MEETING:	**PENSIONS COMMITTEE**
DATE:	**21 JANUARY 2021**
TITLE:	**TREASURY MANAGEMENT 2020/21 – MID YEAR REVIEW**
PURPOSE:	**CIPFA's Code of Practice recommends that a report on the Council's actual Treasury Management during the current financial year is produced.**
RECOMMENDATION:	**RECEIVE THE REPORT FOR INFORMATION**
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EXECUTIVE SUMMARY

During the six month period between 1 April and 30 September 2020, the Council's borrowing and investments remained well within the limits originally set. There were no new defaults by banks in which the Council deposited money. Furthermore, it is estimated that the Council's actual investment income will be lower than the expected income in the 2020/21 budget.

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1. INTRODUCTION

The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that Authorities report on the performance of the treasury management function at least twice yearly (mid-year and at year end). This report provides a mid-year update.

The Council's treasury management strategy for 2020/21 was approved by full Council on 5th March 2020. The Council has 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.

It was decided at the Pensions Committee, 18 March 2020 to allow the surplus funds of the Pension Fund to be pooled and co-invested with the Council's overall cash flow for the financial year 2020/21.

2. CONTEXT

On 30th September 2020, the Council had £63.1m of investments, compared with £27.8m on 31 March 2020, with an average return of 0.61%.

3. INVESTMENT ACTIVITY

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the 6 months, the Council's investment balance ranged between £49.6 and £110.4 million due to timing differences between income and expenditure. The investment position during the period is shown in the table below.

Treasury Investment Position

	31.3.20 Balance £m	6 month Movement £m	30.9.20 Balance £m	30.9.20 Income Returns %
Banks & building societies (unsecured)	8.7	5.0	13.7	0.22
Local authorities	0.0	6.0	6.0	0.08
Debt Management Office	0.0	4.0	4.0	0.01
Money Market Funds	9.1	20.3	29.4	0.07
Pooled Funds (initial investment)	10.0	0.0	10.0	3.30
Total investments	**27.8**	**35.3**	**63.1**	

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 treasury investments before seeking the optimum 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.

In the light of the pandemic crisis and the likelihood of unexpected calls on cash flow, the Council has kept more cash available at very short notice than is normal. Liquid cash was diversified over several counterparties and Money Market Funds to manage both credit and liquidity risks.

£10m of the Authority's investments are held in externally managed strategic pooled property and equity funds where short- term security and liquidity are lesser consideration, and the objectives instead are regular revenue income and long- term price stability. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued stability in meeting the Authority's investment objective are regularly reviewed.

The performance of our pooled property and equity funds at 30 October 2020 can be seen below:

STRATEGIC POOLED FUND PORTFOLIO			GWYNEDD				From: 21/02/2019		To: 31/10/2020	
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	1,158,480	1,145,158	-104,842	99,997	1.7	-8.39%	8.00%	-0.39%	12.2%
CCLA - LAMIT PROPERTY FUND	PROPERTY	1,524,344	4,250,328	-749,672	305,882	1.7	-14.99%	6.12%	-8.88%	6.2%
NINETY ONE (INVESTEC) DIVERSIFIED INCOME FUND	MULTI ASSET	1,209,599	1,202,221	-47,779	85,516	1.7	-3.82%	6.84%	3.02%	6.3%
SCHRODER INCOME MAXIMISER FUND	EQUITY - UK	4,783,773	1,518,370	-981,630	256,234	1.7	-39.27%	10.25%	-29.02%	17.7%
GRAND TOTAL			8,116,076	-1,883,924	747,629	1.7	-18.84%	7.48%	-11.36%	6.8%
			Unrealised capital loss:	-1,883,924	Annualised income return:			4.38%		

It is evident that the combined capital value of £8.116m is less than the initial investment of £10m. Strategic 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. Investment in these funds will be maintained in the medium term.

The falls in the capital values of the underlying assets, in particular bonds and equities were reflected in the 31st March 2020 fund valuations with most funds registering negative capital returns over a 12-month period. Since March there here has been improvement in market sentiment which is reflected in an increase in capital values except for the property funds where dealing 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.

Investment Benchmarking

The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in the table below.

