Chichester District Council

Corporate Governance and Audit Committee 31 October 2022

2022-2023 Treasury Management half-yearly update

1. Contacts

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2. Recommendation

2.1 The Committee is requested to consider the Treasury activity summarised in this report and provide comments to the Cabinet as necessary.

3. Background

3.1 This report provides the Committee with a summary of treasury management activity and regulatory developments for the year to date.

3.2 The Authority's treasury management strategy for 2022/23 was approved by Council in March 2022. The Authority continues to invest in line with this policy and the investment position on 30 September 2022 is shown below.

Table 1: Treasury Management Summary

Investments £000	**Balance 31/03/2022**	**Movement**	**Balance 30/9/2022**
Short term Investments Money Market Funds	23,000 54,400	(5,000) 3,000	18,000 57,400
Total liquid investments	77,400	(2,000)	75,400
Long term Investments Pooled Funds – External Pooled funds – Local Authority Property fund	24,000 10,000	6,000 -	30,000 10,000
Total investments	111,400	4,000	115,400

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

4. 2022-23 Treasury Summary

4.1 Treasury activity during the first six months of the year focussed on using money market funds for short term liquidity due to the rising interest rate environment.

4.2 Lending to Local Authorities continues to play a relatively small part in our treasury activity given the fixed terms offered and the growing trend to request deals well in advance of the actual investment date. In a rising interest rate environment, this often made it difficult to assess if the offered interest rate will be competitive at the date of the investment.

4.3 The Council also invested a further £6m in an external multi-asset pooled fund, and further details of this are provided in section 7. The Council's overall investments in external pooled funds to the end of September are shown in appendix A.

4.4 Appendix B contains the usual suite of benchmarking data for the Council's Treasury portfolio as of 30 September 2022. One indicator is rated red and two are rated amber. Explanations and further information are provided for these indicators in the appendix.

4.5 On a positive note, the Council's return on its investment portfolio is now expected to significantly exceed budget, almost entirely due to the significant tightening of UK and world monetary policy over the last 12 months. More information on this can be found in section 8 and appendix E.

5. Other Non-Treasury Holdings and Activity

5.1 Although not classed as treasury management activity, the CIPFA Code 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 as of 31 March 2022.

5.3 As the property market emerges from the recovery stage and begins to return to some sense of normality, the changing landscape continues to evolve. The Council's commercial property investments must therefore react and adapt to maintain revenue, and where possible, maximise alternative income opportunities.

5.4 Business and consumer sentiment and confidence is a key driver of the commercial property investment markets, given the importance of occupier occupational demand. The economic outlook following the Governments recent 'mini-budget' and subsequent increases in interest rates together with an anticipated recession mean there is continued uncertainty around the future profitability of our commercial property portfolio.

5.5 It therefore remains difficult to determine the long-term impact on our investment portfolio with any certainty and limited tangible evidence to support it, with some property sectors proving to be more robust than others. For example, continued high demand for industrial premises contrasts with downward pressure on high street retail rents and an increased risk of tenant default, whilst sentiment for out-of-town retail is marginally more positive. Investment yields need to reflect the added risk to future income streams and that will ultimately result in lower capital values.

5.6 Presently two of the Council's Investment Properties have a market value that is less than the original purchase price. In aggregate the carried loss on these two properties is £836k, representing 16% of the original investment cost of £5,342k. Putting this into context, the income received annual from our investment properties is around £0.9m per annum and any carried gains or losses are only crystallised as and when the Council disposes of the property. At present, the Council has no need to, or intention of, disposing of these commercial investments.

6. Compliance Report

6.1 How treasury activity complied with the main 2022-23 treasury limits is disclosed at appendix C. There are two exceptions for the reporting period which meant that the Council exceeded its limit of £2.5m in its main bank account twice:

- a large CIL receipt that was received in the Council's bank account after the Council had completed its Treasury calculations at the start of the day;
- an investment maturity date was recorded incorrectly by one day, leading to the repayment being received one day earlier than expected. The sum was again received very late in the day when no other potential investments were open.

7. Other Developments

This section updates the Committee on relevant developments since the last report in earlier this year.

Investments in external funds

7.1 Officers monitor longer term cash projections to identify if longer term, higher yielding investments are possible.

7.2 Following consultation with the s.151 officer and Cabinet Member for Finance, a further £6m investment was made in two tranches (April and September) in the CCLA Diversified Income Fund. The fund is a multi-asset actively managed fund which aims to provide growth in income and capital over the long-term from a diversified portfolio.

New Codes and Regulations

7.3 Following the publication of a consultation on the Statutory Override that isolates the Council's general Fund from gains or losses in the fair value of its external pooled fund investments, the Council submitted a response on 9 September 2022. A copy of this response is included at appendix F.

