Chichester District Council

Corporate Governance and Audit Committee 18 July 2022

2021/2022 Treasury Management outturn report

1. Contacts

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2. Recommendation

2.1. The Corporate Governance and Audit Committee is asked to consider this report and provide comments to Cabinet as necessary.

3. Background and Outcomes

3.1. This is a summary of Treasury Management activity for the year to 31 March 2022. The objective is to demonstrate the effectiveness of Treasury activities undertaken and compliance with the Council's Treasury Management Strategy and Policy statement.

4. Treasury management activity

4.1. On 31 March 2022, the Council had investments of £111.4m (table 1, below). Investment balances remained high across the year, mainly due to continued COVID funding schemes and energy rebate funding due to be paid to residents.

Table 1: Treasury Management Summary

Investments £000	**Balance 01/04/2021**	**Movement**	**Balance 31/03/2022**
Short term Investments	49,500	(26,500)	23,000
Money Market Funds	5,000	49,400	54,400
Total liquid investments	**54,500**	**22,900**	**77,400**
Long term Investments	-	-	-
Pooled Funds – External	24,000	-	24,000
Pooled funds – Local Authority Property fund	10,000	-	10,000
Total investments	**88,500**	**22,900**	**111,400**

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

4.2. As interest rates were close to (and occasionally below) zero money markets were prioritised for liquid investments as these provide equivalent returns but higher liquidity than term deposits with Local Authorities or Banks.

4.3. The Council also maintained a balanced allocation of external investments throughout the financial year. The overall composition, performance and returns of our external pooled investments is shown in appendix A and summarised in the exhibits and tables below.

4.4. The position for all funds by asset class on 31 March 2022 is shown below.

Exhibit 1: External Funds: Asset class breakdown

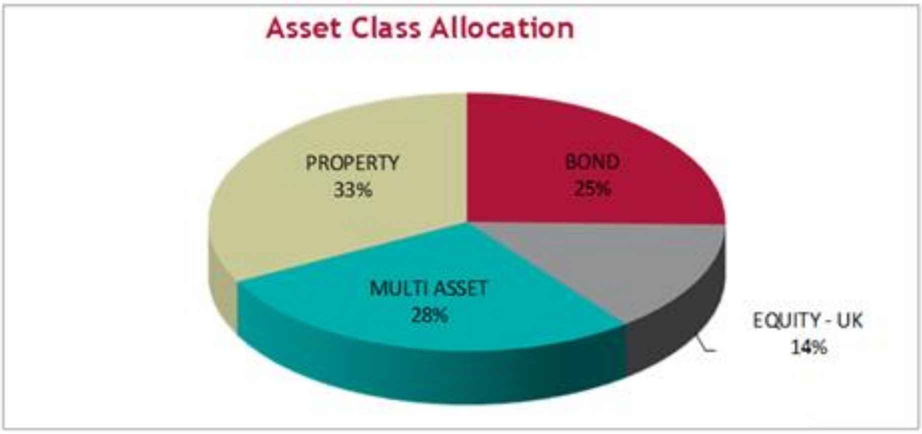

Exhibit 2: External investment performance (cumulative)

