

From:	Peter Oakford, Deputy Leader and Cabinet Member for Finance, Traded and Corporate Services
To:	Zena Cooke, Corporate Director of Finance Governance and Audit Committee – 23 April 2021
Subject:	Treasury Management quarterly update 2020-21
Classification:	Unrestricted

Summary:

This report provides a review of Treasury Management Activity 2020-21 to end February 2021

Recommendation:

Members are recommended to note this report.

FOR DECISION

1. Introduction

- 1.1 This report covers Treasury Management activity for the 11 months to 28 February 2021.
- 1.2 The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that authorities report on the performance of the treasury management function at least twice yearly (mid-year and at year end). This report therefore ensures this council is embracing Best Practice in accordance with CIPFA's recommendations. This report provides an additional quarterly update as set out in the Council's Treasury Management Strategy.
- 1.3 The Council's Treasury Management Strategy for 2020-21 was approved by full Council on 13 February 2020.
- 1.4 The Council has both borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's treasury management strategy. This report covers treasury activity and the associated monitoring and control of risk.

2. External context

- 2.1 The spread of the coronavirus pandemic and the management of the roll out of vaccines has continued to dominate during the period as countries around the world tried to contain the transmission of the virus while supporting their economies. Throughout the period efforts to reach an agreement between the UK and EU on a trade deal were in the headlines. A Brexit trade deal was agreed on 24 December and passed into UK law on 30 December.

- 2.2 The Bank of England (BoE) maintained Bank Rate at 0.1% and in November extended its Quantitative Easing programme by £150 billion to £895 billion.
- 2.3 Government initiatives continued to support the economy, with the furlough (Coronavirus Job Retention) scheme keeping almost 10 million workers in jobs extended in March 2021 to September 2021, as well as grants and loans to businesses.
- 2.4 Having grown by 16% in Q3 (Jul – Sep) GDP grew by 1% in Q4 (Oct – Dec) exceeding expectations due to a surge in spending ahead of Brexit and the tighter pandemic restrictions. A steep decline in GDP was anticipated in Q1 2021 as a result of the lockdown restrictions. Construction, services and production output all rose significantly during Q3 and to a lesser extent in Q4.
- 2.5 The headline rate of UK Consumer Price Inflation (CPI) increased slightly to 0.7% year/year in January still below the Bank of England's 2% target. This low level reflected falling energy prices earlier in 2020 combined with the effects of the pandemic on the economy.
- 2.6 In the three months to January 2021, labour market data showed the unemployment rate fell marginally to 5.0%, 1.1% higher than a year earlier. In the same period the employment rate was 75%, a 1.5% decrease on the year. The extended Coronavirus Job Retention Scheme and new Job Scheme is mitigating the impact of weaker economic activity on the labour market.
- 2.7 The European Central Bank maintained its base rate at 0% and deposit rate at -0.5% but increased the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.
- 2.8 Equity markets continued to rise, with the Dow Jones climbing above its pre-crisis peak on the back of continued outperformance by a small number of technology stocks. The FTSE indices continued to perform well, with the more internationally focused FTSE 100 getting back to around 60% of its pre-March level while the more UK-focused FTSE 250 was closer to 80% of its previous peak over the same period. Central bank and government stimulus packages continue to support asset prices, but volatility remains.
- 2.9 Ultra-low interest rates continue to prevail keeping gilt yields low but volatile over the period with the yield on some short-dated UK government bonds remaining negative. The 5-year UK benchmark gilt yield fell from 0.09% to 0.06% during January (with much volatility in between) and the 10-year gilt yield has also bounced around ending at 0.45% in January.

3. Local context

- 3.1 On 31 March 2020 the Council had £381m of investments arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the capital financing requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These are shown in the following table.

	31.3.20 Actual £m
Loans CFR	1,039.8
External borrowing	-883.8
Internal borrowing	155.9
Less: Usable reserves	-393.0
Less: Working capital	-144.3
Net investments	381.4

3.2 Lower official interest rates have reduced the cost of short-term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing. The Council pursued its strategy of keeping borrowing and investments below their underlying levels, known as internal borrowing, in order to reduce risk and keep interest costs low.

3.3 The treasury management position on 28 February 2021 and the change over the eleven months is shown in the following table.

