

# Chichester District Council

The Cabinet

3 November 2020

## 2020-2021 Treasury Management half-yearly update

### 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.**

### 3. Overall position

- 3.1 The Authority's treasury management strategy for 2020/21 was approved by Council on 3 March 2020. The Authority continues to invest substantial sums of money in line with this policy and to aid the ongoing monitoring and control of risk this report summarises this activity for the 6 months to 30 September 2020.
- 3.2 The position at the end of the reporting period is shown in Tables 1 and 2, below.

Table 1: Treasury Management Summary

Investments £000	Balance 31/03/2020	Movement	Balance w/e 25/9/2020
Short term Investments	35,000	(6,000)	29,000
Money Market Funds	6,050	10,550	16,600
<b>Total liquid investments</b>	<b>41,050</b>	<b>4,550</b>	<b>45,600</b>
Long term Investments	-	-	-
Pooled Funds – External	24,000	-	24,000
Pooled funds – Local Authority	10,000	-	10,000
Property fund	-	-	-
<b>Total investments</b>	<b>75,050</b>	<b>4,550</b>	<b>79,600</b>

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

Table 2: Gains and losses from external pooled funds (£000) – 30 September 2020

<b>Fund</b>	<b>Type of fund</b>	<b>Invested £000</b>	<b>Capital gain (loss)</b>	<b>6.10.20 Market Value</b>	<b>Income 20-21 £k (cash)</b>	<b>Return (annual eq %)</b>
Local Authority Property Fund	Property	10,000	(880)	9,120	227.0	4.54
Ninety-One Diversified Income Fund	Multi Asset	5,000	(246)	4,754	99.1	3.96
Columbia Threadneedle Strategic Bond Fund	Bonds	2,650	31	2,681	46.5	3.27
Aegon Diversified Income (previously Kames)	Multi Asset	5,000	(576)	4,424	108.1	5.18
M&G Strategic Corporate Bond fund	Bonds	4,000	(34)	3,966	64.9	3.24
Schroder Income Maximiser	Equity	5,000	(1,565)	3,435	153.4	6.13
Columbia Threadneedle – short dated bond fund	Bonds	2,350	5	2,355	19.1	1.95
<b>Totals</b>		<b>34,000</b>	<b>(3,265)</b>	<b>30,735</b>	718.10	

#### 4. Economic headlines

- 4.1 The council's external pooled fund investments continue to be subject to significant carried losses, almost entirely due to the global market reaction to the COVID-19 pandemic. With the continuation of the pandemic, the FTSE 100 index was making a tentative recovery between late March 2020 and early June 2020. Since then the FSTE 100 index had plateaued towards the end of July, before once again making a tentative downward trend towards the end of September.
- 4.2 There continues to remain much uncertainty around the extent of the losses banks and building societies will suffer due to the impact from the coronavirus pandemic and for the UK institutions on the council's approved lending list there is the added complication of the end of the Brexit transition period on 31st December and what a trade deal may or may not look like. The institutions on Arlingclose's counterparty list and recommended duration remain under constant review, but at the end of the period no changes had been made to the names on the list or the recommended maximum duration of 35 days.
- 4.3 Continued downward pressure on short-dated cash rate brought net returns on sterling low volatility net asset value money market funds (LVNAV MMFs) close to zero even after some managers have temporarily lowered their fees. At this stage net negative returns are not the central case of most MMF managers over the short-term, and fee waivers should maintain positive net yields, but the possibility cannot be ruled out.
- 4.4 Taking these factors together, the Council's Treasury activity has focussed on lending to Local Authorities for fixed terms ranging from three to six months and on maintaining adequate liquidity via Money Market deposits.

## **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, unchanged from the value established at 31 March 2020
- 5.3 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.

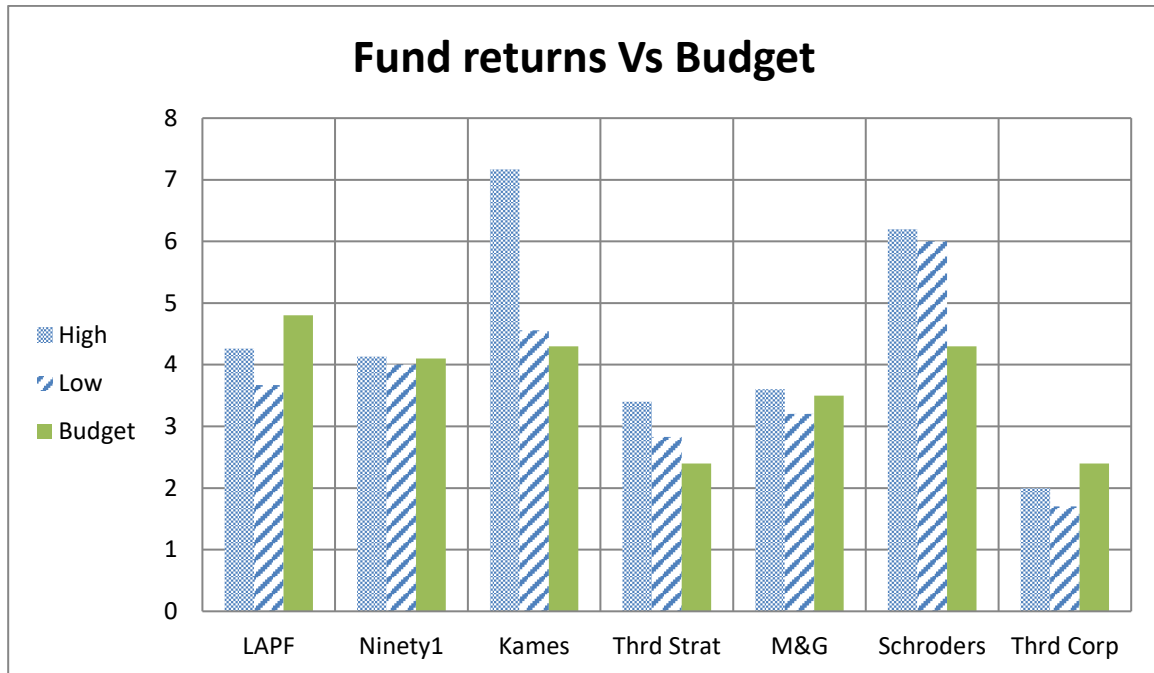
## **7. Other Developments**

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

### **Estimates for income 2020/21**

- 7.2 The corporate world is still adjusting to the economic shock of COVID-19, with probably more to come, and it is still too early to tell which companies will withstand the economic damage in the short- to medium-term or which will choose to conserve cash in very difficult economic conditions simply to survive.
- 7.3 Investment income in the Authority's 2020/21 budget was set against a very different economic backdrop. Bank Rate, which was 0.75% in January/February 2020, now stands at 0.1%. Interest earned from short-dated money market investments will be significantly lower.
- 7.4 In relation to income from the Authority's externally managed strategic funds, dividends and income distributions will ultimately depend on many factors including but not limited to the duration of COVID-19 and the extent of its economic impact, the fund's sectoral asset allocation, securities held/bought/sold and, in the case of equities, the enforced or voluntary dividend cuts or deferral.
- 7.5 As reported to Cabinet in September this may reduce our forecast income from external investments in 2020-21. At present income remains relatively healthy, as shown below, however this could be due to timing lag between the announcement and payment of dividends by both companies and then the external funds themselves. We could see a more pronounced impact on returns from quarter 3 onwards

Chart 1: High/Low dividend payments by fund received in 2020-21.



