

Chichester District Council

The Cabinet

8 September 2020

2019-2020 Treasury Management outturn report

1. Contacts

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2. Recommendation

2.1 The Cabinet is requested to consider the Treasury activity summarised in this report, taking into account any comments provided by the Corporate Governance and Audit Committee.

2.2 The Cabinet is also requested to consider the assessment of the security of the Council's direct investments in commercial property.

3. Overall position

3.1 This report describes the Treasury Management activity undertaken for the year to 31 March 2020, which can mainly be split into two separate periods. Prior to the COVID-19 pandemic, the Council:

- balanced short-term investments between high credit quality banks, local authorities and money market pooled funds; and,
- made further investments in external pooled funds in line with the Council's 2019-20 Treasury strategy.

Since February 2020 the Council's Treasury team has focussed on:

- maximising the amount of liquidity available to the Council, whilst remaining within approved institutional investment limits;
- Securely managing the cash flows associated with Business Relief grants for which the Council was forward funded by the Government in early April 2020; and,
- Scenario planning and modelling cash flows for the next 12 months based on the evolving effects of the national and local responses to COVID-19.

3.2 The position at year end is summarised in Tables 1 and 2, below

Table 1: Treasury Management Summary

| Investments £000 | Balance 01/04/2019 | Movement | Balance 31/03/2020 |
|---------------------------------|-------------------------------|-----------------|-------------------------------|
| Short term Investments | 39,000 | (4,000) | 35,000 |
| Money Market Funds | 4,350 | 1,700 | 6,050 |
| Total liquid investments | 43,350 | (2,300) | 41,050 |
| Long term Investments | 3,000 | (3,000) | - |
| Pooled Funds – External | 7,950 | 16,050 | 24,000 |
| Pooled funds – Local Authority | 10,000 | - | 10,000 |
| Property fund | | | |
| Total investments | 64,300 | 10,750 | 75,050 |

Note: the figures in the table above exclude any movements in Fair value.

Table 2: Gains and losses from external pooled funds (£000) – 31 March 2020

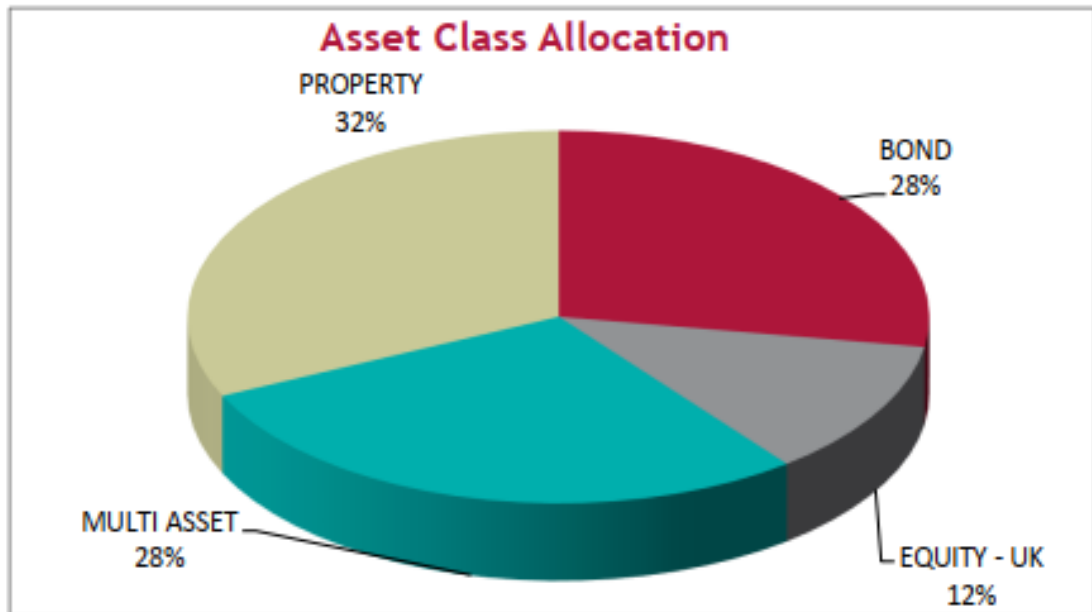
| Fund | Type of fund | Invested £000 | Capital gain (loss) | 31.3.20 Market Value | Latest Market Value 7 Aug 2020 | Income 19-20 £k | Return (Income %) |
|--|-------------------------|--------------------------|------------------------------------|-------------------------------------|---|--------------------------------|----------------------------------|
| Local Authority Property Fund | Property | 10,000 | (485) | 9,515 | 9,105 | 426 | 4.26 |
| Ninety-One Diversified Income Fund | Multi Asset | 5,000 | (544) | 4,456 | 4,786 | 163 | 4.10 |
| Columbia Threadneedle Strategic Bond Fund | Bonds | 2,650 | (216) | 2,434 | 2,682 | 65 | 2.48 |
| Kames Diversified Income | Multi Asset | 5,000 | (960) | 4,040 | 4,484 | 62 | 4.30 |
| M&G Strategic Corporate Bond fund | Bonds | 4,000 | (419) | 3,581 | 4,015 | 32 | 3.58 |
| Schroder Income Maximiser | Equity | 5,000 | (1,470) | 3,530 | 3,623 | 103 | 5.49 |
| Columbia Threadneedle – short dated bond fund | Bonds | 2,350 | (154) | 2,196 | 2,354 | 16 | 1.86 |
| Totals | | 34,000 | (4,248) | 29,752 | 31,049 | 865 | |

3.3 Alongside other property funds, dealing (i.e. buying or selling units) in the CCLA Local Authorities Property Fund was suspended in March 2020. The relative infrequency of property transactions in March as the pandemic intensified meant that it was not possible for valuers to be confident that their valuations correctly reflected prevailing conditions. To avoid material risk of disadvantage to buyers, sellers and holders of units in the property fund, the management company was obliged to suspend transactions until the required level of certainty is re-established. The temporary suspension remains in force at the date of writing this report.

3.4 The Council's approach to these investments has been to develop a balanced portfolio of investments across asset types and using only those funds that projections showed were not required over the medium term (defined as 5 years). The Council's allocation of external investments across asset class is

shown below.

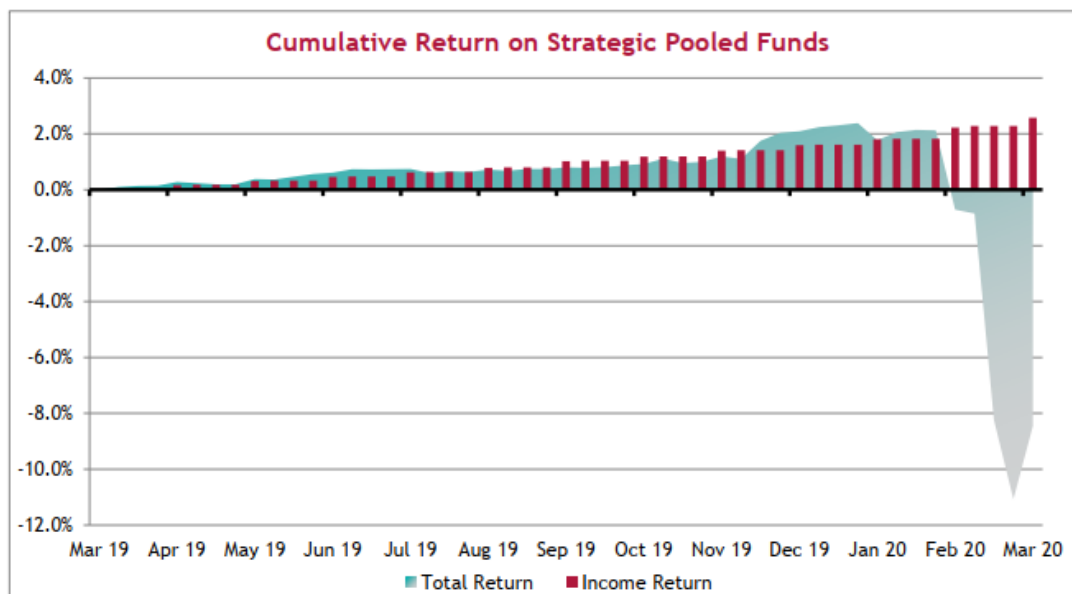
Exhibit 1: Asset class allocation 31 March 2020 External Funds