	31.3.20 Balance £m	2020-21 Movement £m	28.2.21 Balance £m	28.2.21 Rate %
Long-term borrowing	883.8	-29.9	853.9	4.52
Total borrowing	883.8	-29.9	853.9	4.52
Long-term investments	157.3	+15.3	172.6	4.26
Short-term investments	137.4	+35.8	173.2	0.40
Cash and cash equivalents	86.7	-9.0	77.7	0.04
Total investments	381.4	+42.0	423.4	1.51
Net borrowing	502.6	-71.9	430.5	

4. Borrowing update

4.1 As previously reported HM Treasury published details of new PWLB lending terms in November 2020 and the main points to note are:

- A reduction of 1% in all Standard Rate and Certainty Rate PWLB loans from 26 November 2020.
- The PWLB will not lend to an authority that plans to buy investment assets primarily for yield anywhere in their capital plans.

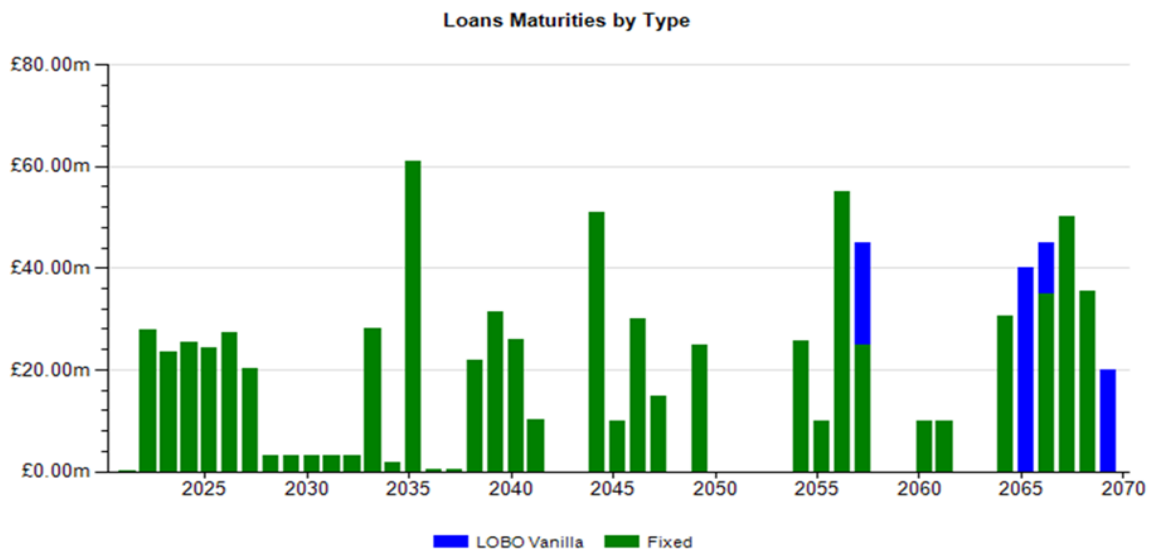
5. Borrowing Strategy during the period

5.1 The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

- 5.2 In keeping with these objectives no new borrowing was undertaken and £29.9m of existing loans were allowed to mature without replacement. On 28 February the Council had total external debt of £854m.
- 5.3 With short-term interest rates remaining much lower than long-term rates, the Council has considered it to be more cost effective in the near term to use internal resources or has borrowed short term loans instead. The Council's strategy has enabled it to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.
- 5.4 The Council continues to hold LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during the period.
- 5.5 The Council's borrowing activity in the 11 months to 28 February 2021 is as follows.

	31.3.20	2020-21	28.2.21	28.2.21	28.2.21
	Balance	Movement	Balance	Weighted average rate	Weighted average maturity
	£m	£m	£m	%	years
Public Works Loan Board	473.28	-23.67	449.61	4.83	16.03
Banks (LOBO)	90.00	0.00	90.00	4.15	42.96
Banks (Fixed Term)	291.80	0.00	291.80	4.40	37.59
Streetlighting project	28.75	-6.18	22.57	1.30	10.28
Total Borrowing	883.83	-29.85	853.98	4.52	26.08

- 5.6 The maturity profile of the Council's outstanding debt is as per the following chart.



