current strategy is to use internal borrowing to reduce risk and keep interest costs low. The treasury management current position and the change over the reporting period is shown below.

	01.04.21	Movement	31.12.21	31.12.21
	Balance	£m	Balance	Rate
	£m		£m	%
Long-term borrowing	79.05	-0.59	78.46	3.39%
Short-term borrowing	0.00	0.00	0.00	0
Total borrowing	**79.05**	**-0.59**	**78.46**	**3.39%**
Long-term investments	0.00	0.00	0	0
Short-term investments	33.00	8.50	41.50	0.05%
Cash and cash equivalents	14.50	4.50	19.00	0.01%
Total investments	**53.50**	**7.00**	**60.50**	**0.04%**
Net Borrowing - Investments	25.55		17.96	

3.2 In the period April 2021 to December 2021, the capacity for investment has increased by £7 million. 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.

3.3 The average value of investments per month are represented in the graph below, illustrating the cash flow trends throughout the year. For the remainder of 2021/22 the graph shows the forecasted investment amounts available. This shows a marked decrease due to repayment of grants and payments valuing £14 million for repayments of long-term loans.



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 forecasting for 2021/22 shows that we will not need to borrow in 2021/22. However, moving into 2022/23 it is likely that borrowing will be required particularly if the council wishes to maintain its professional investor (MIFID) status which requires an investment balance of £10m at all times. We are currently forecasting a balance of below £10m from May 2022 onwards.

4.3 The council has not undertaken any short-term or long-term borrowing during this financial year.

4.4 The council have four PWLB loan repayments due this year. The first two are annuity loans that require part of the principle to be paid each year. The first payment totalling £0.59 million was made on 28 September and the second of the same amount will be made on March 28 2022. The two further loans will be repaid also on 28 March 2022 totalling £13 million. All four of these loans were taken out in 2012 as part of the self-financing of the Housing Revenue Account.

4.5 Interest payments on all loans will total £2.67 million for the 2021/22 financial year

4.6 The balance of the HRA loan redemption reserve when taken together with outstanding loans gives a complete picture of the actual outstanding HRA borrowing and the balance on the reserve forms part of our total investments which are shown in the report.

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 December 2021 the deposit rates on the Debt Management Account Deposit Facility (DMADF) were at 0.01% for all durations. On 15 December 2021 the Monetary Policy Committee voted 8-1 to increase bank rate to 0.25%. This has increased the DMADF deposit returns for longer term investments. Different amounts and time frames now yield different rates of return. This is outlined in the below diagram which represents indicative interest rates as at 31 December 2021. Please note that these change each day.