4. Impact of the COVID-19 pandemic

- 4.1 The Council's external pooled fund investments were subject to significant carried losses at 31 March 2020, almost entirely due to the global market reaction to the COVID-19 emergency, illustrated by exhibit 2 (overleaf).
- 4.2 The events occurring since early 2020 have, at least over the short term, significantly affected the Council's main income streams and officers continue to forecast possible changes for the Council's Treasury returns and liquidity.
- 4.3 It is likely that returns from our internal and external investments will fall in 2020-21 by around £0.5m. The drivers for this are set out in section 9.
- 4.5 On a positive note, Government support for the Council, particularly in the form of reimbursement for Business Rate Reliefs awarded since March 2020, has eased some of the pressure on the overall liquidity position

Exhibit 2: Funds cumulative return 2019-20



5. Other Non-Treasury Holdings and Activity

- 5.1 Although not classed as treasury management activity, the 2017 CIPFA Code now requires the Authority to report on investments held for policy reasons outside of normal treasury management.
- 5.2 The Authority continues to hold approximately £13.6m of investments in directly owned property. The 31 March 2020 valuation of one commercial investment showed a modest decrease in value against the purchase price. In these circumstances, the MHCLG's Investment Guidance requires an updated review of risks to the Council's ability to recover the invested principal for this investment.
- 5.3 The Council's risk assessment at present does not indicate any particular need to take action to mitigate the 'losses' at present. As with all investment valued on the basis of income generating potential, overall risk to security is subject to the market forces of supply and demand and the market conditions at the time of valuation. The short term risk to the Council remains the pressure on high street rents and the security of tenure.
- 5.4 In terms of recouping the principal of the investment, this is entirely dependent on how long we wish to hold the asset. The Council presently has no plans to dispose of the property which has an established tenant signed up to a long term lease. Theoretically, based on the income already received and the property's reported fair value, the aggregate value is higher than the capital initially invested.
- 5.5 Even prior to COVID-19 there were some vacant units within the Council's commercial property portfolio. Some retail premises, particularly Crane Street, have become partially vacant with three units unoccupied.
- 5.6 This was all pre-Covid19 and as such, officers are mindful there may be further reductions in our occupancy levels. Businesses have been hit hard and it is possible that some tenants will not be able to survive this crisis, despite our best

efforts. It could also impact our ability to attract new tenants as demand is likely to fall at least initially.

- 5.7 Further information on the performance of the Council's non-treasury investments is contained in appendix D.

6. Compliance Report

- 6.1 How Treasury activities complied with the Council's main 2020-21 Treasury limits is disclosed at Appendix C. There are no exceptions for the reporting period.

7. Other Developments

- 7.1 This section updates the Cabinet on relevant developments since the last report in earlier this year.

Review of external pooled fund investments

- 7.2 During Autumn 2019 the Council, supported by Arlingclose Ltd, completed a review of its present external fund investments and increased its total investments in external pooled funds during the final quarter of 2019 by:

- Investing a further £5m in a new diversified asset fund, bringing the total in diversified asset funds to £10m
- Investing £5m in a UK equities fund
- Increasing the total invested in corporate bond funds from £4.3m to £10m

- 7.3 Whilst the effects of COVID-19 are keenly felt at present, the fundamental structure of the Council investment portfolio, comprising a well-diversified selection of funds selected to comply with the Council's appetite for risk has not changed. The biggest risk at present is liquidity as set out in section 5, although the long term effects of COVID-19 on market values may come more into focus as end of the 5-year statutory override in respect of IFRS9 approaches and the potential impact on the Council's 2023-24 General Fund.

Proportionality of Commercial Income

- 7.4 During 2019-20 the Council reviewed potential indicators to measure the proportionality of commercial income generated by Chichester District Council. The Council determined that it expected income from commercial properties to remain below 10% of the Council's net cost of services.
- 7.5 In 2019-20 the Council's income from its commercial investments, net of direct costs was £963k, or 5.5% of the Council's net cost of services (£17,479k).

Treasury workshop for Members

- 7.6 A Treasury workshop for all Members was delivered on 16 December 2019 to help inform Members of the issues facing the Council in advance of approving the 2020-21 Treasury and Investment Strategy. A similar event will be held in

December 2020 in advance of the Council's consideration of the same for 2021-22

8. Alternatives Considered

8.1 None

9. Resource and Legal Implications

9.1 It is likely that returns from our internal and external investments will fall in 2020-21, mainly as a result of:

- (a) A reduction in internal cash investments due to short-term cash burn;
- (b) The Bank Base rate cut early in 2020; and,
- (c) Reduced returns on external pooled funds of between 20 to 50% as the corporate world conserves cash and/or defers shareholder distributions

9.2 In total these factors are likely to reduce income from Treasury investments by £0.5m to £1m for 2020-21.

9.3 The Council is required by the Accounts and Audit Regulations to comply with CIPFA's Code of Practice for Treasury Management and the Prudential Code for Capital Finance

10. Consultation

10.1 The key messages in this report were considered by the Council's Corporate Governance and Audit Committee on 1 September 2020 and a verbal update will be provided at Cabinet.

11. Community impact and corporate risks

11.1 Addressed in section 9.

12. Other Implications

| | Yes | No |
|---|-----|----|
| Crime and Disorder | | X |
| Climate Change and Biodiversity | | X |
| Human Rights and Equality Impact | | X |
| Safeguarding and Early Help | | X |
| General Data Protection Regulations (GDPR) | | X |
| Health and Wellbeing | | X |
| Other | | X |

13. Appendices

- A - Movements in Fund fair values and income – Pooled Funds
- B - Benchmarking indicators
- C - Compliance report
- D - Non Treasury investments

E – Outlook for the remainder of 2020-21

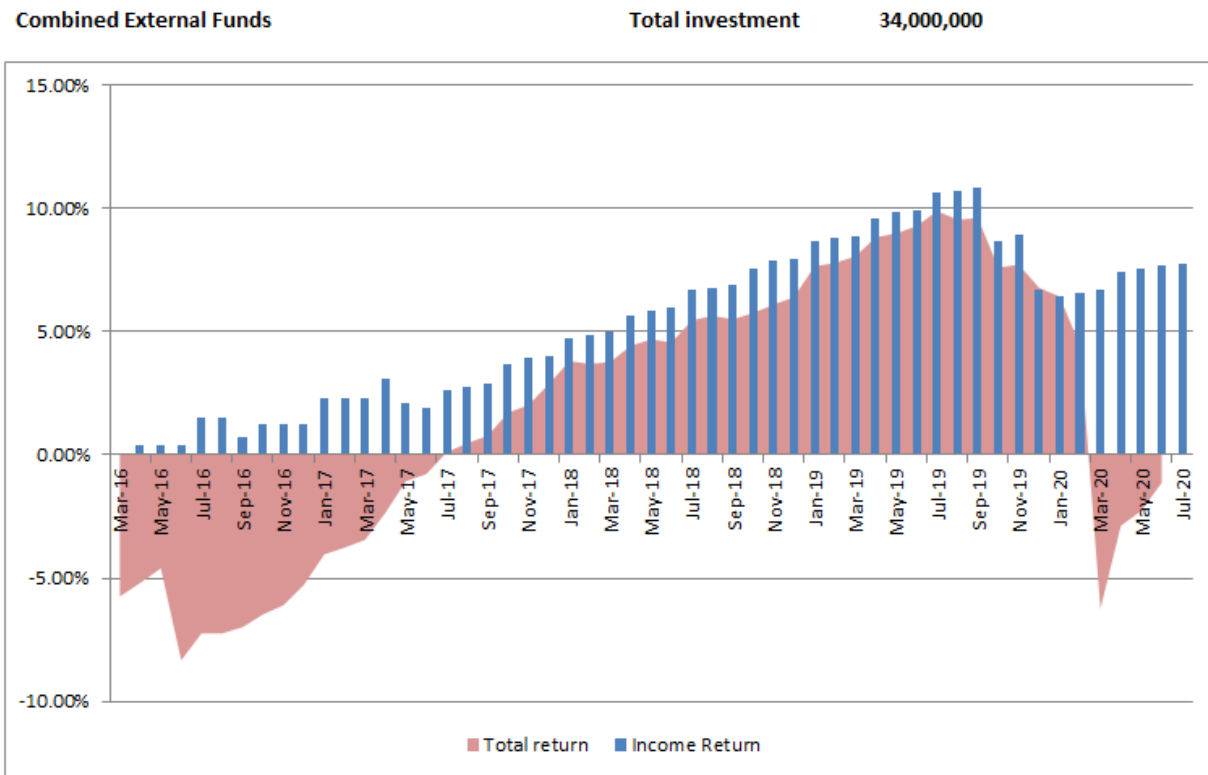
14. Background Papers

14.1 None.

Appendix A: Movements in Fund fair values and income – Pooled Funds

Combined position (all funds)