5.7 The following table shows the maturity profile of KCC debt in 5 year tranches.

Loan Principal Maturity Period	Total Loan Principal Maturing	Balance of Loan Principal Outstanding
Opening Balance 28/02/2021		£853,984,292
Maturity 0 - 5 years	£79,865,787	£774,118,505
Maturity 5 - 10 years	£77,140,446	£696,978,059
Maturity 10 - 15 years	£38,700,173	£658,277,886
Maturity 15 - 20 years	£114,668,374	£543,609,512
Maturity 20 - 25 years	£87,009,512	£456,600,000
Maturity 25 - 30 years	£79,800,000	£376,800,000
Maturity 30 - 35 years	£35,700,000	£341,100,000
Maturity 35 - 40 years	£100,000,000	£241,100,000
Maturity 40 - 45 years	£50,600,000	£190,500,000
Maturity 45 - 50 years	£190,500,000	£0
Total	£853,984,292	

6. Treasury investment activity

6.1 The Council's average investment balances to date have amounted to £429m representing income received in advance of expenditure plus balances and reserves held. During the 11 months to end of February 2021, the Council received total additional central government funding of £95m in relation to COVID-19. This was temporarily invested in short-dated, liquid instruments such as call accounts and money market funds and had mostly been disbursed by the end of February.

6.2 Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

6.3 In the light of the pandemic crisis and the likelihood of unexpected calls on cash flow the Council continues to hold significant balances in money market funds as well as in bank call accounts which have same day availability. This liquid cash was diversified over several counterparties and money market funds to manage both credit and liquidity risks.

6.4 On 28 February 2021 the Council had lent £46m to other local authorities. Each request to borrow or to renew an existing loan is assessed in terms of our own cashflow requirements and within our effective lending policies and procedures. During the 11 months the Council also made loans totalling £5.2m to the no use empty loans programme achieving a return of 1.5% which is available to fund general services.

6.5 The Council's investments during the 11 months to the end of February 2021 are summarised in the table below and a detailed schedule of investments as at 28 February 2021 is in Appendix 1.

	31.3.20	2020-21	28.2.21	28.2.21	28.2.21
	Balance	Movement	Balance	Rate of Return	Average Credit Rating
	£m	£m	£m	%	
Bank Call Accounts	30.0	-9.9	20.1	0.09	A+
Money Market Funds	56.7	0.9	57.6	0.01	AA-
Local Authorities	50.0	-4.0	46.0	0.25	A+
Covered Bonds	84.9	-5.2	79.7	0.64	AAA
DMO Deposits (DMADF)	0.0	40.0	40.0	0.01	AA-
Icelandic Recoveries o/s	0.4	-0.4	0.0		
No Use Empty Loans	0.0	5.2	5.2	1.50	
Equity	2.3	0.0	2.3		
Internally managed cash	224.2	26.6	250.8	0.27	AA
Strategic Pooled Funds	157.3	15.3	172.6	4.26	
Total	381.4	42.0	423.4	1.94	

7 Externally managed investments

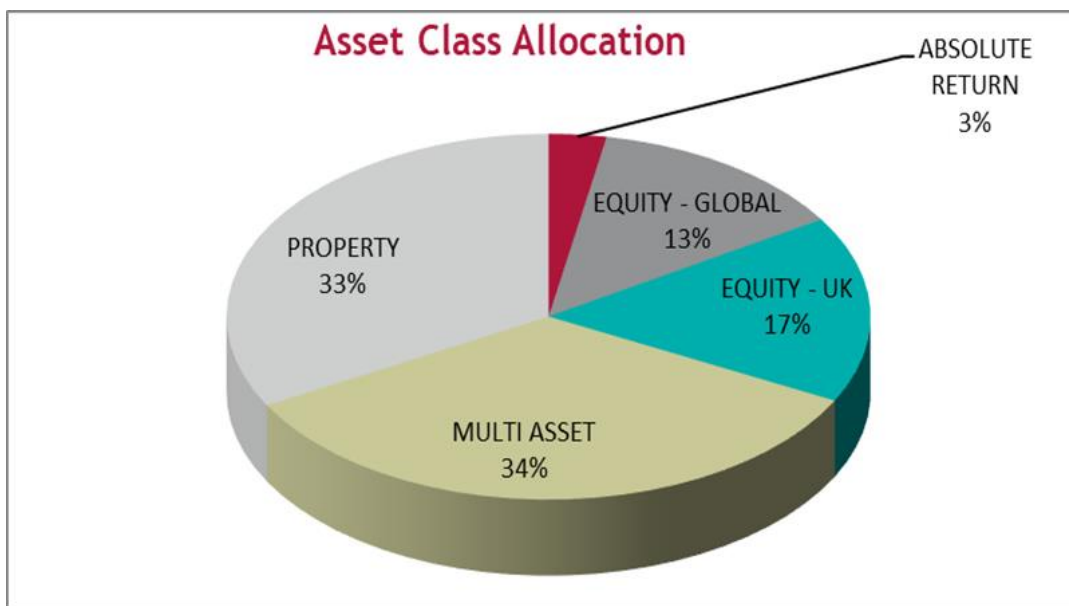
7.1 The Council is invested in equity, multi-asset and property funds. Since March 2020 financial markets have recovered with our holdings increasing in value to £172.6m at the end of February 2021, a gain of £15.3m (9.7%). All the equity and multi asset funds show gains while the CCLA LAMIT Property Fund continues to lag its 31 March value reflecting the ongoing challenges in real estate.