## Negative Interest rates

- 7.6 Expectations for negative rates received a boost following the publication of the minutes of the September monetary policy committee meeting. While Arlingclose's central case for Bank Rate is no change from the current level of 0.1%, further cuts to Bank Rate to zero or even into negative territory cannot be completely ruled out.
- 7.7 The possibility of negative interest rates is explicitly addressed in the council's 2020-21 treasury strategy. If the Bank of England sets its Bank Rate at or below zero, this is likely to feed through to negative interest rates on all low risk, short-term investment options. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

## 8. Alternatives Considered

- 8.1 None

## 9. Resource and Legal Implications

- 9.1 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 19 October 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
<b>Crime and Disorder</b>		X
<b>Climate Change and Biodiversity</b>		X
<b>Human Rights and Equality Impact</b>		X
<b>Safeguarding and Early Help</b>		X
<b>General Data Protection Regulations (GDPR)</b>		X
<b>Health and Wellbeing</b>		X
<b>Other</b>		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

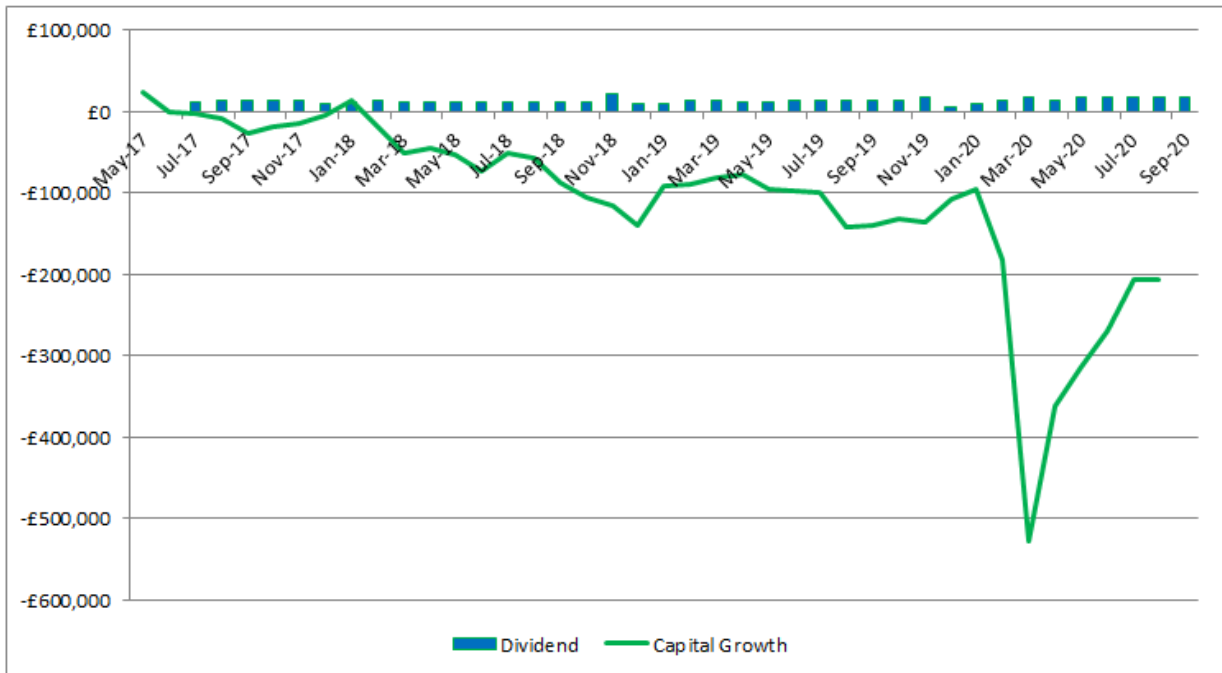
## 14. Background Papers

14.1 None.

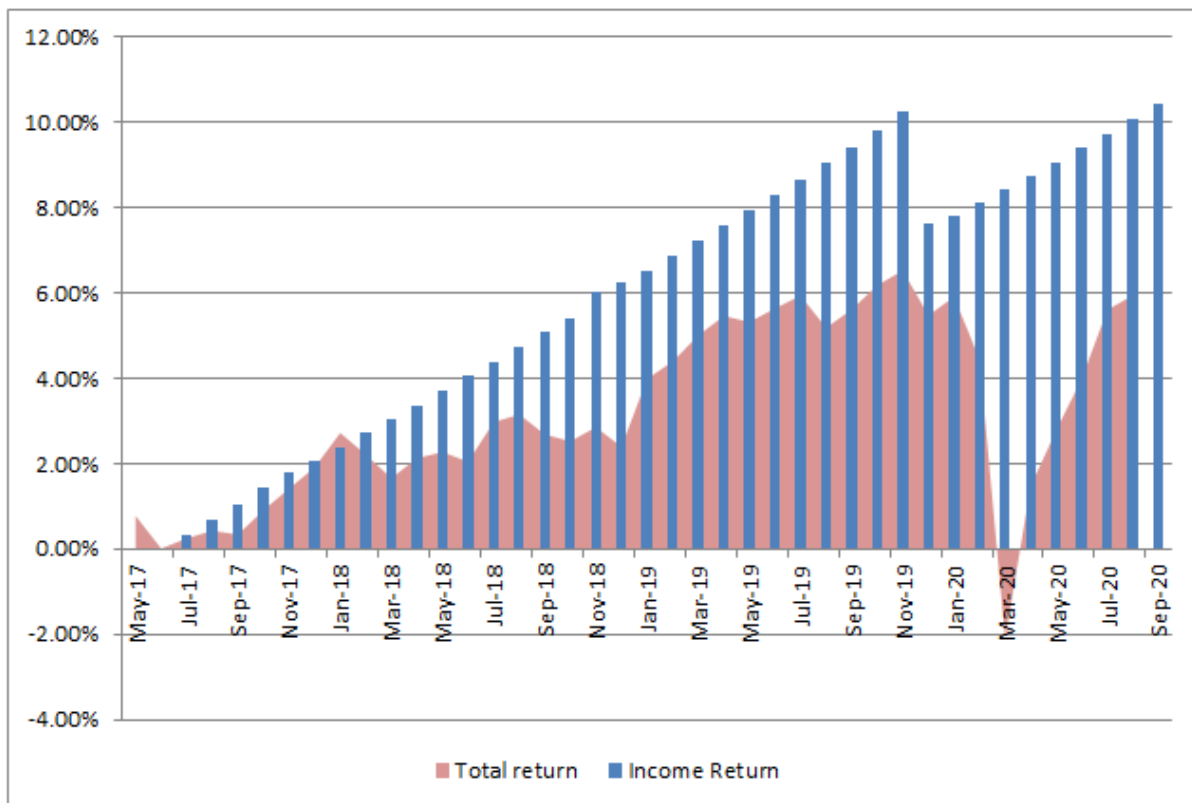
## Appendix A: Movements in Fund fair values and income – Pooled Funds