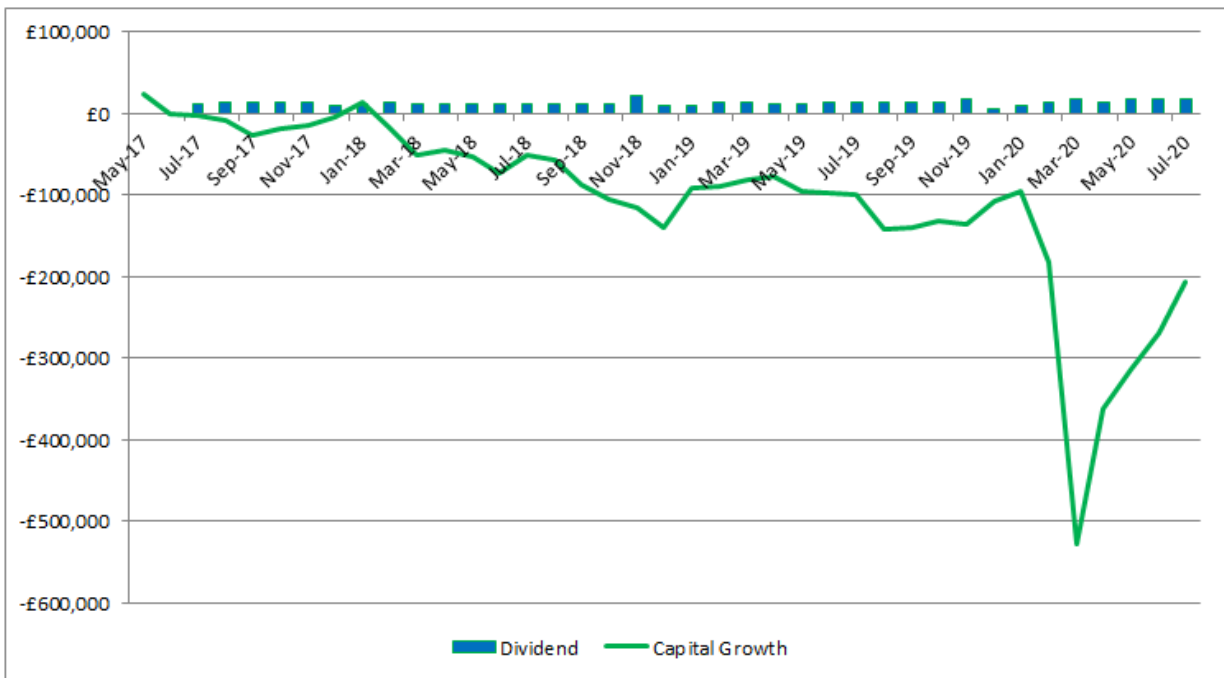
Cumulative returns – total and income only



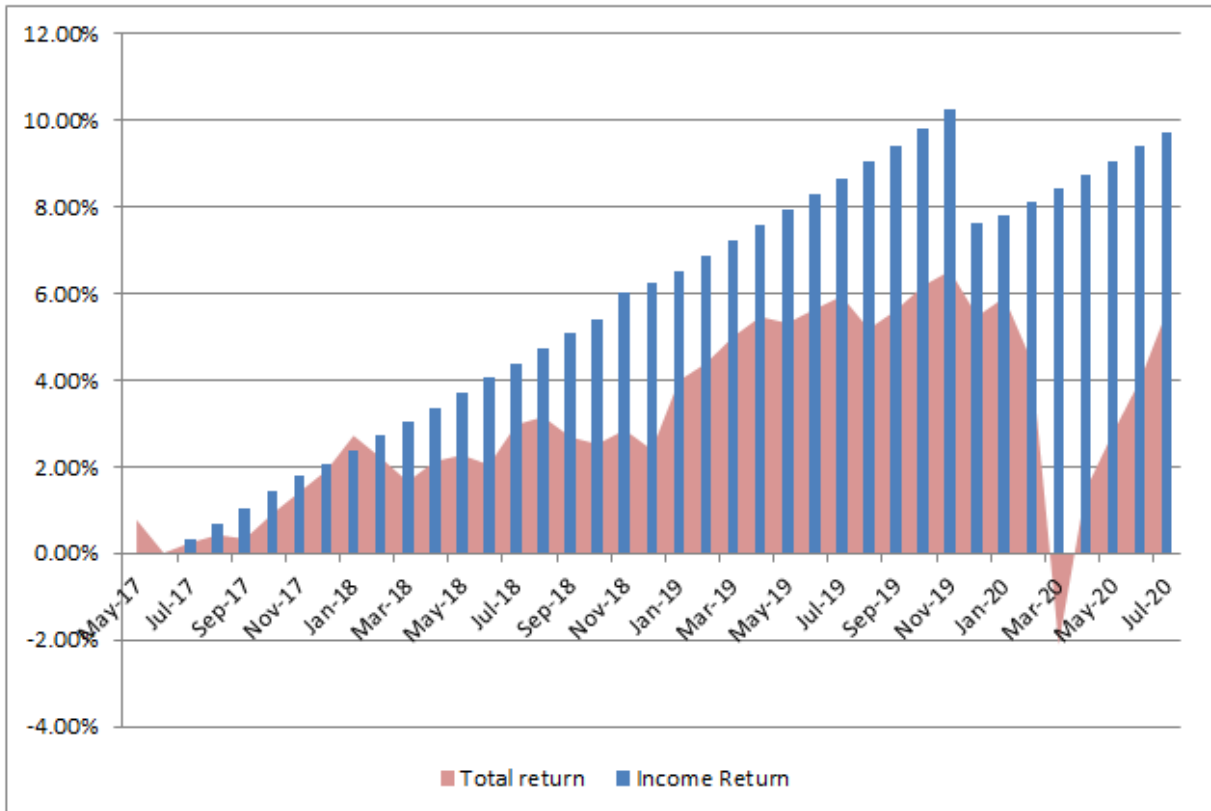
The income return (total distributions/ total investment) falls during late 2019 as a result of the additional investments made during this period.

Ninety One (Investec)

Month By Month



Cumulative

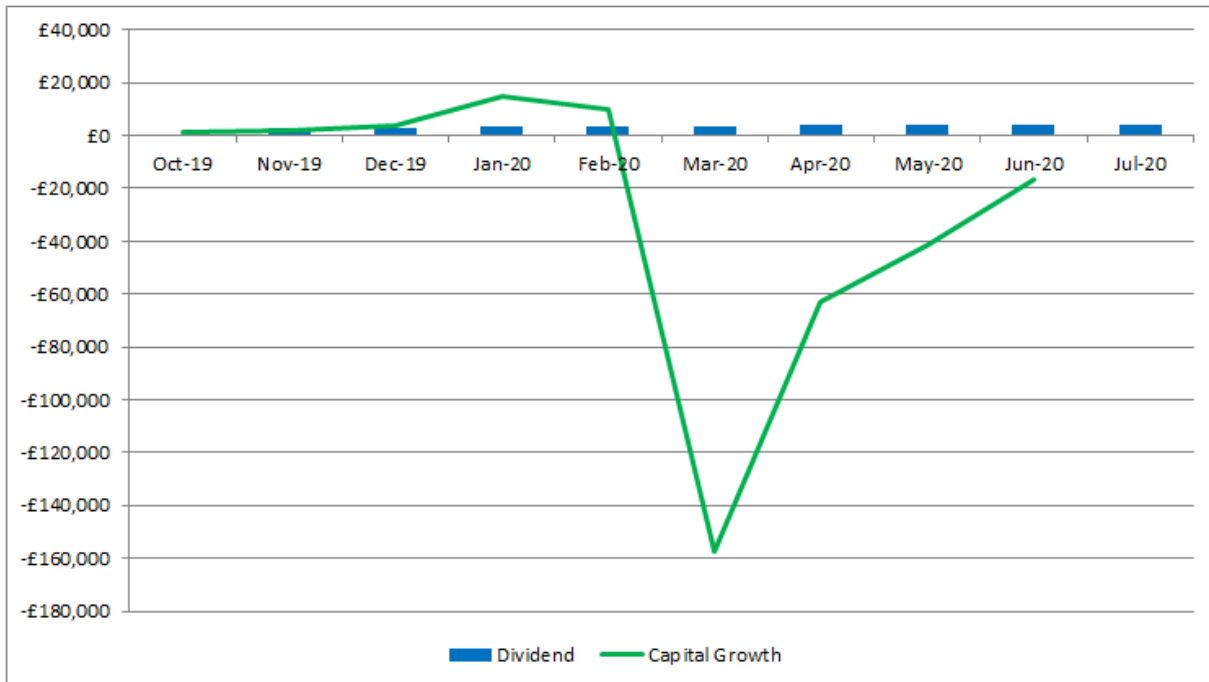


Further investments were made in this fund in late 2019.

