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| To: | Governance and Audit Committee – 8 October 2020 |
| Subject: | **TREASURY MANAGEMENT UPDATE** |
| Classification: | Unrestricted |
| Summary:<br><br>**FOR ASSURANCE** | To report a summary of Treasury Management activity |

## INTRODUCTION

1. This report covers Treasury Management activity and developments in 2020-21 up to the end of July.

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's Treasury Management Strategy for 2020-21 was approved by full Council on 13 February 2020.

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.

## MONTHLY ACTIVITY REPORT

5. A monthly report is circulated to members of the Treasury Management Advisory Group and a copy of the July 2020 report is attached at appendix 1.

## EXTERNAL CONTEXT

6. The global economic impact from coronavirus has taken centre stage since March 2020. The measures taken to stop the spread of the pandemic included the government implementing a nationwide lockdown in late March which effectively shut down almost the entire UK economy. These measures continued throughout most of the period covered by this report with only some easing of restrictions at the end of May and into June. The global economic fallout has also been substantial.

7. In the UK the Bank Rate was maintained at 0.1% and in June the Bank of England increased the asset purchase scheme by £100 billion, taking the recent round of Quantitative Easing (QE) to £300bn and total QE to £745 billion.

8. At the same time, the UK government also implemented a range of fiscal stimulus measures totalling over £300 billion which had been announced in March and designed to dampen the effect of the pandemic on the labour market.

9. The UK has officially entered a recession as GDP fell by 20.4% in April to June 2020 following a fall of 2% in January to March with widespread contractions across all the main sectors of the economy. GDP grew by 8.7% in June 2020 and in July it grew again by 6.6% but July monthly GDP was still 11.7% lower than the pre-pandemic levels seen in February 2020 as the services, production and construction sectors remained lower.

10. The headline rate of UK Consumer Price Inflation (CPI) was 1.1% in July up from 0.8% in June 2020 but still well below the Bank of England's 2% target.

11. In the three months to June, labour market data remained largely unchanged on the previous quarter. This is likely to be due to the government's furlough scheme as more than a quarter of the UK workforce was estimated to be supported by it. However, employers had to contribute towards furlough payments from August and the scheme is due to stop at the end of October so unemployment is expected to rise as a result.

12. After selling off sharply in March, global equity markets started recovering in April and while still down on their pre-crisis levels, the FTSE 100 and 250 have made up around half of the losses while the Dow Jones index has significantly recovered. Measures implemented by central banks and governments continue to maintain some degree of general investor confidence, however volatility remains.

13. Ultra-low interest rates and the flight to quality continued to keep gilts yields low over the period with the yield on some short-dated government bonds turning negative. The 5-year UK benchmark gilt yield dropped from 0.18% at the beginning of April 2020 to -0.06% on 30 June. The 10-year benchmark gilt yield fell from 0.31% to 0.14% over the same period, and the 20-year from 0.69% to 0.52%. 1-month, 3-month and 12-month bid rates averaged 0.04%, 0.28% and 0.44% respectively over the quarter.

**LOCAL CONTEXT**

14. At 31 March 2020 KCC had net investments of £381m 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 UPDATE

15. The National Audit Office published a report in February 2020 which found that spending by local authorities on commercial property had significantly increased in the 3 years to 2018-19 and that some authorities have been borrowing large sums mainly from the Public Works Loan Board (PWLB) to invest in commercial property much of it out of area.

16. The Chancellor’s March 2020 Budget statement included significant changes to PWLB policy and launched a wide-ranging consultation on the PWLB’s future direction.

17. 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.

18. Responses were due by 31 July 2020 and Kent submitted a response broadly supportive of the proposed changes.

## BORROWING STRATEGY ACTIVITY

19. 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.

20. In keeping with these objectives no new borrowing was undertaken while £3.26m 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.

21. At 31 July 2020 the Council held £880m of loans and details of this debt is shown in the table at paragraph 1.1 of Appendix 1.

22. KCC 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

23. The Council's average investment balances to date have amounted to £378m, 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.

24. In March and April the Council received central government funding during the coronavirus pandemic through grants. £67m was received and temporarily invested in short-dated, liquid instruments such as call accounts and Money Market Funds. Most of these monies had been disbursed by the end of June.

25. 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.

26. 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.

27. At 31 July the Council had lent £46m to other local authorities (31 March 2020 £50m) with a maximum duration of 6 months. Loans are made taking account of the risks associated with the local authority as assessed by the Head of Finance (Policy, Planning and Strategy).

<u>Externally Managed Investments</u>

28. The council is invested in equity, multi-asset and property funds. Since March 2020 there has been some improvement in market sentiment which is reflected in an increase in capital values of the funds except for the CCLA property fund, as shown in the table below.

| **Investment Fund** | **Market Value at 31 March 2020** | **2020-21 Movement in market value** | **Market Value at 31 July 2020** | **4 months return to 31 July 2020** | |
|---|---|---|---|---|---|
| | | | | **Income** | **Total** |
| | **£m** | **£m** | **£m** | % | % |
| CCLA - Diversified Income Fund | 4.6 | 0.3 | 4.9 | 1.09 | 8.36 |
| CCLA – LAMIT Property Fund | 57.9 | -2.5 | 55.4 | 1.28 | -3.02 |
| Fidelity Global Multi Asset Income Fund | 23.7 | 1.1 | 24.8 | 1.72 | 6.19 |
| Investec Diversified Income Fund | 9.2 | 0.7 | 9.9 | 1.53 | 9.10 |

| | | | | | |
|---|---|---|---|---|---|
| Kames Diversified Monthly Income Fund | 16.9 | 1.9 | 18.8 | 1.41 | 12.37 |
| M&G Global Dividend Fund | 8.6 | 1.4 | 10.0 | 0.92 | 17.87 |
| Pyrford Global Total Return Sterling Fund | 4.7 | 0.2 | 4.9 | 0.76 | 4.56 |
| Schroder Income Maximiser Fund | 15.8 | 0.1 | 15.9 | 0.02 | 0.84 |
| Threadneedle Global Equity Income Fund | 8.4 | 0.8 | 9.2 | 2.06 | 11.02 |
| Threadneedle UK Equity Income Fund | 7.6 | 0.5 | 8.1 | 0.86 | 7.66 |
| **Total Externally Managed Investments** | **157.3** | **4.5** | **161.8** | 1.23 | 4.08 |

29. Like many other property funds, dealing in the CCLA Local Authorities Property Fund was suspended in March 2020 as it was not possible for valuers to be confident that their valuations correctly reflected prevailing conditions. The temporary suspension remained in force on 31 July.

30. 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.

31. 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

32. The average rate of return on the Council's portfolio is 1.81% that equates to £7m a year which is used to support services in year.

33. In 2020-21 the Council expects to receive lower income from its cash and short-dated money market investments and from its externally managed funds than it did in 2019-20 and earlier years.

## RECOMMENDATION

34. Members are asked to note this report for assurance.

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