Ninety One (Investec)

Month By Month

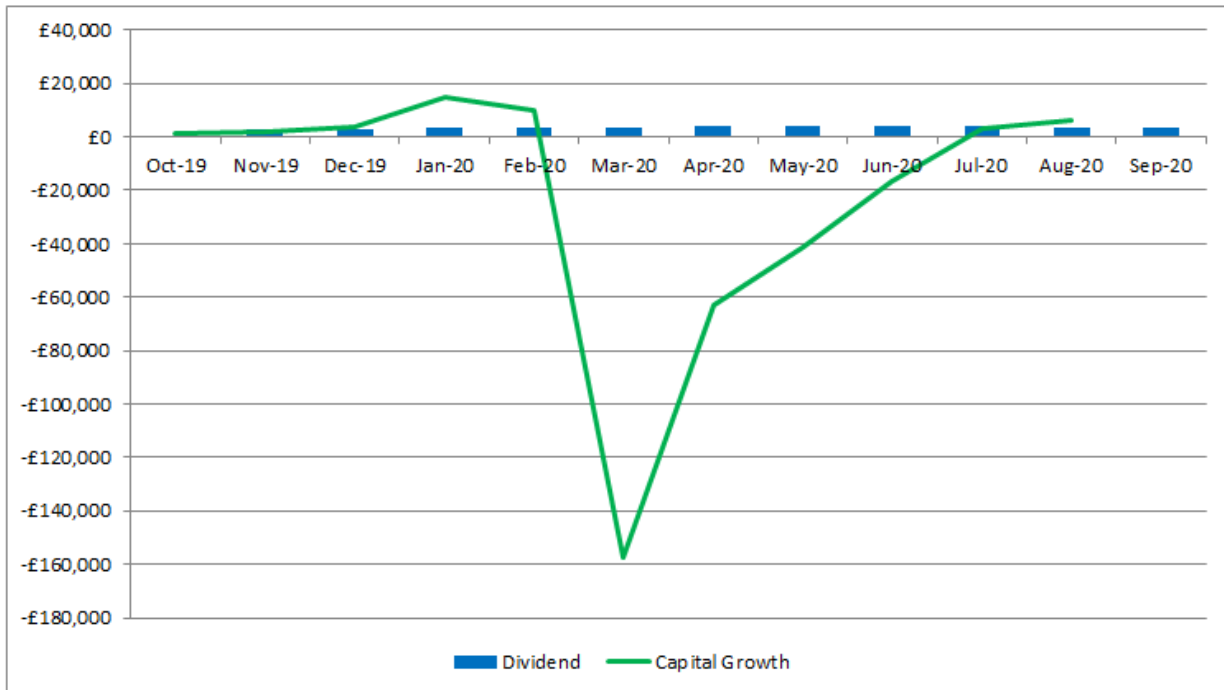


Cumulative

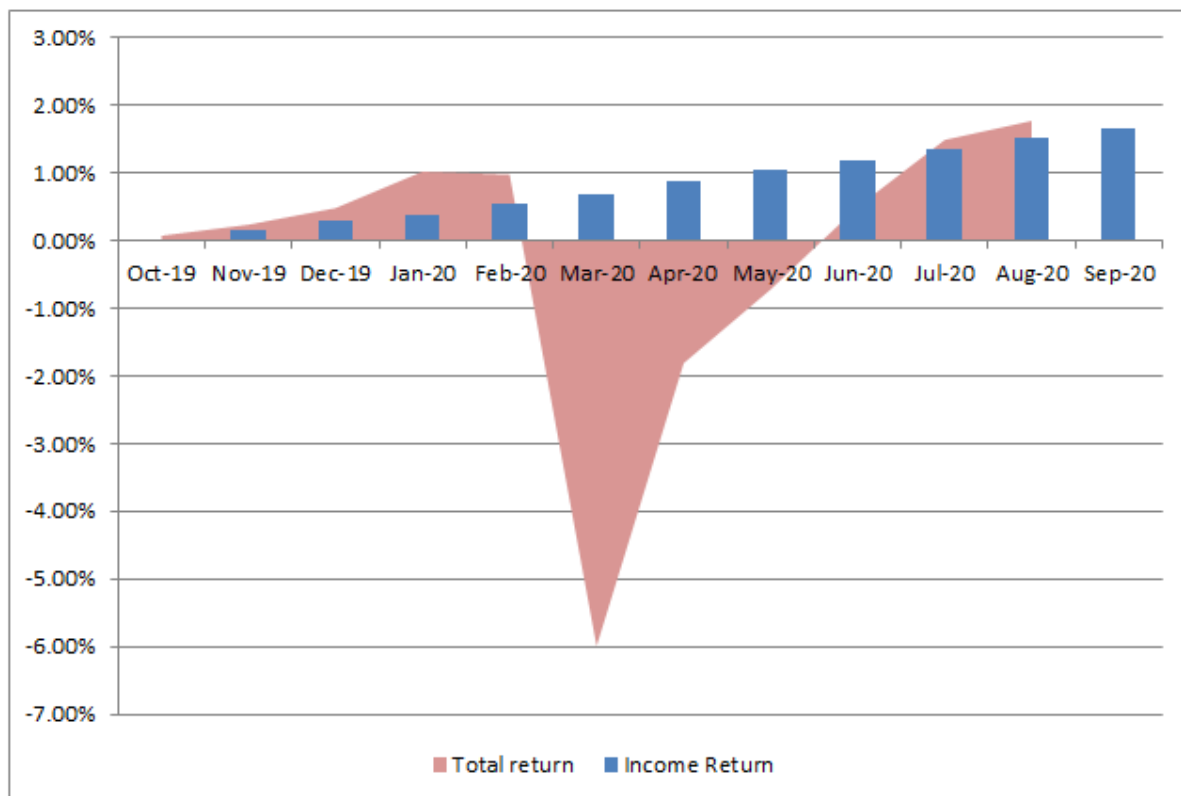


# Columbia Threadneedle Short Dated Corporate Bond Fund

## Month By Month

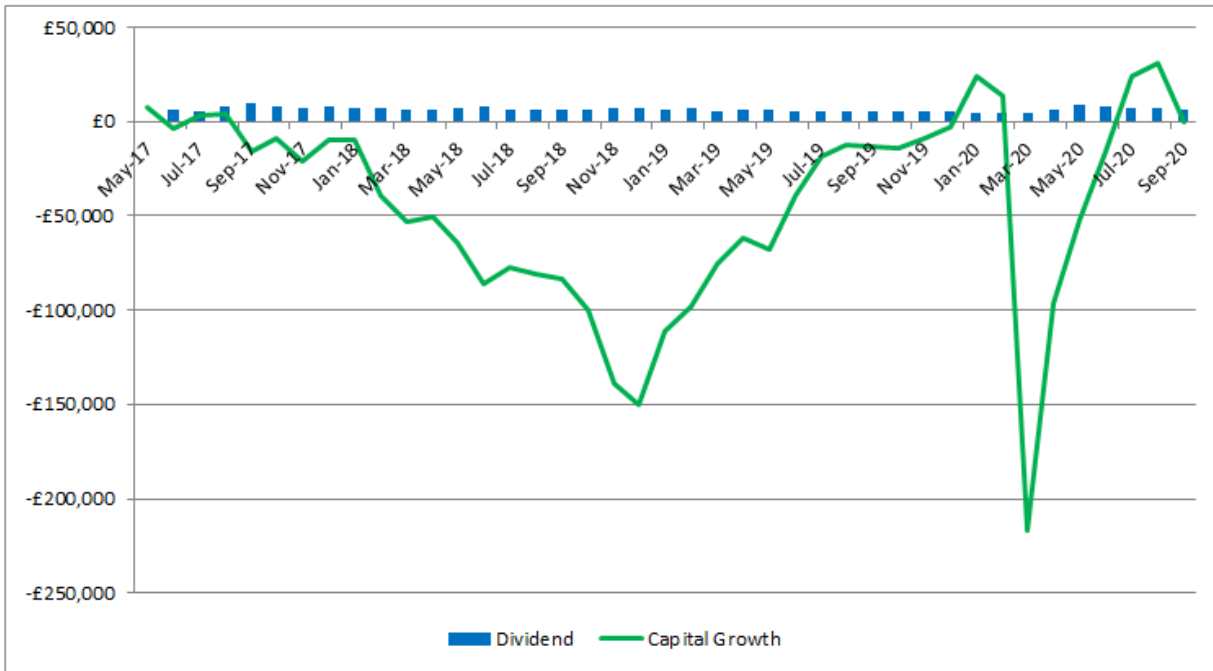


## Cumulative

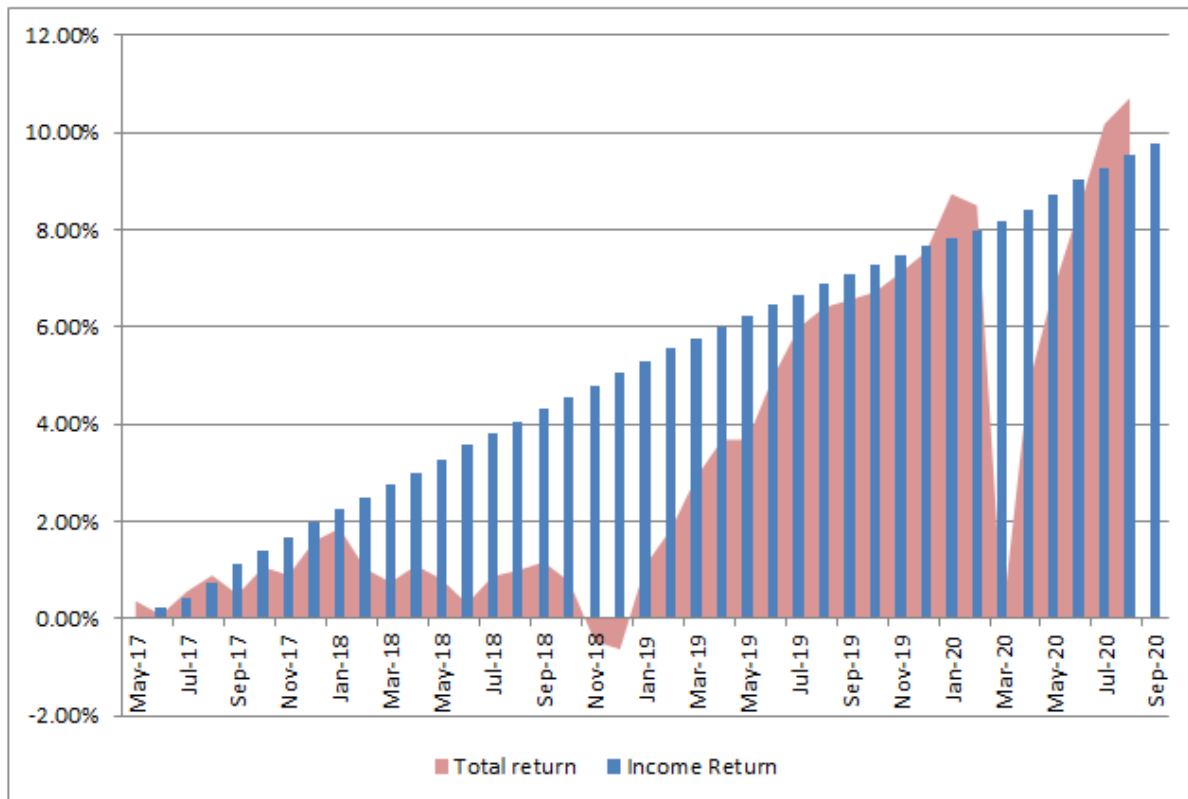


# Columbia Threadneedle Strategic Bond Fund

## Month By Month



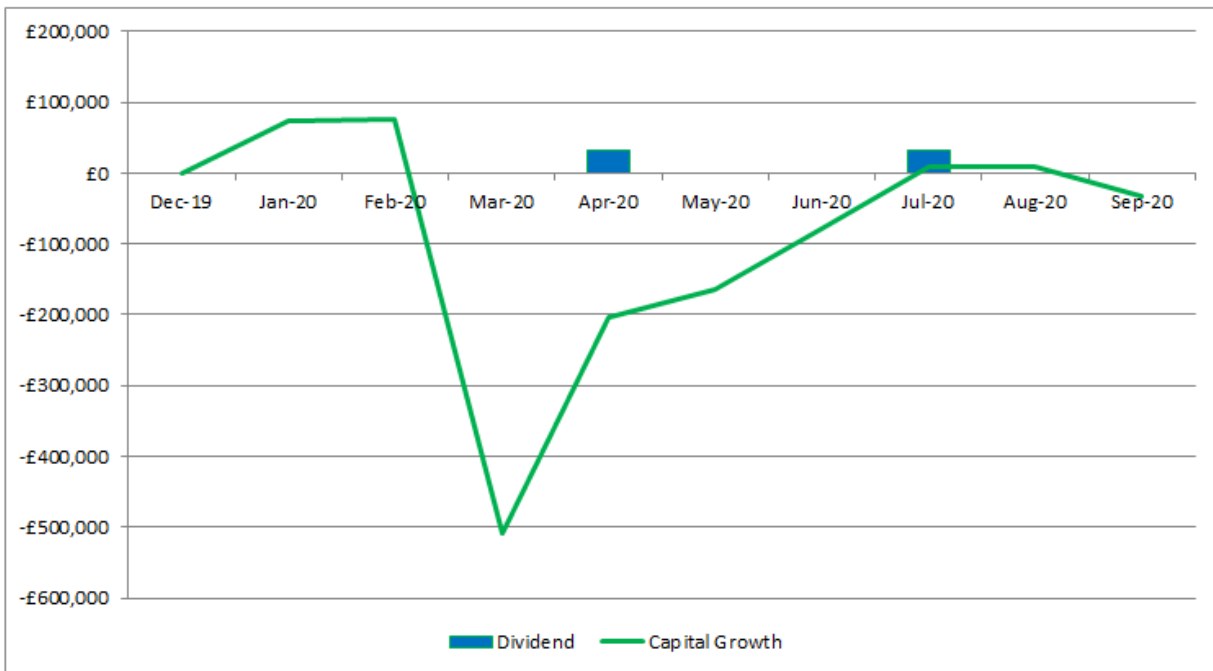
## Cumulative



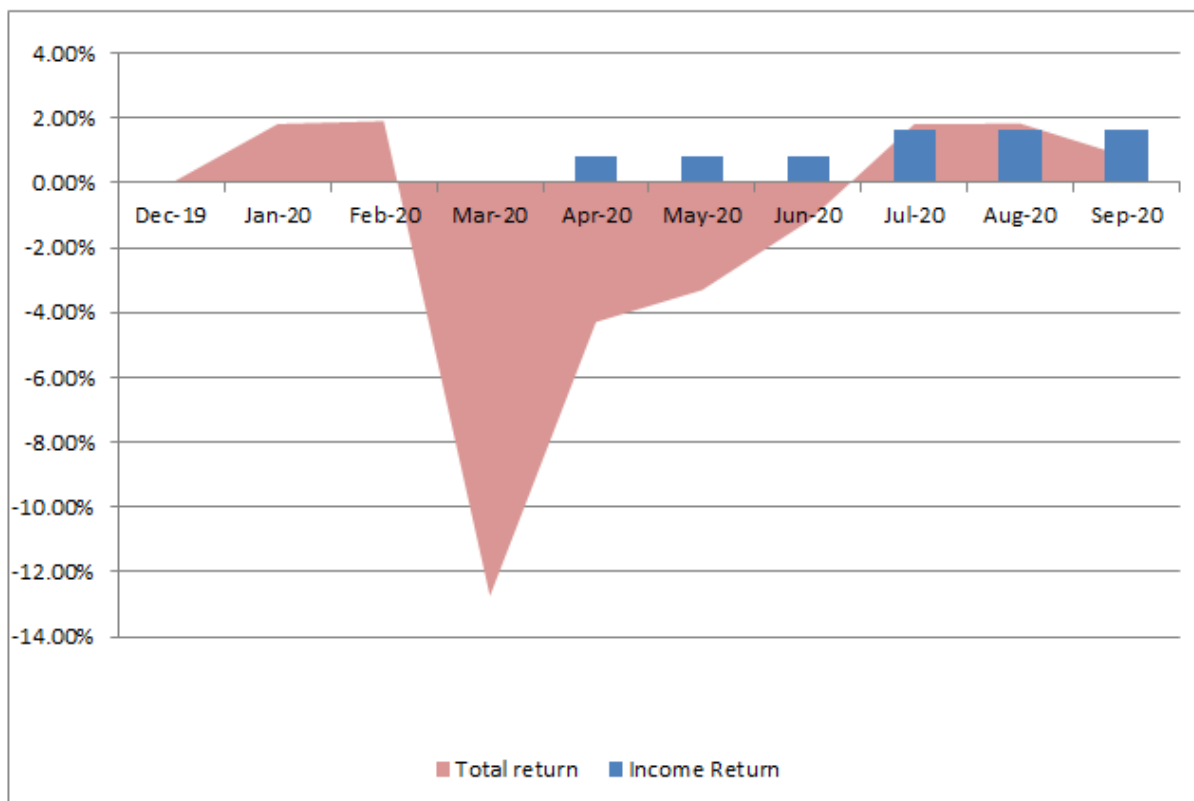


# M&G Strategic Corporate Bond Fund

## Month By Month

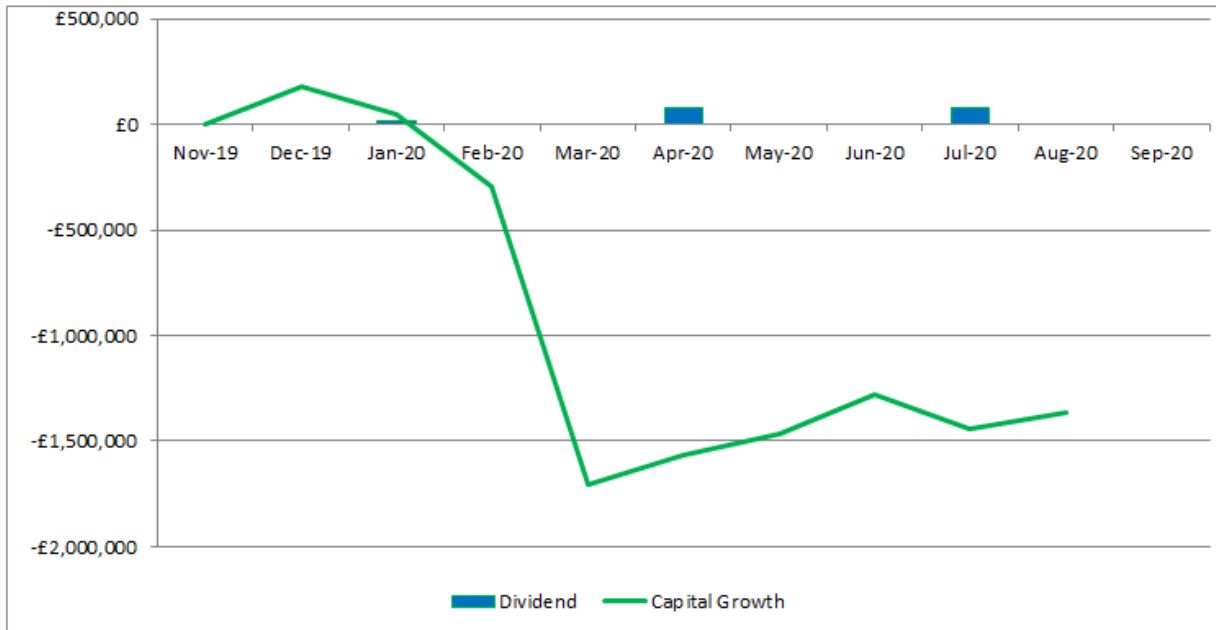


## Cumulative

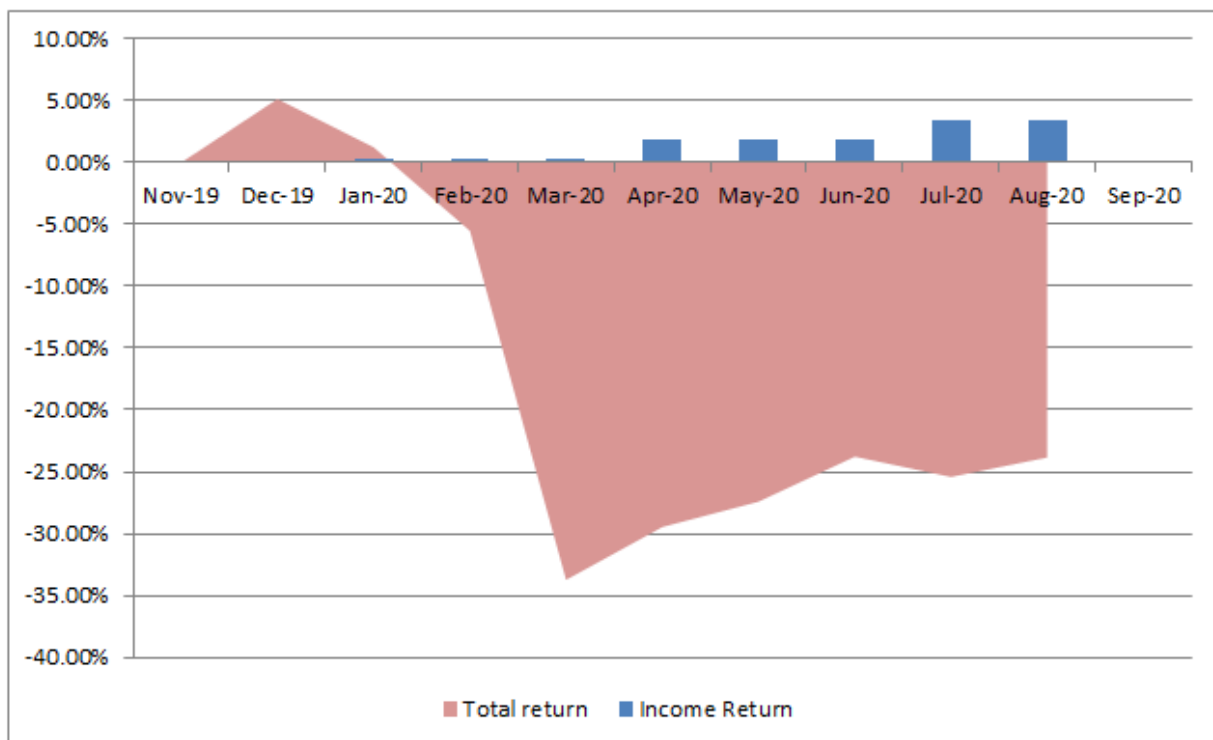


# Schroder Income maximiser

## Month By Month

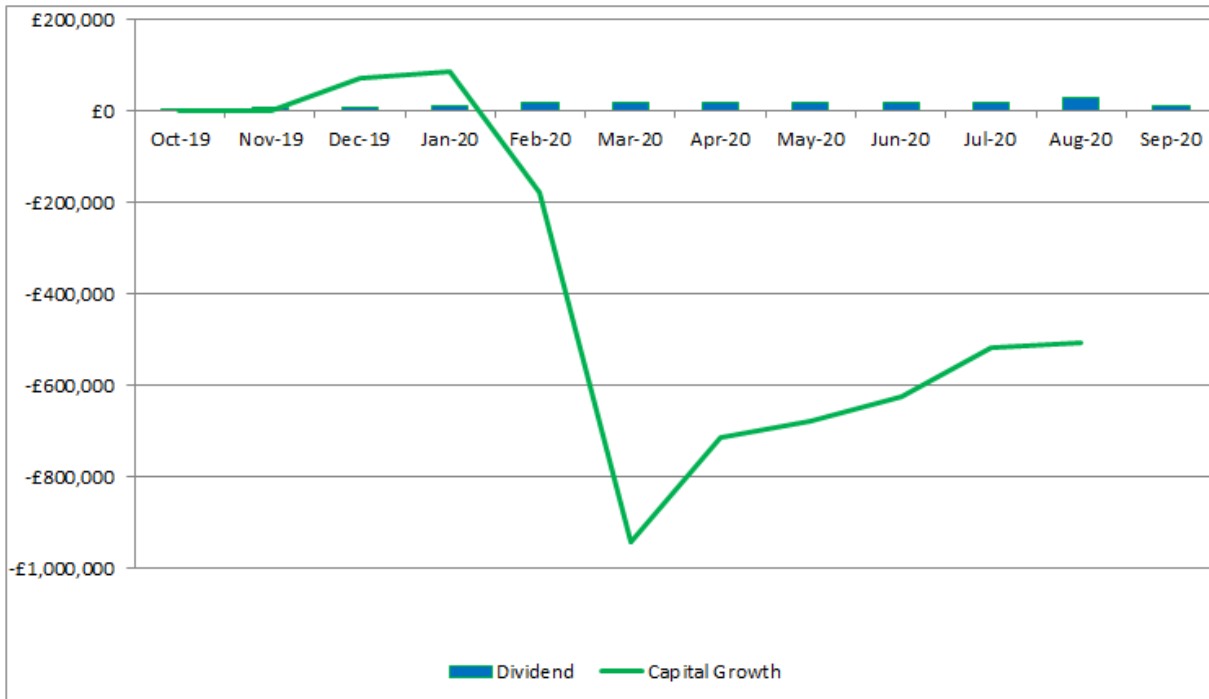


## Cumulative

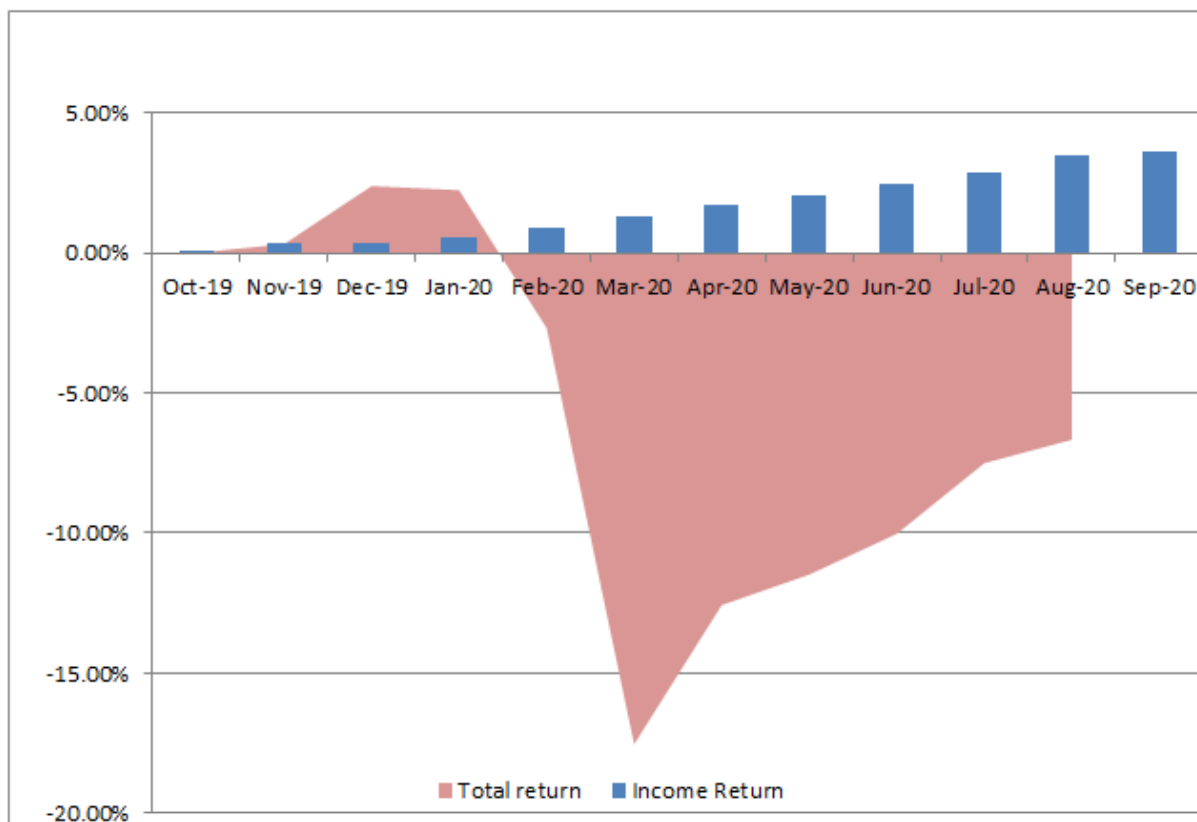


# Kames Diversified Income Monthly Fund

## Month By Month

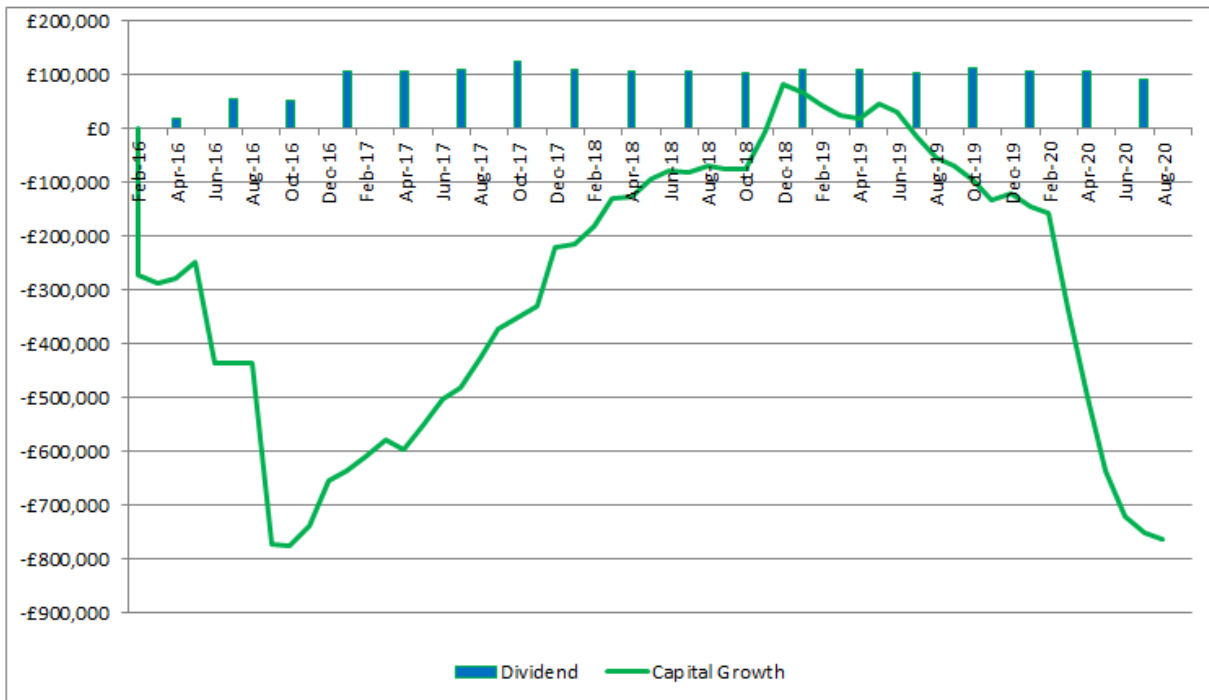


## Cumulative

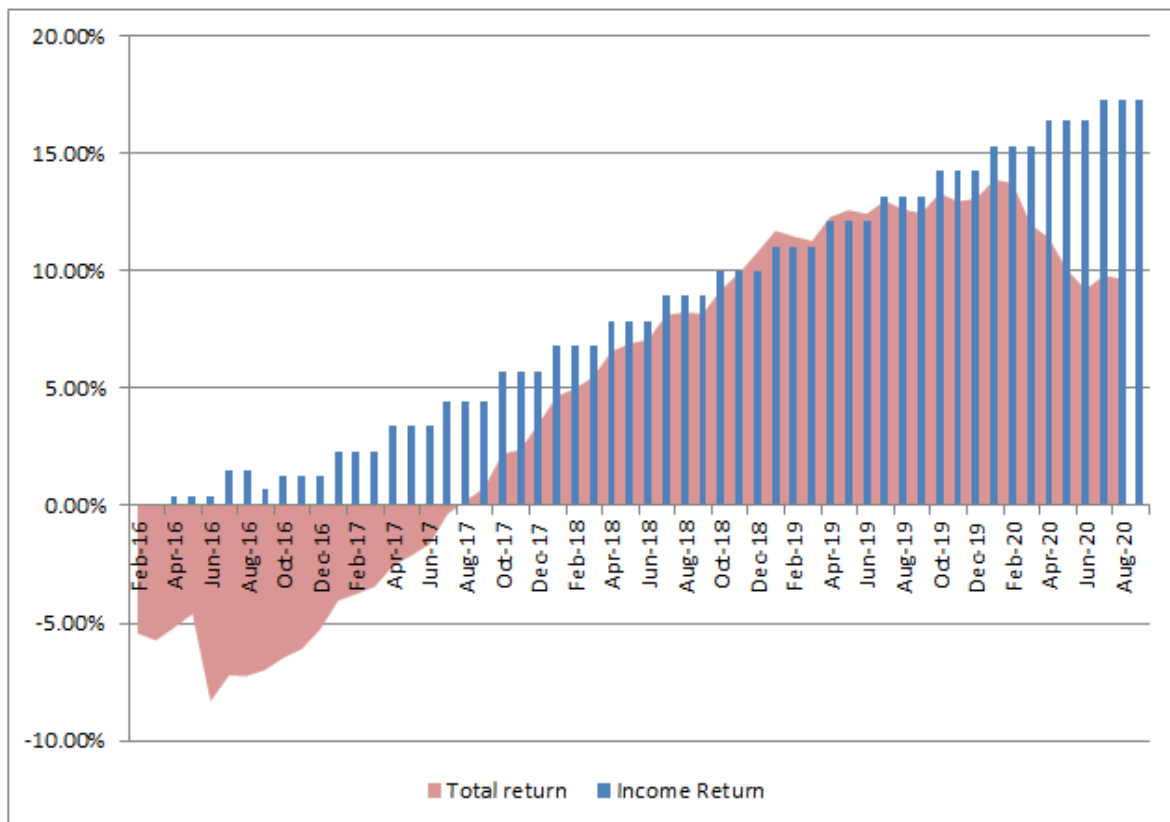


# Local Authority Property Fund: Total Investment £10,000,000

## Month by Month



## Cumulative



## Appendix B: Treasury Management – Benchmarking indicators

### Return

Measure	Qtr 3 19-20	Qtr. 4 19-20	Qtr 1 20-21	Qtr. 2 20-21	Non-met districts Q4 average	Rating
Internal investment return %	0.86	0.81	0.47	0.12	0.30	AMBER
External funds – income return %	3.92	3.97	3.97	3.90	3.52	AMBER