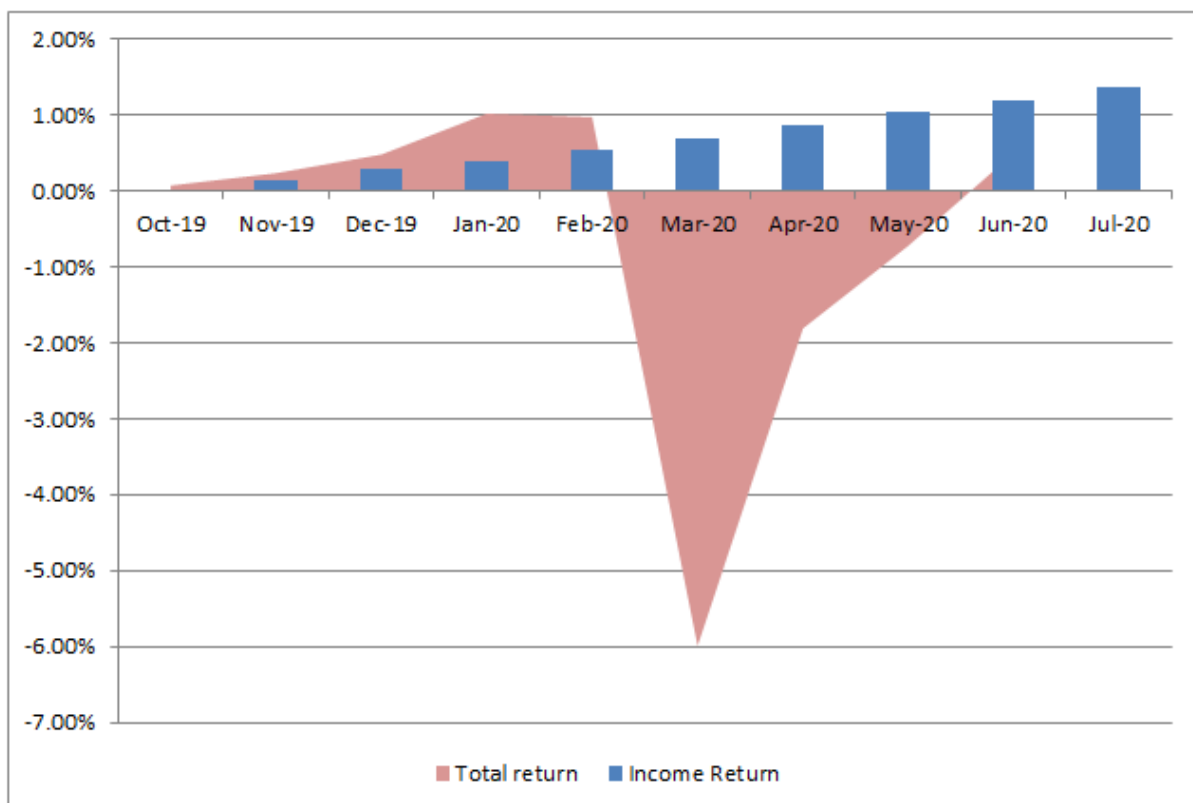
Columbia Threadneedle Short Dated Corporate Bond Fund
 New Investment during 2019-20

Month By Month

Threadneedle Sterling Short Dated Corporate Bond Fund Total investment £2,350,000



Cumulative



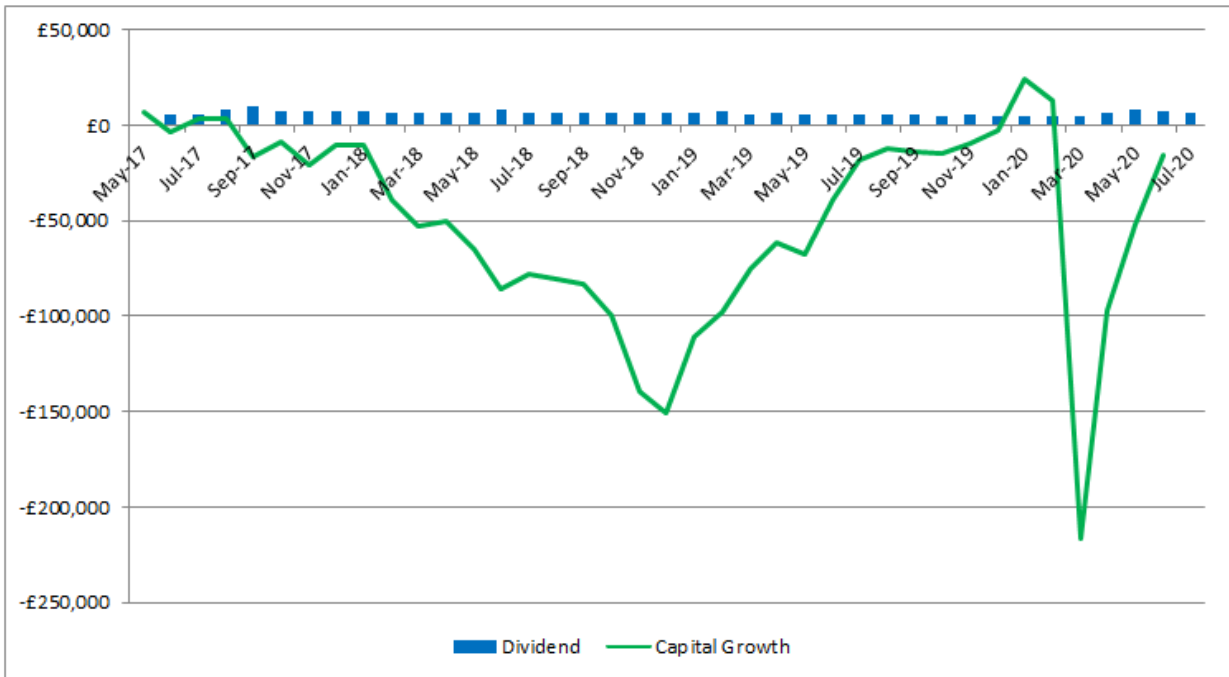
Columbia Threadneedle Strategic Bond Fund