7.4 The response argued that the statutory override should be made permanent in the first instance, and if this is not possible, then it should be extended for another period. The addition of a further source of revenue uncertainty and financial risk at present time this time would be an unwelcome development and may mean further revenue resource being diverted from funding front line services to mitigate fair value risk. This matter is considered in the Council's financial strategy for 2023-24.

2022-23 Treasury workshop

7.5 A workshop for Members will be held on 5 December at East Pallant House. The workshop will address the Treasury Management function at a high level to support understanding of Members' and Officers' roles and responsibilities. It will also consider regulatory and environmental changes that will be reflected in the 2023/24 Treasury Management Strategy Statement and Investment Strategy.

8. Estimates of 2022/23 income

8.1 The Authority's 2022/23 budget was set (in November 2021) against a very different economic backdrop than is presently being experienced. As a result, the budget figures are no longer representative of the actual interest being paid following some strong fiscal tightening by the Bank of England since the start of the year.

8.2 The figures in table 2 for external pooled funds are based on announced dividends to the end of the period, some of which will not be received until a month or two later. Further investments in pooled funds made during Autumn 2022 are also not factored into these projections.

8.3 The actual income will ultimately depend on many factors including but not limited to the present fiscal and economic outlook, the fund's sectoral asset allocation, securities held/bought/sold and, in the case of equities, the enforced or voluntary dividend cuts or deferral.

Table 2: Income by investment type 2022-23

	To date	Full year Estimate	Budget	Comments
LAPF	£155k	£372k	£420k	
Pooled Funds	£577k	£1.366m	£1.13m	Dividend frequencies vary by fund, outturn estimate includes additional £3m investment in CCLA-DIF in September 2022. The outturn effect of any further investments in pooled funds is not included.
Internal Funds	£180k	£1.48m	£78k	The actual returns are highly dependent on the future direction and ceiling of interest rates. The estimate is based on an average return of 3.25% on £60m for 8 months from August 2022.

Note1: The actual figure is adjusted for announced dividends up to the end of August 2022

9. Alternatives Considered

9.1 None

10. Resource and Legal Implications

10.1 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.

11. Consultation

11.1 Not relevant.

12. Community impact and corporate risks

12.1 Not relevant

13. 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

14. 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 2022-23
F - IFRS9 consultation response

15. Background Papers

15.1 None.

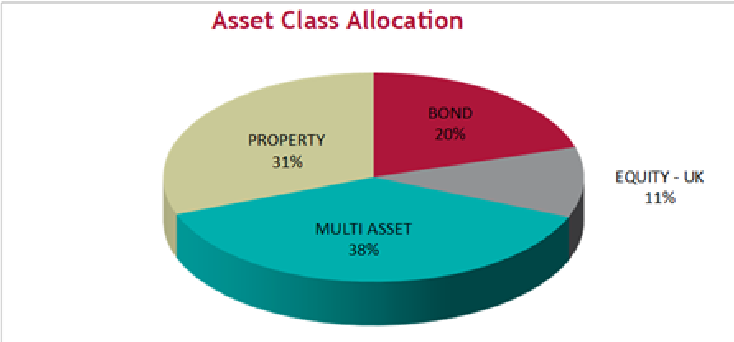
Appendix A: Movements in Fund fair values and income – Pooled Funds

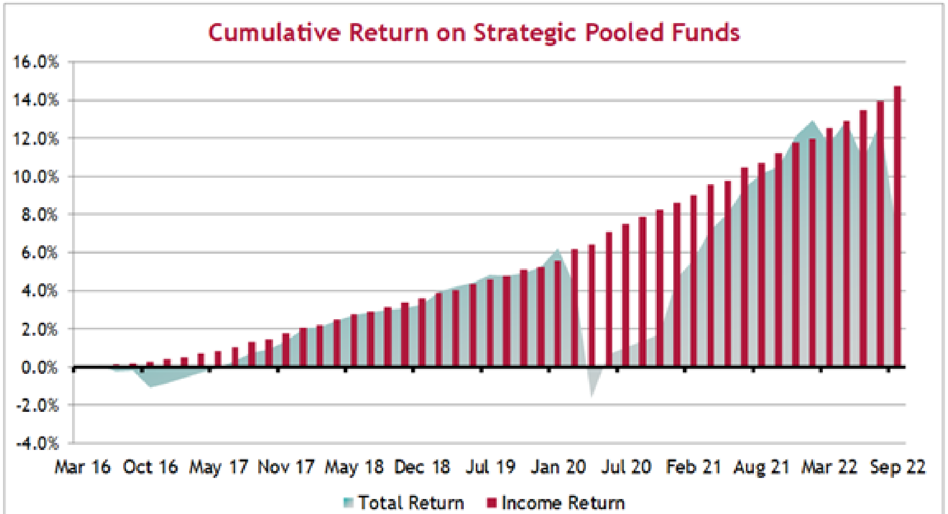
Exhibit A1: Performance (Cumulative: April 2016 to end August 2022)

Overall capital values have been affected by global uncertainty and monetary policy. The value has fallen further since the end of August and on 18 October the carried loss on pooled funds was £3.8m.