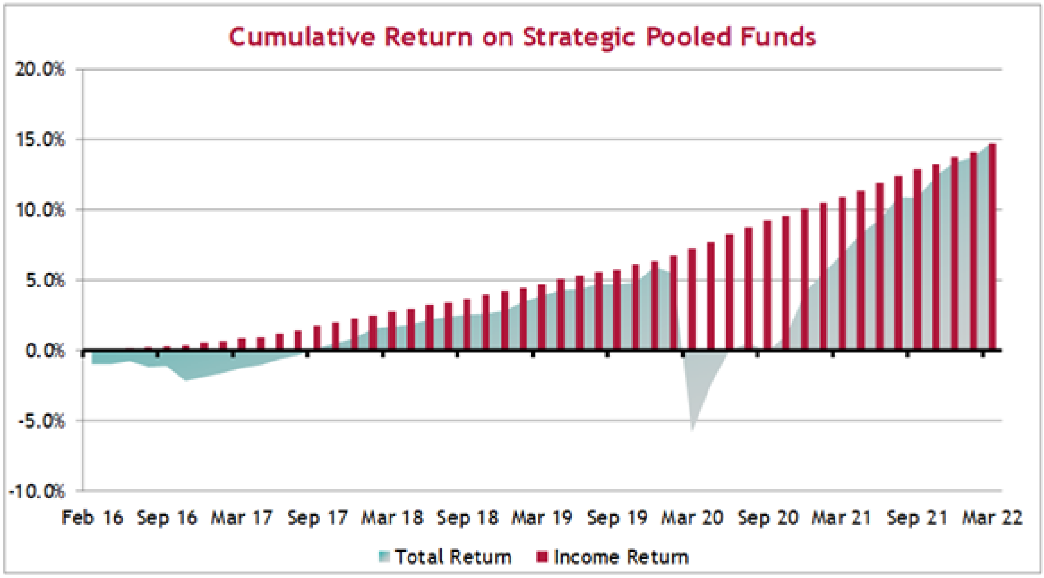

Table 2: External investment performance

	Since purchase £000	Annualised %	2021/22 £000	Annual %
Income return	5,250	3.7	1,277	3.92
Capital return	20	-	1,378	-
Volatility		5.1		3.3

Note 1: Annualised return since purchase

4.5. The current value of the portfolio is now broadly the same as the original investment value and income remains stable at around 4% per annum. In total our external pooled funds have generated over £5m for Council services and are expected to continue to generate over £1m a year going forwards.

4.6. Benchmarks and red/ amber/ green risk ratings across a series of indicators focussed on measuring security, liquidity and return are reported at appendix B with a short commentary against each.

4.7. Two themes dominated the latter stages of 2021/22: higher interest rates and the military invasion of Ukraine by Russia.

4.8. The increase in the Bank Rate from 0.10% to 0.25% in December was quickly followed by further adjustments upwards. The Council's latest advice (May 2022, exhibit 3) indicates further increases are expected during 2022.

Exhibit 3: Interest Rate Forecast – May 2022

	Current	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0
Arlingclose Central Case	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.
Downside risk	0.00	-0.25	-0.25	-0.25	-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0

4.9. The overall interest rate outlook is likely to depress the Council's bond fund values over the short to medium term, as bond yields (which are related to interest rates) vary inversely to bond prices.

4.10. The conflict in Ukraine has only added further volatility to this already uncertain outlook. As far as can be determined, the Council has no direct exposure to Russian or Belarusian assets. Indirect exposure is also considered immaterial, although this is difficult to quantify as information on assets held by banks and financial institutions that are held by external pooled funds is not readily available.

4.11. Over the next 12 months the Council will consider if further investments in external pooled funds can be made. Alongside the wider economic uncertainties outlined above, one important factor in this decision will be the potential sunsetting of the statutory override on 31 March 2023 (see paragraph 8.9, below). If nothing changes, movements in capital values will be charged to the Council's General Fund from that point onwards.

4.12. To mitigate this, the Council maintains an investment risk reserve to mitigate the risk to the Council's General Fund of adverse fair value movements. The balance of this reserve was £1.4m as at 31.3.2022. With investments of £34m and volatility of 5.1% (appendix A), this amount is expected to cover potential annual losses 80% of the time.

5. Treasury Budget

5.1. The outturn budget performance for 2021/22 is £129k favourable, as shown in table 3 above. The main driver for this variance was returns from external pooled funds which did not tail off following the pandemic by the extent anticipated.

Table 3: Treasury Income budgets

	BUDGET 2021/22 £k	ACTUAL 2021/22 £k	BUDGET 2022/23 £k
Internally managed	35	44	78*
Property Fund dividends	347	431	430
External fund dividends and interest	786	915	1,091

5.2. The 2022/23 budget was set prior to the recent increases in Bank Rate and actual returns are expected to exceed this. The external fund budget includes expected returns from a new £3m investment with the CCLA diversified income fund made 1 April 2022.

6. Other Non-Treasury Holdings and Activity

6.1. The definition of investments in CIPFA's revised 2021 Treasury Management Code covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).