Month By Month

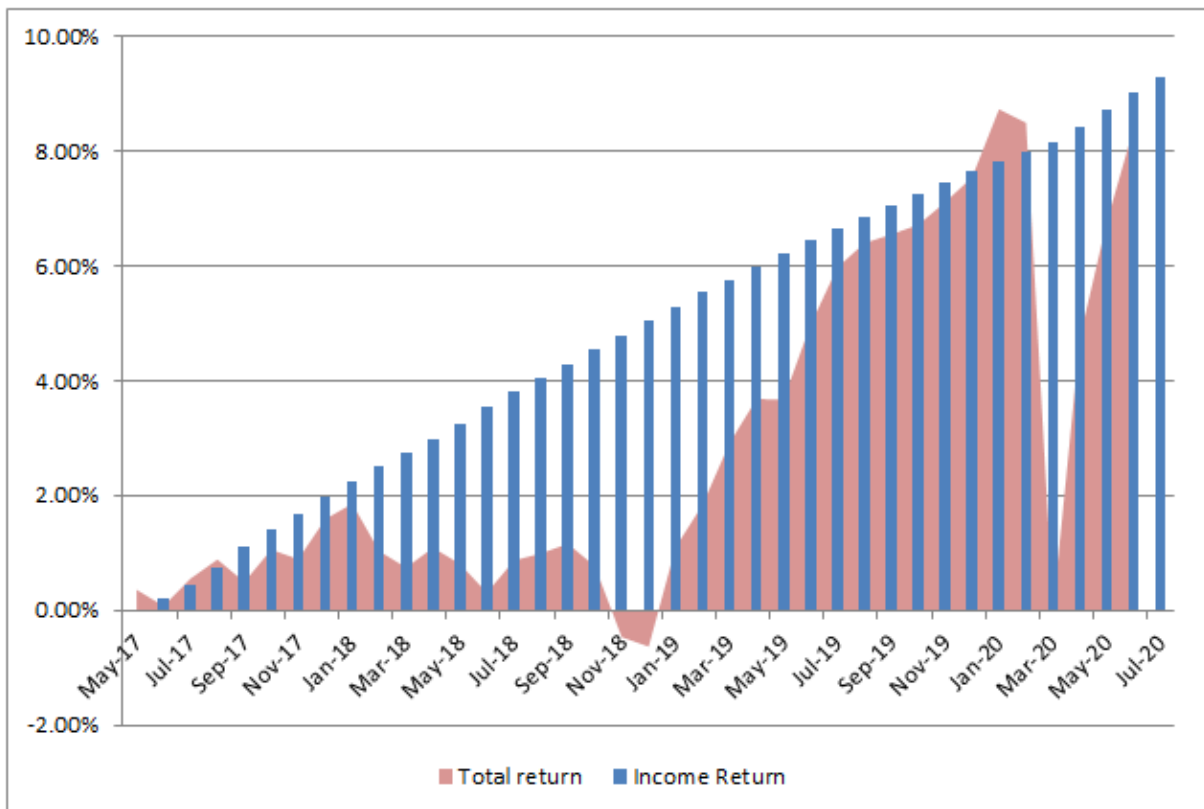
Threadneedle Strategic Bond Fund

Total investment

£2,650,000



Cumulative



M&G Strategic Corporate Bond Fund

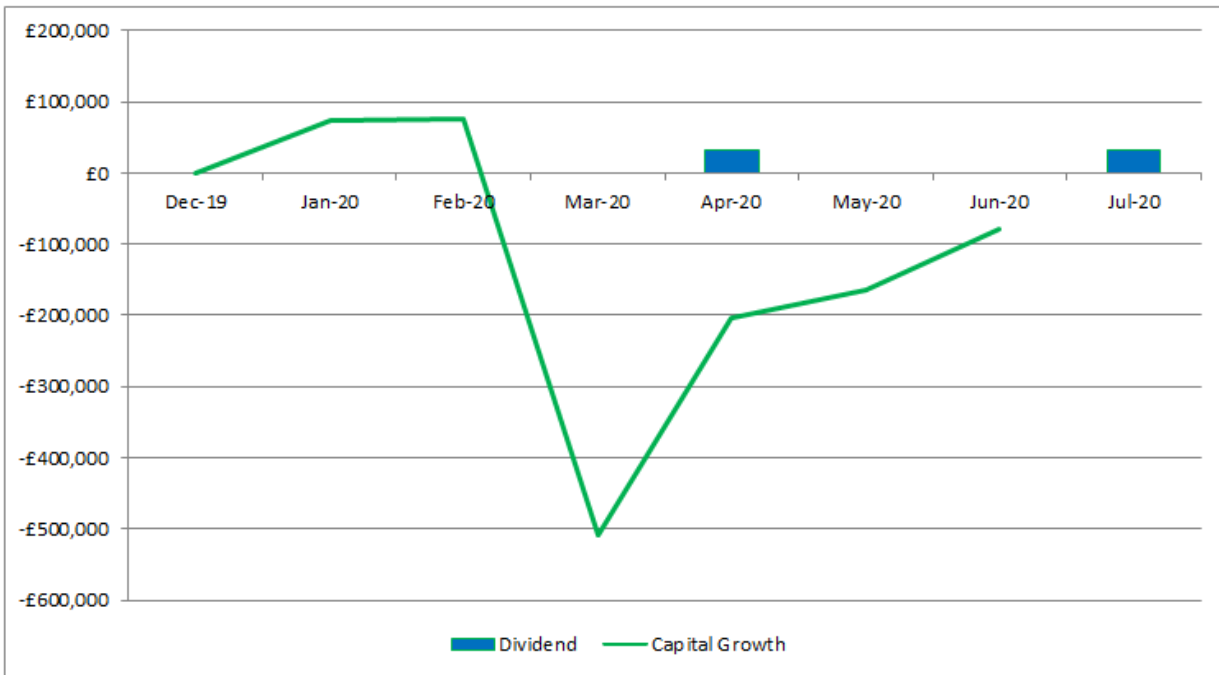
New Investment during 2019-20

Month By Month

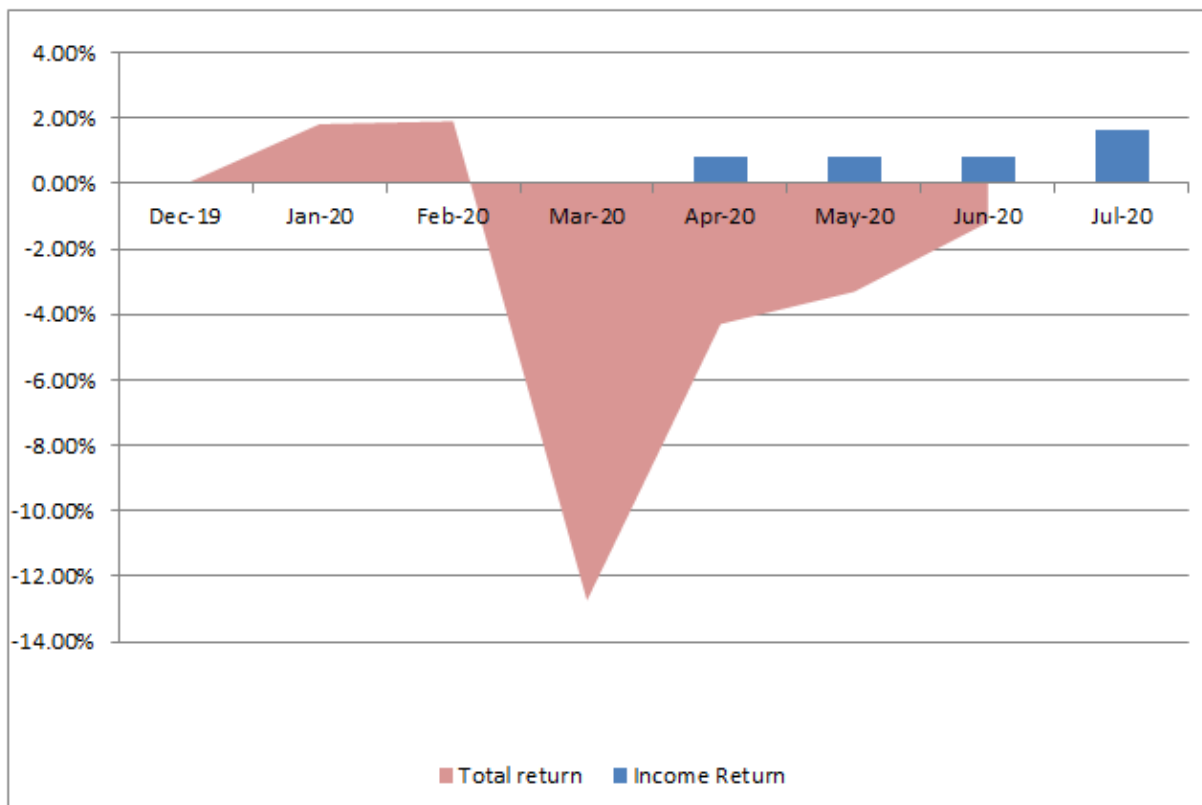
M&G Strategic Corporate Bond Fund

Total investment

£4,000,000



Cumulative

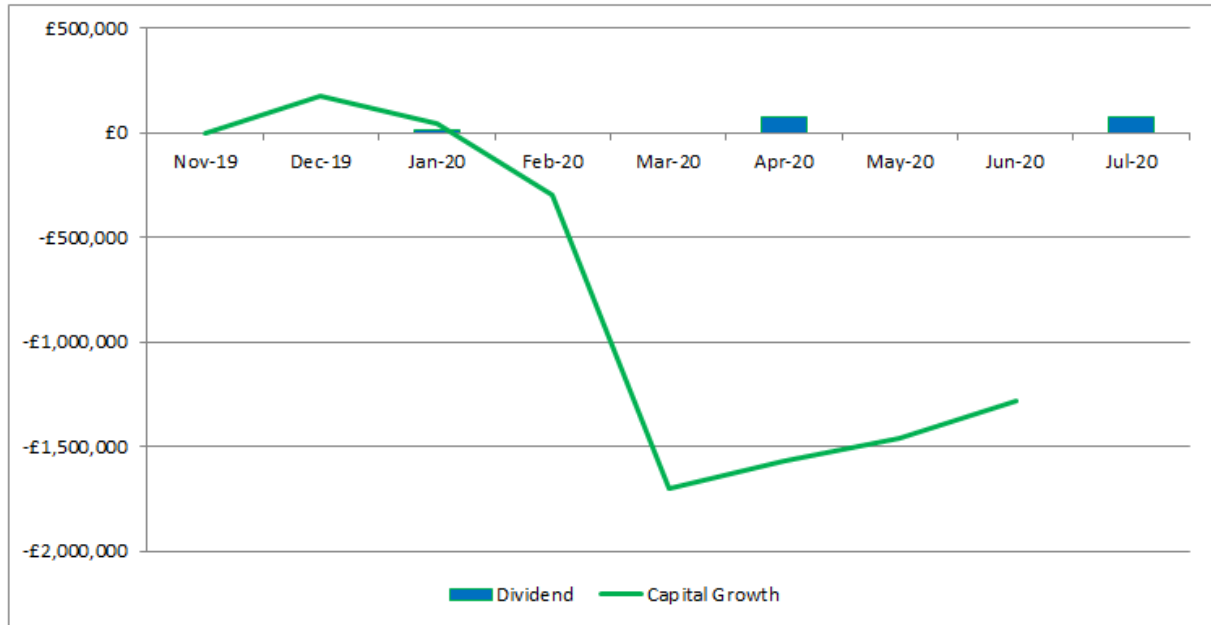


Schroder Income maximiser

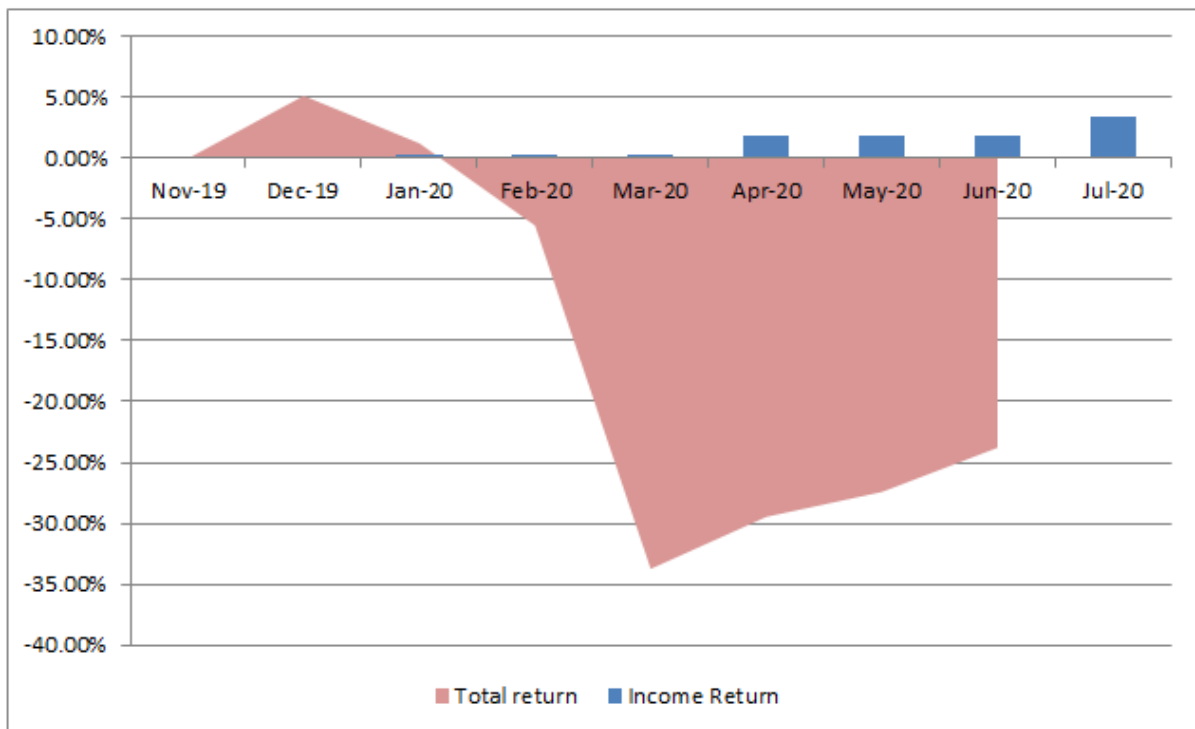
New Investment during 2019-20

Month By Month

Schroder Income Maximiser Z Total investment £5,000,000



Cumulative

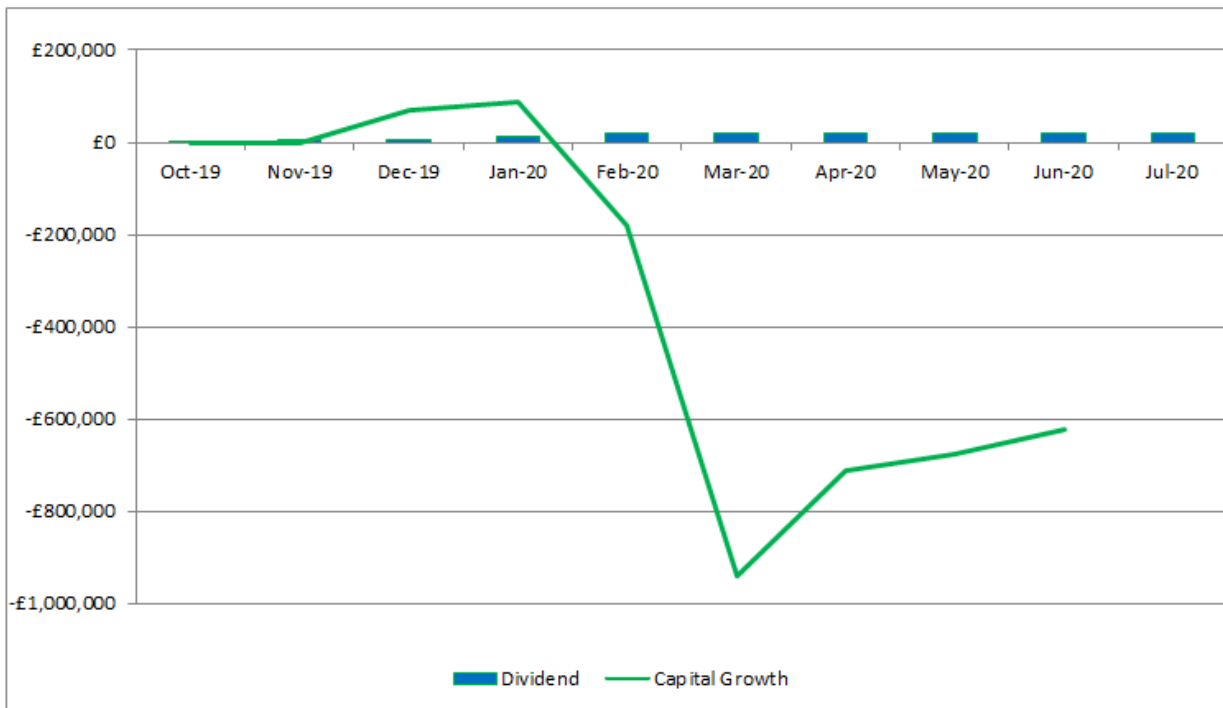


Kames Diversified Income Monthly Fund

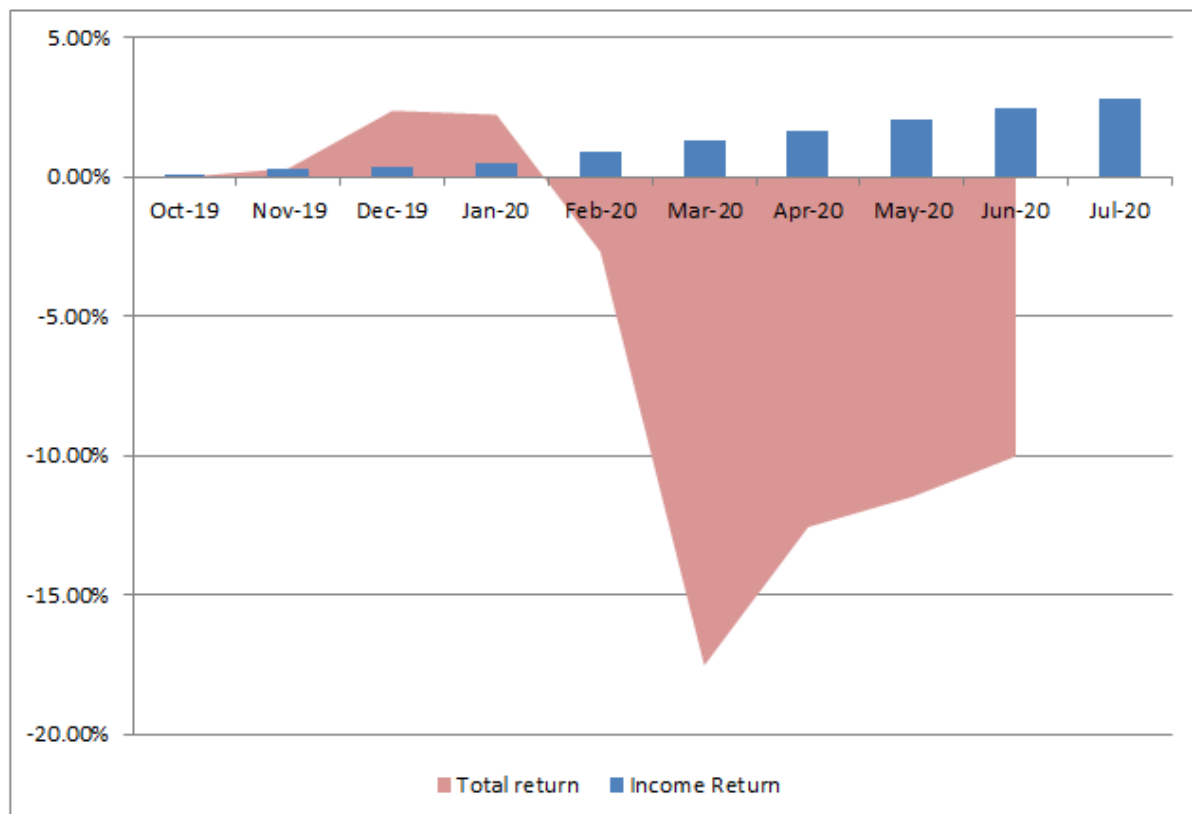
New Investment during 2019-20

Month By Month

Kames Diversified Monthly Income Fund **Total investment** **£5,000,000**

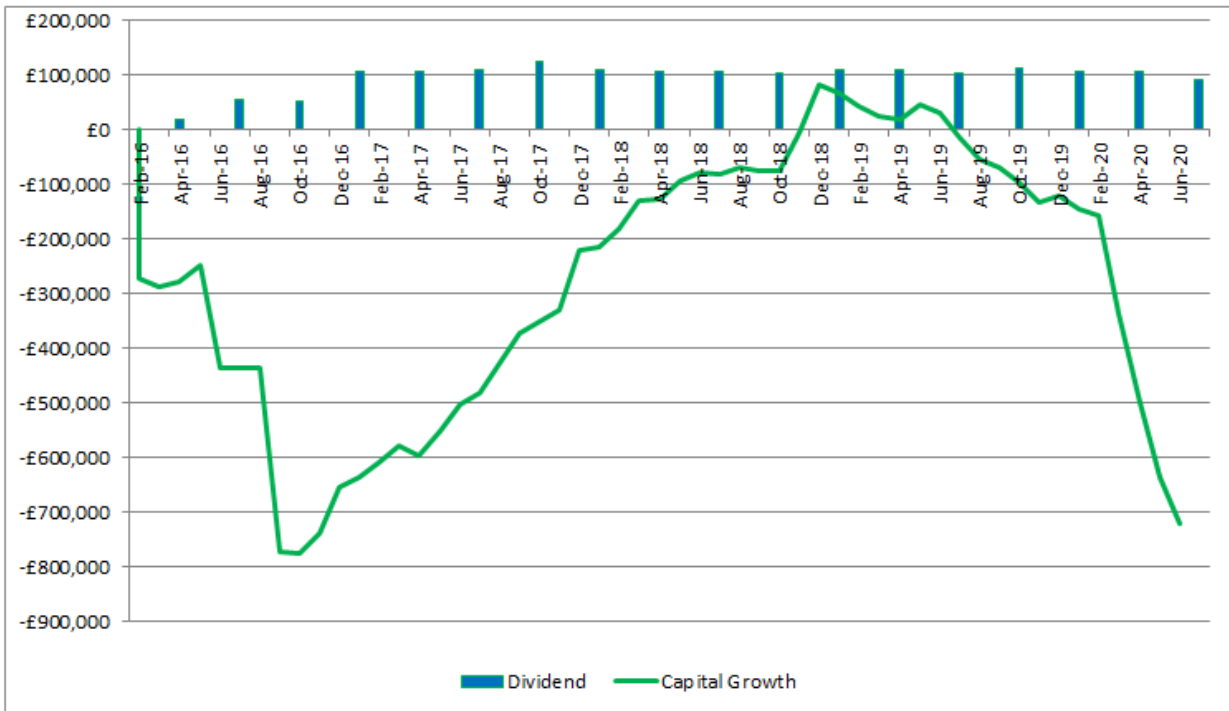


Cumulative

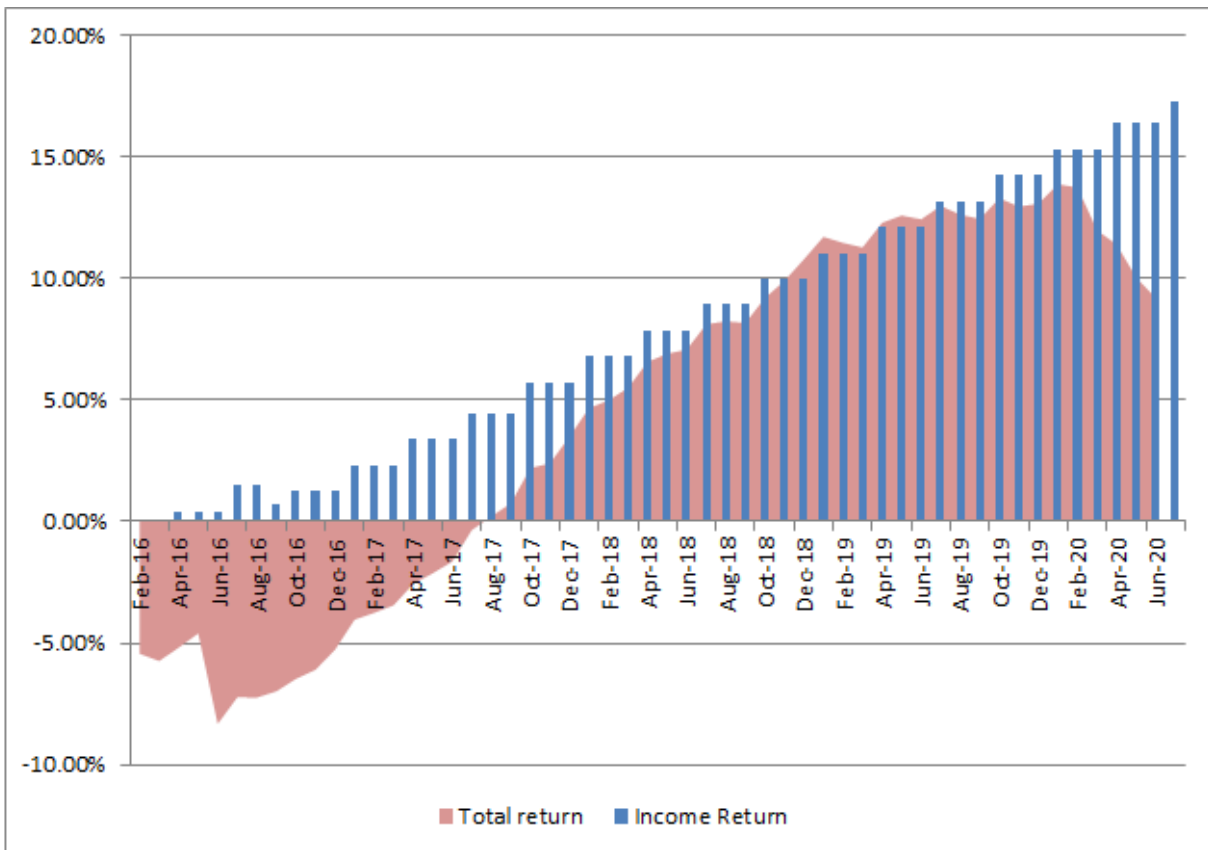


Local Authority Property Fund: Total Investment £10,000,000

Month by Month



Cumulative



Appendix B: Treasury Management – Benchmarking indicators

Return

| Measure | Qtr. 1 19-20 | Qtr2 19-20 | Qtr 3 19-20 | Qtr. 4 19-20 | Non-met districts Q4 average | Rating |
|---|-----------------|---------------|----------------|-----------------|---------------------------------------|--------|
| Internal investment return % | 0.95 | 0.89 | 0.86 | 0.81 | 0.68 | AMBER |
| External funds – income return % | 4.08 | 3.86 | 3.92 | 3.97 | 3.84 | AMBER |
| External funds – capital gains/losses % | 0.83 | 0.33 | 0.48 | -7.87 | -7.26 | AMBER |
| Total treasury Investments – income return % | 1.70 | 1.52 | 1.96 | 2.14 | 1.55 | AMBER |

External fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three to five-year period total returns will exceed cash interest rates. Despite this, an amber rating has been set due to:

1. The outlook for income return has deteriorated as set out in section 5;
2. the significant unrealised capital losses incurred in the last quarter of 2019-20.

Security

| | Average Credit Score (higher = better) | Average Credit Rating | Bail-in exposure (lower = better) | |
|------------------------------|--|--------------------------|---|-------|
| 31 March 2019 | 4.16 | AA- | 31% | |
| 31 March 2020 | 3.85 | AA- | 29% | GREEN |