STRATEGIC POOLED FUND PORTFOLIO | CHICHESTER | From: 31/03/2016 | To: 30/09/2022

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	4,013,316	-986,684	674,575	2.8	-19.73%	13.49%	-6.24%	8.0%
CCLA - DIVERSIFIED INCOME FUND	MULTI ASSET	3,912,347	5,540,275	-459,725	63,564	0.3	-7.68%	1.06%	-6.62%	3.9%
CCLA - LAMIT PROPERTY FUND	PROPERTY	3,268,201	11,190,320	1,550,129	2,599,654	6.2	16.08%	26.97%	43.05%	4.1%
M&G STRATEGIC CORPORATE BOND FUND	BOND	3,976,338	3,124,625	-875,375	310,879	2.8	-21.82%	7.75%	-14.07%	3.8%
NINETY ONE (INVESTEC) DIVERSIFIED INCOME FUND	MULTI ASSET	4,843,652	4,261,068	-738,932	908,548	4.6	-14.78%	18.17%	3.39%	2.8%
SCHRODER INCOME MAXIMISER FUND	EQUITY - UK	11,187,364	3,944,665	-1,055,335	897,378	2.7	-21.11%	17.95%	-3.16%	9.8%
THREADNEEDLE STERLING SHORT-DATED CORPORATE BOND FUND	BOND	2,332,345	2,027,207	-322,792	116,566	2.9	-13.74%	4.96%	-8.78%	2.3%
THREADNEEDLE STRATEGIC BOND FUND	BOND	2,561,534	2,254,150	-395,850	392,392	5.4	-14.94%	14.81%	-0.13%	3.5%
GRAND TOTAL			36,355,625	-3,273,417	6,090,393	3.6	-7.93%	14.75%	6.82%	3.9%
		Unrealised capital loss since purchase:	-3,644,418		Annualised income return:			3.80%		





Appendix B: Treasury Management – Benchmarking indicators

Return

Measure	Qtr. 3 21-22	Qtr. 4 21-22	Qtr. 1 22-23	Qtr. 2 22-23	Non-met districts Q4 average	Rating
Internal investment return %	0.04	0.52	0.93	1.89	1.70	GREEN
External funds – income return %	3.87	4.01	3.97	4.20	3.87	GREEN
External funds – capital gains/losses %	6.16	4.17	(1.52)	(7.41)	(1.73)	RED
Total treasury Investments – income return %	2.76	2.86	1.40	0.23	0.90	AMBER

On 18 October, the cumulative carried loss on the Council's pool funds was £3.8m

A red risk score has been assigned to the external fund fair value movements as it is significantly above that of the comparator group. This is mainly due to the preponderance of CCLA property fund only portfolios in the comparator group. The CCLA property fund has been far more resilient over the last 6 months than more diverse portfolios with a mix of asset classes, especially those exposed to bonds.

It remains true that the best external portfolio over the long term is a mix of asset classes, not a single investment in one fund/ asset class.

Security

	Average Credit Score Time weighted (lower = better)	Average Credit Rating Time weighted	Bail-in exposure (lower = better)	
31 March 2022	4.59	A+	74%	
30 September 2022	4.88	A+	76%	AMBER
Similar Local Authorities	4.23	AA-	57%	

CDC's overall credit score has been affected by the size of the Council's investments in money market funds. Whilst AAA rated as funds, Arlingclose bases their credit score on a more detailed analysis of individual securities comprising each fund. The recent economic troubles have affected individual credit scores which have, in turn, resulted in the movement in benchmark credit scores shown above.

The use of money market funds, which comprise many individual investments, is still considered to be more secure overall than direct investment in individual banks and financial institutions.

Liquidity

	7-day liquidity	100-day liquidity	Average maturity	
31 March 2022	49%	54%	39	
30 September 2022	51%	67%	8	GREEN
Similar Local Authorities	41%	62%	42	

The low average days to maturity is a managed position given the rising interest rate environment.