7.2 During the 11 month period, we achieved an income return of 4.26% as funds continued to pay dividends albeit at a lower level than before Covid. Details of the externally managed funds are shown in the following table.

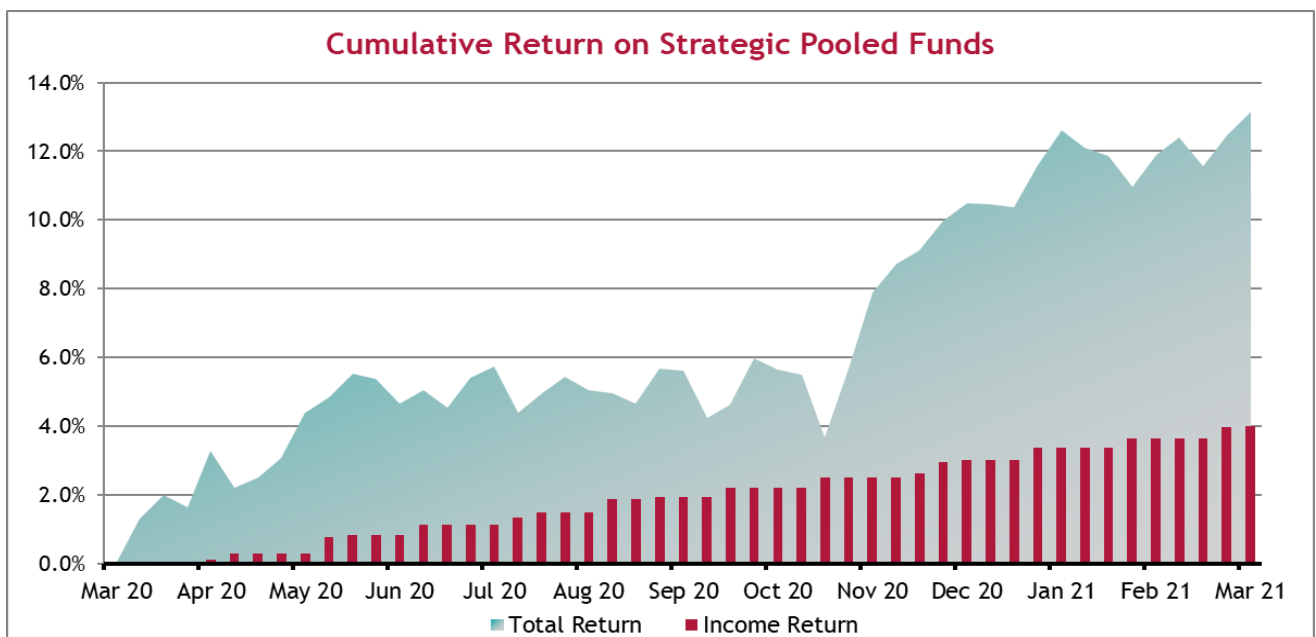
Investment Fund		31.3.20	2020-21	28.2.21	28.2.21	
	Book cost	Market Value	Movement	Market Value	11 months return	
					Income	Total
	£m	£m	£m	£m	%	%
Aegon (Kames) Diversified Monthly Income Fund	20.0	16.9	2.85	19.75	4.09	20.93
CCLA - Diversified Income Fund	5.0	4.6	0.32	4.92	2.81	10.57
CCLA – LAMIT Property Fund	60.0	57.9	0.81	57.09	4.00	2.63
Fidelity Global Multi Asset Income Fund	25.0	23.7	0.77	24.47	4.21	7.44
Investec Diversified Income Fund	10.0	9.2	3.05	12.25	2.75	45.57