| Similar Local Authorities | 3.95 | AA- | 59% | |

The Council has maintained a low exposure to bail-in risk throughout 2019-20.

Liquidity

| | 7 day liquidity | 100 day liquidity | Average maturity | |
|------------------------------|-----------------|----------------------|---------------------|-------|
| 31 March 2019 | 15% | 51% | 101 days | |
| 31 March 2020 | 13% | 43% | 52 days | GREEN |
| Similar Local Authorities | 43% | 62% | 53 days | |

Pressures on liquidity due to the effects on cash flows of COVID-19 relief measures have eased significantly. Various Government measures have helped, including grant funding of the COVID-19 business rate reliefs awarded to certain sectors of the local economy.

Appendix C – Compliance report

Compliance with investment limits

| | 2019/20 Limit | Complied/ Exception Ref |
|--------------------------------------|--------------------------|------------------------------------|
| Banks unsecured, total | £30m | Complied |
| Corporates, total | £10m | Complied |
| Local Authority property fund, total | £10m | Complied |
| Other pooled investment funds, total | £25m | Complied |
| Council's own bank, total max 7 days | £2.5m | Complied |
| Money market Funds, total | £24m | Complied |
| Counterparty ratings | various | Complied |

Interest rate exposure

This indicator is set to control the Authority's exposure to interest rate risk.

To measure this, the Council calculates the effect of a 1% change in interest rates and has set a reportable exception level where the impact of this exceeds 50% of the Council's individual counterparty limit (£3m).

| | 31.3. 20 Actual | 2019/20 Limit | |
|---|----------------------------|--------------------------|-----------------|
| Upper limit on one-year revenue impact of a 1% change in interest rates | 0.42m | £3m | Complied |

The figure above excludes any effect on returns from the external pooled fund which are subject to a large diverse asset base of differing securities and investments.

Principal Sums Invested for Periods Longer than 364 days

The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The long-term principal sums invested to final maturities beyond the period end were:

| | 2019/20 | 2020/21 | 2021/22 |
|---|-----------------|-----------------|-----------------|