External funds – capital gains/losses %	0.48	-7.87	-8.09	-8.17	-6.56	AMBER
Total treasury Investments – income return %	1.96	2.14	1.89	1.64	1.31	AMBER

The amber rating reflects the outlook for returns reported at paragraph 7.2 of the main report. The effect of Local Authority deposits made before base rate was cut in March by appears to be the most likely reason for the variation in internal investment returns between CDC and other local authorities.

### Security

	Average Credit Score Time weighted (lower = better)	Average Credit Rating Time weighted	Bail-in exposure (lower = better)	
31 March 2020	3.85	AA-	29%	
30 September 2020	3.88	AA-	39%	GREEN
Similar Local Authorities	4.20	AA-	65%	

Benchmarks remain relatively stable and the average credit score remains below the average value of other similar authorities.

### Liquidity

	7 day liquidity	100 day liquidity	Average maturity	
31 March 2020	13%	43%	52 days	
30 September 2020	19%	39%	83 days	GREEN
Similar Local Authorities	41%	59%	51 days	

The increase in average maturity follows recent six to nine month investments taken out in the last quarter as part of our response to the risk of negative interest rates. As this is a managed change, the RAG rating remains green.

## **Appendix C – Compliance report**

### **Compliance with investment limits**

	<b>2020/21 Limit</b>	<b>Complied/ Exception Ref</b>