M&G Global Dividend Fund	10.0	8.6	1.50	10.10	3.76	13.59
Pyrford Global Total Return Sterling Fund	5.0	4.7	0.29	4.99	1.80	7.62
Schroder Income Maximiser Fund	25.0	15.8	3.24	19.04	8.58	29.30
Threadneedle Global Equity Income Fund	10.0	8.4	2.14	10.54	3.35	28.26
Threadneedle UK Equity Income Fund	10.0	7.6	1.86	9.46	3.42	28.14
Total Externally Managed Investments	180.0	157.3	15.31	172.61	4.26	13.96

7.3 A breakdown of the external investments by asset class is as follows:



7.4 The following chart tracks the returns earned on the pooled funds over the 11 months.



- 7.5 Because the pooled funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives are regularly reviewed.
- 7.6 Strategic pooled fund investments are made in the knowledge that capital values will fluctuate however the Council is invested in these funds for the long term and with the confidence that over a three to five year period total returns will exceed cash interest rates.

8 Investment benchmarking at 31 December 2020

- 8.1 The Council's treasury advisor, Arlingclose, monitors the risk and return of some 130 local authority investment portfolios. The metrics over the 9 months to 31 December 2020 have been extracted from their quarterly investment benchmarking.
- 8.2 As shown in the table below the risk within the Kent internally managed funds has been consistent throughout the 9 month period while being lower than that of other local authorities. The income return has fallen reflecting reduced rates payable on our cash investments.

Internally managed investments	Credit Score	Credit Rating	Bail-in Exposure %	Weighted Average Maturity (days)	Rate of Return %
Kent - 31.03.2020	3.02	AA	39	349	2.42
Kent – 31.12.2020	3.51	AA-	37	224	0.25
Similar LAs	4.40	AA-	45	879	0.37
All LAs	4.73	A+	63	17	0.16

- 8.3 The following table shows that overall KCC's investments in strategic pooled funds are achieving a strong income return compared with that of other local authorities. All authorities saw a fall in the capital values of their strategic funds during 2020 resulting in negative total returns for the year. The returns do not take account of the further improvement in the financial markets in the 3 months to 31 March 2021.

	Rate of Return – Income only %	Total Rate of Return %
Strategic Funds at 31.12.2020		
Kent	4.19	-6.09
Similar LAs	3.58	-4.25
All LAs	3.41	-4.02
Total Investments at 31.12.2020		
Kent	1.79	-0.59
Similar LAs	1.00	-0.12
All LAs	0.77	0.00

9 Forecast outturn

- 9.1 The forecast return on the Council's investment portfolio is £7m, 1.6%, which is used to support services in year.
- 9.2 The forecast average rate of debt interest payable in 2020-21 is 4.59%, based on an average debt portfolio of £879.3m.

10 Recommendation

10.1 Members are recommended to note this report.

Alison Mings

Acting Business Partner – Kent Pension Fund Ext: 03000 416488

March 2021

Investments as at 28 February 2021

1. Internally Managed Investments

1.1 Term deposits, Call accounts and Money Market Funds

Instrument Type	Counterparty	Principal Amount £	Interest Rate	End Date
Fixed Deposits	Conwy County Borough Council	5,000,000	0.17%	21/06/21
Fixed Deposits	Conwy County Borough Council	3,000,000	0.17%	30/06/21
Fixed Deposits	Conwy County Borough Council	3,000,000	0.17%	30/06/21
Fixed Deposits	Thurrock Borough Council	10,000,000	0.35%	04/05/21
Fixed Deposits	Thurrock Borough Council	10,000,000	0.35%	04/07/21
Fixed Deposits	Cheltenham Borough Council	5,000,000	0.12%	17/05/21
Fixed Deposits	London Borough of Waltham Forest	10,000,000	0.22%	04/05/21
Total Local Authority Deposits		46,000,000		
Fixed Deposits	DMADF (Debt Management Account Deposit Facility)	20,000,000	0.005%	10/03/21
Fixed Deposits	DMADF (Debt Management Account Deposit Facility)	20,000,000	0.005%	11/03/21
Total DMADF deposits		40,000,000		
Call Account	National Westminster Bank plc	75,000	0.01%	
Call Account	Santander UK plc	15,000,000	0.12%	
Call Account	Lloyds Bank plc	5,000,000	0.01%	
Total Bank Call Accounts		20,075,000		
No Use Empty Loans		5,173,000	1.5%	
Registered Provider	£10m loan facility – non utilisation fee		0.40%	31/03/23
Money Market Funds	Federated Short-term Sterling Prime Fund GBP KCC	948	0.50%	
Money Market Funds	SSgA GBP Liquidity Fund (Stable NAV)	5,553	0.01%	
Money Market Funds	HSBC Sterling Liquidity Fund	6,727	0.04%	
Money Market Funds	LGIM Sterling Liquidity Fund 4 KCC	17,594,984	0.01%	
Money Market Funds	Insight Liquidity Funds PLC	271	0.01%	
Money Market Funds	Aberdeen Liquidity Fund (Lux) KCC	19,996,509	0.42%	
Money Market Funds	Northern Trust Sterling Cash Fund	19,995,164	0.01%	
Money Market Funds	Aviva Investors Sterling Liquidity Fund 3 GBP Inc	948	0.06%	
Money Market Funds	Deutsche Managed Sterling Platinum	5,554	0.02%	
Total Money Market Funds		57,600,156		
Equity and Loan Notes	Kent PFI (Holdings) Ltd	2,325,225		n/a

