From:	Peter Oakford, Deputy Leader and Cabinet Member for Finance, Traded and Corporate Services Zena Cooke, Corporate Director of Finance
To:	Governance and Audit Committee – 22 September 2021
Subject:	**TREASURY MANAGEMENT UPDATE**
Classification:	Unrestricted

Summary

This report provides an overview of Treasury Management activity and developments in 2021-22 up to the end of July 2021.

Recommendation

The Committee is recommended to note the report

FOR INFORMATION

Introduction

1. The Council's Treasury Management Strategy for 2021-22 was approved by full Council on 11 February 2021.

2. The Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management Code (CIPFA's TM Code) requires that authorities report on the performance of their treasury management function at least twice yearly (mid-year and at year end). This report provides an additional quarterly update as set out in the Council's Treasury Management Strategy.

3. 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.

Monthly activity report

4. A monthly report is circulated to members of the Treasury Management Advisory Group and a copy of the July 2021 report is attached at appendix 1.

External Context

5. Economic resurgence from the coronavirus pandemic continued to dominate the first quarter of the financial year as the vaccine programme was rolled out across the UK.

6. At its meeting on 4 August 2021 the Monetary Policy Committee (MPC) held Bank Rate at 0.1% throughout the period and maintained its Quantitative Easing programme at £895 billion, unchanged since the November 2020 meeting. The MPC expects GDP growth to continue into the latter half of the year, albeit at a slightly slower pace than predicted in the May report with a forecast of 3% growth in Q3. The reason for the slightly more pessimistic forecast is the recent minor negative developments in the pandemic such as large numbers of workers being asked to self-isolate. The Committee maintains its forecast for gross domestic product (GDP) to reach pre-pandemic levels by the end of the year before contractionary fiscal policy begins to slow the rate of growth going forward.

7. Government initiatives continued to support the economy over the period, following the range of measures announced by the Chancellor in the 2021 Budget, which included extending the furlough (Coronavirus Job Retention) scheme until September 2021.

8. The latest labour market data showed that in the three months to June 2021 the unemployment rate fell to 4.7% and growth in average total pay (including bonuses) and regular pay (excluding bonuses) among employees was 5.2% for this period. The seemingly high growth partly reflected a base effect from a decline in average pay in the spring of last year, associated with the reduced pay of employees on the furlough scheme.

9. Annual CPI inflation was lower than expected at 2.0% year on year to July down from 2.5% in June due to lower prices in the recreation and culture sectors offset by higher transport prices. The Bank of England expects inflation to exceed 3% for a temporary period. The CPIH which is CPI including owner-occupied housing was 2.1% year/year, also lower than expectations.

10. Early estimates suggested that GDP increased by 4.8% in the second quarter of 2021. The largest contributor to this growth in GDP was household consumption likely to be due to the gradual easing of lockdown restrictions over the period. There were also increases in every other main component of GDP except for trade.

11. Ongoing monetary and fiscal stimulus together with improving economic growth prospects and successful vaccine rollout programmes continued to boost equity markets over the period. The Dow Jones reached a record high during the period while the UK-focused FTSE 250 index was back above pre-pandemic levels and the more internationally focused FTSE 100 had recouped around three-quarters of 2020 losses.

12. Inflation worries continued during the period but declines in bond yields between April and June suggest bond markets may be expecting any general price increases to be less severe, or more transitory, that was previously thought.

13. The 5-year UK benchmark gilt yield began the financial year at 0.36% before declining to 0.32% by the end of June 2021. Over the same period the 10-year gilt yield fell from 0.80% to 0.71%, despite jumping to 0.90% in May. The 20-year yield declined from 1.31% to 1.21%.

14. 1-month, 3-month and 12-month SONIA bid rates averaged 0.03%, 0.02% and 0.15% respectively over the period.

15. The successful vaccine rollout programme is credit positive for the financial services sector in general, but there remains much uncertainty around the extent of the losses banks and building societies will suffer due to the economic slowdown which has resulted due to pandemic-related lockdowns and restrictions. We continue to keep the institutions and durations on the Council's counterparty list recommended by treasury management advisors Arlingclose under constant review.

Local context

16. At 31 March 2021 the Council had borrowed £853.7m and invested £502.0m 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. The Council's current strategy is to maintain borrowing and investments below their underlying levels, known as internal borrowing, in order to reduce risk and keep interest costs low. This strategy is regularly reviewed with the Council's treasury advisors taking account of capital spending plans and available cash resources.