Banks unsecured, total	£30m	<b>Complied</b>
Corporates, total	£10m	<b>Complied</b>
Local Authority property fund, total	£10m	<b>Complied</b>
Other pooled investment funds, total	£30m	<b>Complied</b>
Council's own bank, total max 7 days	£2.5m	<b>Complied</b>
Money market Funds, total	£24m	<b>Complied</b>
Counterparty ratings	various	<b>Complied</b>

### **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).

	<b>25/9/20 Actual</b>	<b>2020/21 Limit</b>	
Upper limit on one-year revenue impact of a 1% change in interest rates	£0.26m	£3m	<b>Complied</b>

The risk of interest rate exposure faced by the council is relatively low as the council's investments are still primarily short duration fixed interest or overnight money market deposits.

### **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:

	<b>2020/21 September</b>	<b>2021/22</b>	<b>2022/23</b>
Actual principal invested beyond year end	£34.0m	£34.0m	£34.0m
Limit on principal invested beyond year end	£50m	£50m	£50m
	<b>Complied</b>	<b>Complied</b>	<b>Complied</b>

## 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	30 September 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	This indicator is only calculated and reported as at 31 March each year.
Net operating surplus	This indicator measures the contribution received from the investment portfolio at a net level (income less costs) over time.	This indicator is only calculated and reported as at 31 March each year  For the first half year, rent received totalled £469k (19-20 full year £963k net of direct costs not deducted from the above figure.)
Vacancy levels and tenant exposure	Monitoring vacancy levels to ensure the property portfolio is being managed productively.	Voids at 30th September: <ul style="list-style-type: none"> <li>• Industrial 3/15</li> <li>• Retail 2/26</li> <li>• Offices 2/8</li> </ul> Total 7/49 = 14.3% (19/20 14%)
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	None
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.	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. This value remains the latest valuation  It is generally accepted that it remains too early to know the full impact of Covid -19 on the commercial property market, or how long for. It is almost impossible to predict the full impact on our investment properties with any certainty and with limited to zero tangible evidence to support it.  What is consistent within the profession is the expectation that investment properties, particularly retail, will have suffered significantly and will continue to do so as a consequence to government restrictions in place as a result of Covid-19. In addition to anticipated downward pressure on rents and increasing risk of tenant default, investment