LESS THAN 25M

	BID <25m
O/N	-0.45
1W	-0.27
2W	-0.15
3W	-0.10
1M	-0.07
2M	0.02
3M	0.08
4M	0.10
5M	0.11
6M	0.12

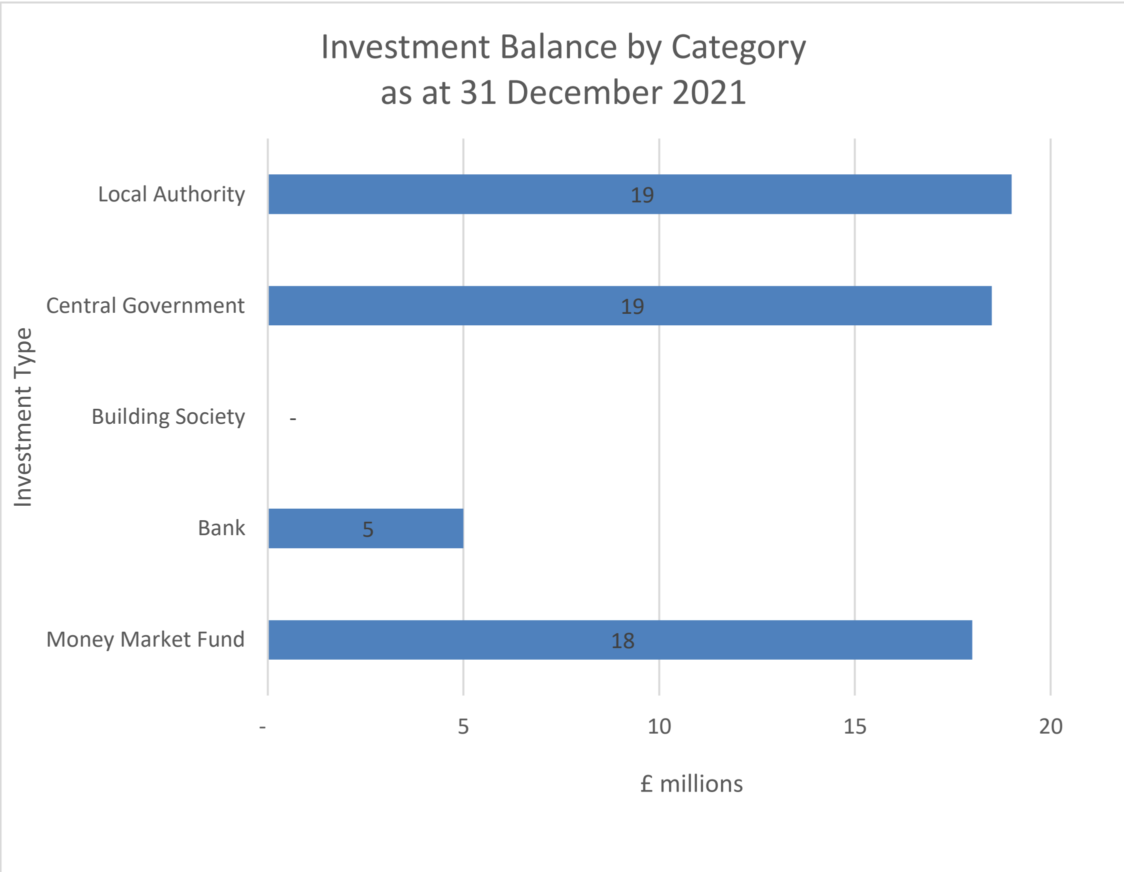
25M AND GREATER

	BID >25m
O/N	-0.45
1W	-0.27
2W	-0.15
3W	-0.10
1M	-0.07
2M	0.02
3M	0.08
4M	0.10
5M	0.11
6M	0.12

6.4 The return on Money Market Funds net of fees remained very low between 0.005% 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 our 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 as at 31 December 2021 was 0.04%. For comparison purposes the benchmark return at the start of December 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 so we will also be using the 7-day Sterling Over Night Rate (SONIA) this was at 0.05%.

6.9 The Council's Treasury Management Advisors produce investment-benchmarking information quarterly. The latest available benchmarking data is from the 30 September 2021. This shows that the Councils 0.05% interest yield is significantly lower than other Councils which sit at 2.35% and 3.65% for non-met districts. These figures do not represent all other UK councils, but all councils overseen by Arlingclose. The smaller interest return is largely due to the lack of longer-term investments that some other councils engage in such as strategic funds and cash plus funds. Due to the forecasted shortfall in cashflow longer term investments are not feasible for the Council as CIPFA's prudential code advises against borrowing for investment purposes. The full benchmarking summary can be seen in Appendix B.

6.10 Short and long term borrowing interest rates have been at a historical low point with the Bank of England keeping base rate at 0.10% combined with local authorities' cash demand being low as a result of grants received from central government. With the base rate having risen on 15 December 2021 to 0.25% it is anticipated this will increase slightly over the coming weeks.

6.11 There were 53 investments made during the period April 2021 to December 2021 totalling £184 million and 45 maturities totalling £171 million. The average balance held for the period was £59 million.

6.12 The fixed term investments for the period were for amounts ranging between £4m and £10m.

6.13 The budget for investment income for 2021/2022 for the General Fund and Housing Revenue Account was £14,000. Investment activity from April 2021 to December 2021 has generated £22,000 in interest for the financial year. The current outturn forecast is estimated to be £26,000

6.14 Of this total forecast, an amount is removed from the total due to interest earnt on investment balances held on behalf of external funds. This external income largely represents balances from S106 contributions that have not yet been spent. The forecasted amount of interest earnt from these external funds is an estimated £4,000. 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 After the external fund income discussed above is removed the forecasted interest earnt for the 2021/22 financial year the resulting forecasted Interest earnt is £22,000. This will be apportioned between the General Fund and the Housing Revenue Account as shown in the table below.

	Budget 2021/22	**Projected 2021/22**
General Fund	£8,906	£14,181
Housing Revenue Account	£5,130	£8,169
Sub-Total	**£14,036**	**£22,351**
External Balances		£3,736
Total	**£14,036**	**£26,087**

6.16 There was a breach of the Treasury Management Strategy Statement (TMSS) on 1 December 2021. This was caused as a result of an unexpected payment of £350,000 arriving into the bank late in the day. As a result, the operational bank account finished the day with a balance of £5,079,500. The limit within the TMSS is £5 million thus resulting in a breach of £79,500. Procedures have been updated to mitigate the risk of this occurring in the future by leaving a £500,000 headroom in the bank account for incoming payments late in the day. Practically this means that the operational bank account will not exceed £4.5 million unless a late payment is received.