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	GREEN
Local authorities & other government entities	10 years	£6m	Unlimited	GREEN
Secured investments	10 years	£6m	Unlimited	GREEN
Banks (unsecured)	13 months	£3m	Unlimited	Exception *
Building societies (unsecured)	13 months	£3m	£6m	GREEN
Money market funds	n/a	£6m or 0.5% of fund value	Unlimited	GREEN
Strategic pooled funds (excluding LAPF)	n/a	£6m	£30m	GREEN
Strategic pooled funds (CCLA - LAPF)	n/a	£15m	£10m	GREEN
Real estate investment trusts	n/a	£2m	£4m	GREEN
Other investments	2 years	£3m	£6m	GREEN

* details of the exception are reported at Section 6 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 (£3m).

	31/3/22 Actual	2022/23 Limit	
Upper limit on one-year revenue impact of a 1% change in interest rates	£0.50m	£3m	GREEN

This limit is only calculated as at 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:

	2022/23 expected	2023/24 forecast	2024/25 forecast
Actual principal invested beyond year end*	£45m	£45m	£45m
Limit on principal invested beyond year end	£80m	£80m	£80m
	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	30 September 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	This indicator is only calculated and reported as of 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 of 31 March each year
Vacancy levels and tenant exposure	Monitoring vacancy levels to ensure the property portfolio is being managed productively.	Voids on 30th September 2022: • Industrial 1/9 • Retail 1/23 • Offices 1/8 Total 3/40 = 7.5% (20/21 10.2%)
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
Fair value of commercial properties	This indicator will track the Council's ability to recover its investment in any commercial investment should the need arise.	See main report section 5

Appendix E

Arlingclose's Economic Outlook for the remainder of 2022/23 (based on 26th September 2022 interest rate forecast)

	Current	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
Official Bank Rate													
Upside risk	0.00	0.50	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	**2.25**	**4.25**	**5.00**	**5.00**	**5.00**	**5.00**	**5.00**	**5.00**	**5.00**	**4.75**	**4.25**	**3.75**	**3.25**
Downside risk	0.00	-1.00	-1.00	-0.75	-0.50	-0.50	-0.50	-0.75	-1.25	-1.50	-1.75	-1.75	-1.75

Arlingclose expects Bank Rate to rise further during 2022/23 to reach 5% by the end of the year.

The MPC is particularly concerned about the demand implications of fiscal loosening, the tight labour market, sterling weakness and the willingness of firms to raise prices and wages. The MPC may therefore raise Bank Rate more quickly and to a higher level to dampen aggregate demand and reduce the risk of sustained higher inflation. Arlingclose now expects Bank Rate to peak at 5.0%, with 200bps of increases this calendar year.

This action by the MPC will slow the economy, necessitating cuts in Bank Rate later in 2024.

Gilt yields will face further upward pressure in the short term due to lower confidence in UK fiscal policy, higher inflation expectations and asset sales by the BoE. Given the recent sharp rises in gilt yields, the risks are now broadly balanced to either side. Over the longer term, gilt yields are forecast to fall slightly over the forecast period.

Background:

Monetary policymakers are behind the curve having only raising rates by 50bps in September. This was before the "Mini-Budget", poorly received by the markets, triggered a rout in gilts with a huge spike in yields and a further fall in sterling. In a shift from recent trends, the focus now is perceived to be on supporting sterling whilst also focusing on subduing high inflation.

There is now an increased possibility of a special Bank of England MPC meeting to raise rates to support the currency. Followed by a more forceful stance over concerns on the looser fiscal outlook. The MPC is therefore likely to raise Bank Rate higher than would otherwise have been necessary given already declining demand. A prolonged economic downturn could ensue.

Uncertainty on the path of interest rates has increased dramatically due to the possible risk from unknowns which could include for instance another Conservative leadership contest, a general election, or further tax changes including implementing windfall taxes.

The government's blank cheque approach to energy price caps, combined with international energy markets priced in dollars, presents a fiscal mismatch that has contributed to significant decline in sterling and sharp rises in gilt yields which will feed through to consumers' loans and mortgages and business funding costs.
UK government policy has mitigated some of the expected rise in energy inflation for households and businesses flattening the peak for CPI, whilst extending the duration of elevated CPI. Continued currency weakness could add inflationary pressure.

The UK economy already appears to be in recession, with business activity and household spending falling. The short- to medium-term outlook for the UK economy is relatively bleak.

Global bond yields have jumped as investors focus on higher and stickier US policy rates. The rise in UK government bond yields has been sharper, due to both an apparent decline in investor confidence and a rise in interest rate expectations, following the UK government's shift to borrow to loosen fiscal policy. Gilt yields will remain higher unless the government's plans are perceived to be fiscally responsible.

The housing market impact of increases in the Base Rate could act as a "circuit breaker" which stops rates rising much beyond 5.0%, but this remains an uncertainty.