| Actual principal invested beyond year end | £34.0m | £34.0m | £34.0mm |
| Limit on principal invested beyond year end | £50m | £50m | £50m |
| | Complied | Complied | Complied |

Appendix D: Non-Treasury investment indicators

The Council has set the following indicators to measure its exposure to risk associated with non-treasury investments.

| Measure | Description | 31 March 2020 |
|--|---|--|
| Commercial income to net service expenditure | This indicator measures the Council's dependence on income from its commercial property investments as a proportion of the net cost of services | In 2019-20 the Council's income from its commercial investments, net of direct costs was £963k, or 5.5% of the Council's net cost of services (£17,479k). The upper limit for this indicator is 10%. |
| Net operating surplus | This indicator measures the contribution received from the investment portfolio at a net level (income less costs) over time. | Net rental income from the Council's Investment Property portfolio for 2019-20 was £963k, giving a return of approximately 8.0% (7.7% 2018-19) against the initial investment (book cost). |
| Vacancy levels and tenant exposure | Monitoring vacancy levels to ensure the property portfolio is being managed productively. | Void level for the investment properties is currently at 14.0 %. This is monitoring and managed by the Council's Property and Growth team. |
| Exposure to credit default events for loans made | This will measure the Council's exposure to loss through default for non-treasury loans made to third parties | <p>Commercial Properties</p> <p>One credit default event occurred during 2019-20 involving approximately £20,000 in rental and service charge arrears. Action was taken to recover the amount and although this was initially successful at the end of February we commenced enforcement forfeiture proceedings were subsequently taken against the tenant. In the wider sense, monthly monitoring of debtors is undertaken, designed to provide an early flag of any potential debt issues.</p> <p>The Council incurred a small loss on an assisted house purchase loan made under the Councils recruitment and retention policy.</p> |