yields will need to reflect the added risk to future income streams and will ultimately result in lower capital values. These values may well fall below the original purchase price of the investment properties, although we should not lose sight of the income received since the acquisition when

		comparing to the original purchase price.
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## Appendix E

### Arlingclose's Outlook for the remainder of 2020/21

	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Downside risk	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50

The medium-term global economic outlook is weak. While the strict initial lockdown restrictions have eased, coronavirus has not been suppressed and second waves have prompted more restrictive measures on a regional and national basis. This ebb and flow of restrictions on normal activity will continue for the foreseeable future, at least until an effective vaccine is produced and importantly, distributed.

The global central bank and government responses have been significant and are in many cases on-going, maintaining more stable financial, economic and social conditions than otherwise. This has supported a sizeable economic recovery in Q3.

However, the scale of the economic shock to demand, on-going social distancing measures, regional lock downs and reduced fiscal support will mean that the subsequent pace of recovery is limited. Early signs of this are already evident in UK monthly GDP and PMI data, even before the latest restrictions.

This situation will result in central banks maintaining low interest rates for the medium term. In the UK, Brexit is a further complication. Bank Rate is therefore likely to remain at low levels for a very long time, with a distinct possibility of being cut to zero. Money markets have priced in a chance of negative Bank Rate.

Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, or if the UK leaves the EU without a deal.

Arlingclose expects Bank Rate to remain at the current 0.10% level and additional monetary loosening in the future most likely through further financial asset purchases (QE). While Arlingclose's central case for Bank Rate is no change from the current level of 0.1%, further cuts to Bank Rate to zero or even into negative territory cannot be completely ruled out.

Gilt yields are expected to 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 of England expressly rules out negative Bank Rate or growth/inflation prospects improve.

Downside risks remain in the near term, as the government dials down its fiscal support measures, reacts to the risk of a further escalation in infection rates and the Brexit transition period comes to an end.