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
31.03.2020	4.99	A+	100%	31	1.97
30.06.2020	4.39	AA-	71%	13	0.85
30.09.2020	3.98	AA-	74%	14	0.68
Similar LAs	**4.41**	**AA-**	**44%**	**177**	**0.40**
All Las	**4.14**	**AA-**	**64%**	**18**	**0.90**

Treasury Management Performance

The Council measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates.

Investment income in the Council's 2020/21 budget was set against a very different economic backdrop. Bank rate, which was 0.75% in February, now stands at 0.1%, but interest earned from short dated money markets will be significantly lower. In relation to income from the Council's externally managed strategic funds, dividend 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 and securities held.

The Council's budgeted investment income for the year is £0.4m, however the actual expected investment income for the year 2020/21 is estimated at £0.08m. This is based on the following expectation:

- Bond funds and property fund: 20% lower
- Multi asset income funds: 25% lower
- Equity income funds: 50% lower
- Overnight rate: 0.01%-0.06%

4. COMPLIANCE

The Council's borrowing and investments remained well within the limits originally set. The only indicator that was not met is Interest Rate Exposures.

Debt Limits

	Maximum during period	**30.9.20 Actual**	**2020/21 Operational Boundary**	**2020/21 Authorised Limit**	**Complied**
Borrowing	£124.9m	£110.0m	£184m	£194m	✓
PFI & finance leases	£1.7m	£1.7m	£6m	£6m	✓
Total debt	**£126.6m**	**£111.7m**	**£180m**	**£200m**	✓

Investment Limits

	Maximum during period	30.9.20 Actual	2020/21 Limit	Complied
Any single organisation, except the UK Government	£7m	£7m	£8m each	✓
UK Central Government	£45.4m	£4m	Unlimited	✓
Any group of organisations under the same ownership	£0	£0m	£8m per group	✓
Any group of pooled funds under the same management	£5m	£5m	£20m per manager	✓
Negotiable instruments held in a broker's nominee account	£0	£0	£40m per broker	✓
Limit per non-UK country	£5m	£4m	£8m per country	✓
Registered providers	£0	£0	£20m in total	✓
Unsecured investments with building societies	£0	£0	£8m in total	✓
Loans to unrated corporates	£0	£0	£8m in total	✓
Money Market Funds	£40m	£29.4m	£40m in total	✓
Real Estate Investment Trusts	£0	£0	£20m in total	✓

Treasury Management Indicators

The Council measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one year revenue impact of a 1% rise or fall in interest was:

Interest rate risk indicator	2021/21 Limit	2020/21 Target	Complied
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	£374,303	£324,000	✗
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	£5,096	£23,000	✓

Since setting this indicator the economic outlook for interest rates has changed completely with the onset of the global pandemic. The average interest rate received on short term balances was 0.07% during the six month period to 30th September 2020, with more recent investment being made as low as 0.01%. This indication was set when the base rate was 0.75% and therefore it is reasonable that there is such an impact of a 1% rise, and demonstrates the severe impact that the pandemic has had on investment returns.

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating or credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

	Target	**Actual**	**Complied**
Portfolio average credit score	6.0	3.98	✓

Liquidity: The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments.

	30.9.20 Actual	**2020/21 Target**	**Complied**
Total cash available within 3 months	£53.1m	£10m	✓

Maturity Structure of Borrowing: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	**Lower**	**Actual**
Under 12 months	25%	0%	5.0%
12 months and within 24 months	25%	0%	1.4%
24 months and within 5 years	50%	0%	8.6%
5 years and within 10 years	75%	0%	9.9%
10 years and above	100%	0%	75.1%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal Sums Invested for Periods Longer than 364 days: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2020/21	2021/22	2022/23
Actual principal invested beyond year end	£0m	£0m	£0m
Limit on principal invested beyond year end	£20m	£20m	£20m
Complied	✓	✓	✓

5. INVESTMENT TRAINING

During the period, officers have attended investment training with Arlingclose and CIPFA relevant to their roles.

6. OTHER

IFRS 16: The implementation of the new IFRS 16 Leases accounting standard has been delayed until 2021/22.

7. OUTLOOK FOR THE REMAINDER OF 2020/21

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.