7.0 **Treasury Advisor's Commentary – Arlingclose Ltd –** This commentary is provided by our treasury management advisors and was last updated in July 2021 and remains relevant.

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). 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 December 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, 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.

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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Appendix A

LIST OF COUNTERPARTIES, CURRENT INVESTMENT AND RATE

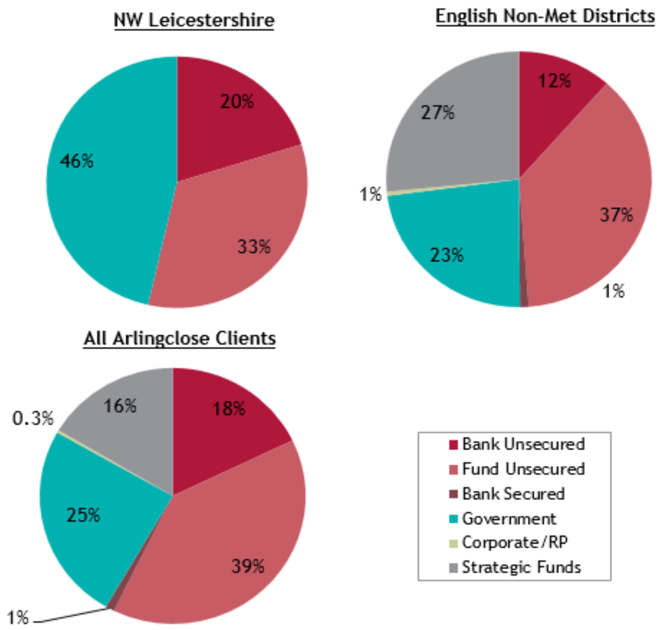
Investments as of 31/12/2021			
Counterparty	**Length**	**Amount**	**Interest Rate**
Blackrock MMF	Overnight	5,000,000.00	0.01%
Aberdeen Asset Management MMF	Overnight	4,000,000.00	0.01%
Federated Investors MMF	Overnight	5,000,000.00	0.01%
CCLA MMF	Overnight	4,000,000.00	0.02%
Lloyds Notice Account	32 days	2,000,000.00	0.03%
Santander Notice Account	35 days	2,000,000.00	0.15%
Lloyds Market Call Account	Overnight	1,000,000.00	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 Heath Borough Council	184 days	4,000,000.00	0.03%
London Borough of Barking & Dagenham	140 days	5,000,000.00	0.03%
DMADF	Overnight	18,500,000.00	0.03%
Total		**60,500,000.00**	**0.04%**

Appendix B

Investment benchmarking 30th September 2021

Investment Benchmarking
30 September 2021

	NW Leicestershire	51 English Non-Met Districts Average	129 LAs Average
Internal Investments	£53.8m	£36.1m	£72.7m
Cash Plus & Short Bond Funds	£0.0m	£1.9m	£2.2m
Strategic Pooled Funds	£0.0m	£14.1m	£13.1m
TOTAL INVESTMENTS	**£53.8m**	**£51.7m**	**£87.9m**
Security			
Average Credit Score	4.77	4.66	4.69
Average Credit Rating	A+	A+	A+
Average Credit Score (time-weighted)	4.48	4.57	4.53
Average Credit Rating (time-weighted)	AA-	A+	A+
Number of Counterparties / Funds	13	13	13
Proportion Exposed to Bail-in	54%	69%	69%
Liquidity			
Proportion Available within 7 days	48%	48%	56%
Proportion Available within 100 days	74%	65%	75%
Average Days to Maturity	45	32	10
Market Risks			
Average Days to Next Rate Reset	62	55	44
Strategic Fund Volatility	-	3.0%	3.9%
Yield			
Internal Investment Return	0.05%	0.08%	0.08%
Cash Plus Funds - Income Return	-	0.39%	0.33%
Strategic Funds - Income Return	-	4.20%	4.27%
Total Investments - Income Return	**0.05%**	**1.20%**	**0.78%**
Cash Plus Funds - Capital Gain/Loss	-	-0.03%	0.03%
Strategic Funds - Capital Gain/Loss	-	9.28%	9.42%
Total Investments - Total Return	**0.05%**	**3.65%**	**2.35%**



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.