Borrowing Strategy during the period

17. At 31 July 2021 the Council held £851.4m of loans and details of this debt is shown in the table at paragraph 1.1 of Appendix 1.

18. 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 Authority's long-term plans change being a secondary objective.

19. In keeping with these objectives no new borrowing was undertaken while £2.3m of existing loans were allowed to mature without replacement. This strategy enabled the Council to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

20. 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.

Treasury investment activity

21. The Council's average investment balances to date have amounted to £556.5m**,** representing income received in advance of expenditure plus balances and reserves held. Forecast cash balances are shown in the graph at paragraph 2.1 in appendix 1.

22. 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.

23. The Council's investments during the 4 months to the end of July are summarised in the table at paragraph 3.2 in appendix 1 and a detailed schedule of investments as at 31 July is attached in Appendix 2.

Internally managed investments

24. Given the ongoing uncertainty around its cash flows 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.

25. Deposit rates with the Debt Management Account Deposit Facility (DMADF) are now largely around zero while the net return on Money Market Funds net of fees, which had fallen after Bank Rate was cut to 0.1% in March 2020, are also now at or very close to zero. Fund management companies have temporarily lowered or waived fees to avoid negative net returns.

26. At 31 July the Council had lent £14m to other local authorities (31 March 2021 £51m) with a maximum duration of 6 months. Lending opportunities have been limited and any loans are made taking account of the risks associated with the local authority as assessed by the Head of Finance (Policy, Planning and Strategy).

27. During the 4 months the Council loaned £3.5m to the no use empty loans programme. At 31 July the total lent totalled £9.1m achieving a return of 1.5% which is available to fund general services. £20.m of covered bonds were purchased in the 4 months bringing the total bond portfolio up to the £100m limit per the treasury strategy. These are tradeable, have the benefit of collateral cover and pay an above base rate return.

28. The progression of credit risk and return metrics for KCC's investments are shown in the extract from Arlingclose's quarterly investment benchmarking in the table below.

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Income Rate of Return
31.03.2021	3.76	AA-	53%	146	1.70%
30.06.2021	3.39	AA	31%	160	1.54%
Similar LAs	4.23	AA-	45%	1,101	0.94%
All Las	4.64	A+	67%	12	0.82%

29. The full summary of the investment benchmarking results is at paragraph 5.2 in appendix 1

Externally Managed Investments

30. The Council has invested in equity, multi-asset and property funds. Since March 2021 there has been further improvement in market sentiment which is reflected in an increase in the capital values of the funds, as shown in the table below. In line with previous reports we have shown the returns over 12 month period. However, it is worth noting that the total return between July 2020 and July 2021 includes the recovery on equity funds following reductions in the immediate aftermath of the first Covid-19 lockdown and therefore not representative of normal expected growth patterns.

Investment Fund		31.3.21	2021-22	31.7.21	31.7.21	
	Book cost	Market Value	Movement	Market Value	12 month return	
					Income	Total
	£m	£m	£m	£m	%	%
Aegon (Kames) Diversified Monthly Income Fund	20.0	20.2	0.0	20.2	4.70%	12.46%
CCLA - Diversified Income Fund	5.0	5.0	0.2	5.2	3.05%	9.69%
CCLA – LAMIT Property Fund	60.0	57.1	3.1	60.2	4.13%	12.89%
Fidelity Global Multi Asset Income Fund	25.0	24.7	0.1	24.8	4.30%	4.27%
Investec Diversified Income Fund	10.0	12.2	0.5	12.7	3.65%	30.38%

M&G Global Dividend Fund	10.0	10.1	0.0	10.1	4.27%	6.36%
Pyrford Global Total Return Sterling Fund	5.0	5.0	0.0	5.0	1.94%	3.97%
Schroder Income Maximiser Fund	25.0	19.4	0.1	19.5	8.11%	30.53%
Threadneedle Global Equity Income Fund	10.0	10.9	0.1	11.0	3.28%	23.39%
Threadneedle UK Equity Income Fund	10.0	9.6	0.6	10.2	3.65%	29.20%
Total Externally Managed Investments	**180.0**	**174.1**	**4.8**	**178.9**	**4.40%**	**14.99%**

31. 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 Authority's investment objectives are regularly reviewed.

32. Strategic 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.

Estimates for income 2020-21

33. The average rate of return on the Council's portfolio is 1.53% that equates to £7.7m a year which is used to support services in year.

Recommendation

34. Members are asked to note this report.

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