6.2. The Authority continues to hold approximately £13.6m of investments assessed as being for a commercial purpose, which comprise the Council's directly owned investment properties. Further information on the performance of the Council's Commercial investments in contained in appendix D.

6.3. The Council has a very limited portfolio of service investments as shown in Table 4.

Table 4: Service investments

	£000s
Car Loans	213
Private sector renewal loans	221

Figures above are as at 31.3.2021 (latest available). Actual outturn figures for 2021-22 will be included in the 2022-23 half-year Treasury update.

6.4. Given the size of these non-Treasury loans, and the low level of financial risk associated with them, officers intend a very light touch response to satisfy the additional Regulatory requirements described from paragraph 8.5 onwards.

7. Compliance Report

7.1. How Treasury activities complied with the Council's main 2021/22 Treasury limits is disclosed at Appendix C.

7.2. There are two exceptions for the reporting period:

(a) Although individual Counterparty limits for Two bank deposits were not exceeded, the reduction in overall Group limit from £6m to £5m for 2021/22 meant that, for part of the year, the total invested with Lloyds Group Banks exceeded the allowed limit by £1m. Once identified, action was immediately taken to reduce the total invested across the group to within allowed limits.

(b) The Council's bank account exceeded £2.5m on one occasion in 2021/22. This was caused by a lack of communication when dealing with staff shortages due to COVID.

8. Other issues

8.1. This section updates the Committee on other matters relevant to Treasury activity.

Proportionality of Commercial Income

8.2. The Council's view is that income from commercial properties is proportional to wider Council budgets if it remains below 10% of the Council's net cost of services.

8.3. For 2021/22 the outturn figure was not available at the time this report was written, however, based on budgets the figures are expected to remain at around 4.3% of the Council's budgeted net cost of services. Actual outturn figures for 2021-22 will be included in the 2022-23 half-year Treasury update.

Treasury workshop for Members

8.4. A Treasury workshop for all Members was delivered on 2 December 2021. A similar event will be held in December 2022 in advance of the Council's consideration of the same for 23-24.

Regulatory updates

8.5. In August 2021 HM Treasury significantly revised guidance for the PWLB lending facility. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

8.6. CIPFA published its revised Prudential Code for Capital Finance and Treasury Management Code on 20th December 2021. The key changes in the two codes are around permitted reasons to borrow, knowledge and skills, and the management of, and governance arrangements for, non-treasury investments.

8.7. The principles of the Prudential Code took immediate effect although local authorities could defer introducing the revised reporting requirements until the 2023/24 financial year if they wish. Given the short time between publishing of the Code and the start of 2022/23, the revised reporting requirements will be implemented for the 2023/24 financial year.

8.8. Unlike the Prudential Code, there is no mention of a date of initial application in the Treasury Management Code which now includes extensive additional requirements for service and commercial investments, far beyond those in the 2017 version. For consistency, changes in reporting requirements will also only commence from the 2023/24 financial year

Sunsetting of the statutory override

8.9. Members will be aware of the temporary statutory arrangements which require the Council to charge any movements in the fair value of our external pooled funds to a reserve rather than against the Council Tax.

8.10. These arrangements are due to expire on 31 March 2023. Officers understand that DHULC will consult on this issue later this summer and it will be important for the Council to present its case in this consultation. Absent clarity from DHULC, an estimate of the potential revenue impact of changes in the fair values of pooled funds may have to be included in the Council's 2023-24 financial projections.

9. Community impact and corporate risks

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. 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