| Market value of commercial properties | This indicator will track the Council's ability to recover its investment in any commercial investment should the need arise. | <p>Commercial investment valuations were prepared as at 31st March 2020 and the Council's statement of accounts discloses a value of £13.6m for the Council's investment properties on that date.</p> <p>During that period, there was the start of the coronavirus pandemic, which has had and will have an impact on the global and national economy. CDC's valuations comply with RICS guidelines and the methodology and caveats are set out in the Council's statement of accounts.</p> |

Appendix E

Outlook for remainder of 2020-21 – Arlingclose Ltd (May 2020)

The medium-term global economic outlook is exceedingly weak. While containment measures taken by national governments in response to coronavirus (COVID-19) are being eased, it is likely to be some time before demand recovers to pre-crisis levels due to rises in unemployment, the on-going need for virus control measures and the impact on consumer/business confidence.

The responses from the Bank of England, HM Treasury as well as other central banks and governments have been significant and will act to support the recovery when it occurs, by keeping financial conditions stable and many businesses solvent/employees employed than would otherwise have been the case. There will be an economic bounce in the second half of the year, as businesses currently dormant begin production/supply services once more.

However, the scale of the economic shock to demand and the probable on-going social distancing measures necessary before a vaccine is produced will mean that the subsequent pace of recovery is limited.

Arlingclose expects that:

- (a) the Bank Rate to remain at the current 0.10% level. The central case for Bank Rate is no change, but further cuts to the Bank Rate to zero or even into negative territory cannot be ruled out.
- (b) Gilt yields will remain very low in the medium term. Shorter term gilt yields are currently negative and will remain around zero or below until either the Bank expressly rules out negative Bank Rate or growth prospects improve.
- (c) Downside risks remain in the near term, as households and businesses react to an unprecedented set of economic circumstances.

Exhibit: Arlingclose Ltd interest rate forecast