1.2 Bond Portfolio

Bond Type	Issuer	Adjusted Principal	Coupon Rate	Maturity Date
		£		
Fixed Rate Covered Bond	Bank of Scotland	4,484,701	1.71%	20/12/2024
Fixed Rate Covered Bond	National Australia Bank	4,989,355	1.35%	10/11/2021
Fixed Rate Covered Bond	Leeds Building Society	4,203,756	1.29%	17/04/2023
Fixed Rate Covered Bond	Santander UK	3,133,306	0.65%	14/04/2021

Fixed Rate Covered Bond	Bank of Nova Scotia	4,996,900	0.88%	14/09/2021
Fixed Rate Covered Bond	National Australia Bank	3,000,636	1.10%	10/11/2021
Floating Rate Covered Bond	TSB Bank	2,502,518	0.88%	15/02/2024
Floating Rate Covered Bond	Lloyds	2,501,641	0.24%	27/03/2023
Floating Rate Covered Bond	Lloyds	2,502,190	0.24%	27/03/2023
Floating Rate Covered Bond	Nationwide Building Society	3,996,908	0.76%	10/01/2024
Floating Rate Covered Bond	Lloyds	4,500,000	0.65%	14/01/2022
Floating Rate Covered Bond	Australia and New Zealand Banking group	3,000,000	0.73%	24/01/2022
Floating Rate Covered Bond	Santander UK	2,002,022	0.74%	12/02/2024
Floating Rate Covered Bond	Nationwide Building Society	4,502,710	0.26%	12/04/2023
Floating Rate Covered Bond	Bank of Montreal	5,003,003	0.28%	17/04/2023
Floating Rate Covered Bond	Santander UK	3,750,250	0.23%	13/04/2021
Floating Rate Covered Bond	Lloyds	5,003,869	0.24%	27/03/2023
Floating Rate Covered Bond	Canadian Imperial Bank of Commerce	5,012,165	0.21%	10/01/2022
Floating Rate Covered Bond	Santander UK	5,001,516	0.49%	16/11/2022
Floating Rate Covered Bond	Nationwide Building Society	5,583,412	0.25%	12/04/2023
Total Bonds		79,670,858		

Total Internally managed investments	£ 250,844,244
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2. Externally Managed Investments

Investment Fund	Book Cost	Market Value at	8 months return to	
			28 February 2021	
			Income	Total
	£	£		
Aegon (Kames) Diversified Monthly Income Fund	20,000,000	19,747,434	4.09%	20.93%
CCLA - Diversified Income Fund	5,000,000	4,924,048	2.81%	10.57%
CCLA – LAMIT Property Fund	60,000,000	57,085,107	4.00%	2.63%
Fidelity Global Multi Asset Income Fund	25,038,637	24,467,319	4.21%	7.44%
Investec Diversified Income	10,000,000	12,250,961	2.75%	45.57%
M&G Global Dividend Fund	10,000,000	10,103,428	3.76%	13.59%
Pyrford Global Total Return Sterling Fund	5,000,000	4,986,803	1.80%	7.62%
Schroder Income Maximiser Fund	25,000,000	19,035,267	8.58%	29.30%
Threadneedle Global Equity Income Fund	10,000,000	10,544,063	3.35%	28.26%
Threadneedle UK Equity Income Fund	10,000,000	9,463,256	3.42%	28.14%
Total External Investments	180,038,637	172,607,686	4.26%	13.96%