11. Appendices

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

12. Background Papers

12.1. None.

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

All Funds – cumulative

STRATEGIC POOLED FUND PORTFOLIO				CHICHESTER			From:	29/02/2016	To:	31/03/2022
FUND NAME	ASSET CLASS	No of Units Held in Period	Current Value £	Capital Growth £	Dividends Earned £	Holding Period (yrs)	Capital Return	Income Return	Total Return	Volatility
AEGON (KAMES) DIVERSIFIED MONTHLY INCOME FUND	MULTI ASSET	4,418,978	4,795,466	-204,534	520,817	2.3	-4.09%	10.42%	6.33%	11.5%
CCLA - LAMIT PROPERTY FUND	PROPERTY	3,268,201	11,106,001	1,106,000	2,417,572	5.8	11.06%	24.18%	35.24%	3.7%
M&G OPTIMAL INCOME FUND	BOND	1,101,193	0	11,150	126,837	2.6	0.68%	7.69%	8.36%	2.0%
M&G STRATEGIC CORPORATE BOND FUND	BOND	3,976,338	3,776,582	-223,418	246,614	2.3	-5.57%	6.15%	0.58%	6.4%
NINETY ONE (INVESTEC) DIVERSIFIED INCOME FUND	MULTI ASSET	4,843,652	4,677,999	-322,001	808,050	4.2	-6.44%	16.16%	9.72%	4.8%
SCHRODER INCOME MAXIMISER FUND	EQUITY - UK	11,187,364	4,812,804	-187,196	680,646	2.2	-3.74%	13.61%	9.87%	10.8%
THREADNEEDLE STERLING SHORT-DATED CORPORATE BOND FUND	BOND	2,332,345	2,252,733	-97,266	96,069	2.4	-4.14%	4.09%	-0.05%	2.1%
THREADNEEDLE STRATEGIC BOND FUND	BOND	2,561,534	2,587,149	-62,851	353,898	4.9	-2.37%	13.35%	10.98%	5.4%
GRAND TOTAL			34,008,734	19,884	5,250,500	3.7	0.06%	14.72%	14.78%	5.1%
		Unrealised capital gain since purchase:		8,691	Annualised income return:			3.69%		

All Funds – 2021-22 Financial Year

STRATEGIC POOLED FUND PORTFOLIO				CHICHESTER			From:	31/03/2021	To:	31/03/2022
FUND NAME	ASSET CLASS	No of Units Held in Period	Current Value £	Capital Growth £	Dividends Earned £	Holding Period (yrs)	Capital Return	Income Return	Total Return	Volatility
AEGON (KAMES) DIVERSIFIED MONTHLY INCOME FUND	MULTI ASSET	4,418,978	4,795,466	-7,826	239,208	1.0	-0.16%	4.98%	4.82%	5.8%
CCLA - LAMIT PROPERTY FUND	PROPERTY	3,268,201	11,106,001	1,658,285	366,395	1.0	17.55%	3.88%	21.43%	5.3%
M&G STRATEGIC CORPORATE BOND FUND	BOND	3,975,350	3,776,582	-270,606	98,791	1.0	-6.69%	2.44%	-4.25%	2.5%
NINETY ONE (INVESTEC) DIVERSIFIED INCOME FUND	MULTI ASSET	4,843,652	4,677,999	-220,635	172,291	1.0	-4.50%	3.52%	-0.99%	1.8%
SCHRODER INCOME MAXIMISER FUND	EQUITY - UK	11,187,364	4,812,804	472,360	309,286	1.0	10.88%	7.13%	18.01%	10.4%
THREADNEEDLE STERLING SHORT-DATED CORPORATE BOND FUND	BOND	2,332,345	2,252,733	-111,035	33,230	1.0	-4.70%	1.41%	-3.29%	1.2%
THREADNEEDLE STRATEGIC BOND FUND	BOND	2,561,534	2,587,149	-143,039	58,714	1.0	-5.24%	2.15%	-3.09%	2.1%
GRAND TOTAL			34,008,734	1,377,504	1,277,916	1.0	4.22%	3.92%	8.14%	3.3%
		Unrealised capital gain since purchase:		8,691	Annualised income return:			3.93%		

Appendix B: Treasury Management – Benchmarking indicators

Return

Measure	Qtr 1 21/22	Qtr. 2 21/22	Qtr 3 21/22	Qtr. 4 21/22	Non-met districts Q4 average	Rating
Internal investment return %	0.08	0.05	0.04	0.52	0.46	GREEN
External funds – income return %	4.27	4.35	3.87	4.01	3.80	GREEN
External funds – capital gains/losses %	7.29	8.45	6.16	4.17	8.04	GREEN
Total treasury Investments – income return %	1.39	1.31	2.76	2.86	2.38	GREEN

Security

	Average Credit Score Time weighted (lower = better)	Average Credit Rating Time weighted	Bail-in exposure (lower = better)	
31 March 2021	4.54	A+	27%	
31 March 2022	4.59	A+	74%	GREEN
Similar Local Authorities	4.11	AA-	61%	

The increase in bail-in exposure is due to greater use of Money Market Funds in 2021/22. These funds are very diversified and the bail-in risk for individual banks is very low The credit score difference between CDC and similar local authorities reflects greater use of the Government's Debt Management Office by other Councils – CDC chose to use Money Market Funds in preference to the DMO as DMO funds are for fixed terms. As this was a Treasury decision, the score is maintained at GREEN

Liquidity

	7 day liquidity	100 day liquidity	Average maturity	
31 March 2021	11%	33%	103 days	
31 March 2022	49%	54%	39	GREEN
Similar Local Authorities	51%	66%	43	

The liquidity measure used is a value weighted average. At 31 March 2022 the Council had a greater proportion of liquid investments as previously explained. This was a common picture across many local councils as the sector continues to manage both COVID and energy rebate funding from the Government. Overall score assessed as GREEN as the movement is part of a nationwide picture.

Appendix C – Compliance report

Compliance with investment limits

Sector	Time limit	Counterparty limit	Sector limit	Complied/ Exception Ref
The UK Government	25 years	Unlimited	n/a	Complied
Local authorities & other government entities	10 years	£5m	Unlimited	Complied
Secured investments	10 years	£5m	Unlimited	Complied
Banks (unsecured)	13 months	£3m	Unlimited	Exception *
Building societies (unsecured)	13 months	£3m	£5m	Complied
Money market funds	n/a	£5m or 0.5% of fund value	Unlimited	Complied
Strategic pooled funds (excluding LAPF)	n/a	£5m	£30m	Complied
Strategic pooled funds (CCLA - LAPF)	n/a	£10m	£10m	Complied
Real estate investment trusts	n/a	£2m	£4m	Complied
Other investments	2 years	£3m	£5m	Complied

* details of the exception are reported at Section 7 of the main report

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 (£2.5m).

	31/3/22 Actual	2021/22 Limit	
Upper limit on one-year revenue impact of a 1% change in interest rates	£0.53m	£2.5m	Complied

This limit is only calculated as of 31 March each year.

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:

	2021/22	2022/23	2023/24
Actual principal invested beyond year end*	£34m	£47m*	£47m*
Limit on principal invested beyond year end	£60m	£60m	£60m
	Complied	Complied	Complied

* expected figure– additional £3m invested April 2022 and assumes a further £10m later in 2022/23

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 2022
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	See paragraph 8.3 of main report
Net operating surplus	This indicator measures the contribution received from the investment portfolio at a net level (income less costs) over time.	The Council's investment property portfolio generated £927k rental income and incurred £68k direct costs leaving a surplus of £859k before any changes in fair value.
Vacancy levels and tenant exposure	Monitoring vacancy levels to ensure the property portfolio is being managed productively.	Voids at 31st March 2022: • Industrial 2/9 • Retail 2/26 • Offices 1/8 Total 5/43 = 11.63% (20/21 16.33%)
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 2022 and the Council's statement of accounts discloses a value of £13.87m for the Council's investment properties on that date. This remains the latest valuation of our investment portfolio. As we continue with the recovery phase it is evident that Covid 19 has negatively impacted rental values in some sectors. It remains challenging to predict the full impact on our investment properties with any certainty, particularly as other Macro issues are influencing the markets. The challenges to the commercial property market have been compounded as a result of the cost of living crisis, Brexit and Russian invasion of Ukraine, which have each contributed to supply issues, impacted imports and exports and increased costs. Government support packages and grant funding has only been able to mitigate against this to a small degree. Accordingly, downward pressure on rents and risk of tenant default continues, with investment yields needing to reflect the added risk to future income streams which 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 generated since the acquisition when comparing to the original purchase price. Funds should also be made available for planned maintenance to maximise potential rental income.