3. Total Investments

Total Investments	£423,451,925
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GLOSSARY

Local Authority Treasury Management Terms

Bond	A certificate of long-term debt issued by a company, government, or other institution, which is tradable on financial markets
Borrowing	Usually refers to the stock of outstanding loans owed and bonds issued.
CFR	Capital Financing Requirement. A council's underlying need to hold debt for capital purposes, representing the cumulative capital expenditure that has been incurred but not yet financed. The CFR increases with capital expenditure and decreases with capital finance and MRP.
Capital gain or loss	An increase or decrease in the capital value of an investment, for example through movements in its market price.
Collective investment scheme	Scheme in which multiple investors collectively hold units or shares. The investment assets in the fund are not held directly by each investor, but as part of a pool (hence these funds are also referred to as 'pooled funds').
Cost of carry	When a loan is borrowed in advance of need, the difference between the interest payable on the loan and the income earned from investing the cash in the interim.
Counterparty	The other party to a loan, investment or other contract.
Counterparty limit	The maximum amount an investor is willing to lend to a counterparty, in order to manage credit risk.
Covered bond	Bond issued by a financial institution that is secured on that institution's assets, usually residential mortgages, and is therefore lower risk than unsecured bonds. Covered bonds are exempt from bail-in.
CPI	Consumer Price Index - the measure of inflation targeted by the Monetary Policy Committee.
Deposit	A regulated placing of cash with a financial institution. Deposits are not tradable on financial markets.
Diversified income fund	A collective investment scheme that invests in a range of bonds, equity and property in order to minimise price risk, and also focuses on investments that pay income.
Dividend	Income paid to investors in shares and collective investment schemes. Dividends are not contractual, and the amount is therefore not known in advance.
DMADF	Debt Management Account Deposit Facility – a facility offered by the DMO enabling councils to deposit cash at very low credit risk. Not available in Northern Ireland.
DMO	Debt Management Office – an executive agency of HM Treasury that deals with central government's debt and investments.
Equity	An investment which usually confers ownership and voting rights
Floating rate note (FRN)	Bond where the interest rate changes at set intervals linked to a market variable, most commonly 3-month LIBOR or SONIA
FTSE	Financial Times stock exchange – a series of indices on the London Stock Exchange. The FTSE 100 is the index of the largest 100 companies on the exchange, the FTSE 250 is the next largest

	250 and the FTSE 350 combines the two
GDP	Gross domestic product – the value of the national aggregate production of goods and services in the economy. Increasing GDP is known as economic growth.
Income return	Return on investment from dividends, interest and rent but excluding capital gains and losses.
GILT	Bond issued by the UK Government, taking its name from the gilt-edged paper they were originally printed on.
LIBID	London interbank bid rate - the benchmark interest rate at which banks bid to borrow cash from other banks, traditionally 0.125% lower than LIBOR.
LIBOR	London interbank offer rate - the benchmark interest rate at which banks offer to lend cash to other banks. Published every London working day at 11am for various currencies and terms. Due to be phased out by 2022.
LOBO	Lender's Option Borrower's option
MMF	Money Market Funds. A collective investment scheme which invests in a range of short-term assets providing high credit quality and high liquidity. Usually refers to Constant Net Asset Value (CNAV) and Low Volatility Net Asset Value (LVNAV) funds with a Weighted Average Maturity (WAM) under 60 days which offer instant access, but the European Union definition extends to include cash plus funds
Pooled Fund	Scheme in which multiple investors hold units or shares. The investment assets in the fund are not held directly by each investor, but as part of a pool (hence these funds are also referred to as 'pooled funds').
PWLB	Public Works Loan Board – a statutory body operating within the Debt Management Office (DMO) that lends money from the National Loans Fund to councils and other prescribed bodies and collects the repayments. Not available in Northern Ireland.
Quantitative easing (QE)	Process by which central banks directly increase the quantity of money in the economy to promote GDP growth and prevent deflation. Normally achieved by the central bank buying government bonds in exchange for newly created money.
SONIA	Sterling overnight interest average – a benchmark interest rate for overnight deposits.
Short-dated	Usually means less than one year
Total return	The overall return on an investment, including interest, dividends, rent, fees and capital gains and losses.