COTSWOLD
DISTRICT COUNCIL

Council name	**COTSWOLD DISTRICT COUNCIL**
Name and date of Committee	**AUDIT COMMITTEE – 26 NOVEMBER 2020**
Report Number	**AGENDA ITEM 10**
Subject	**TREASURY MID-TERM REPORT 2020-21**
Wards affected	N/A
Accountable member	Cllr. Mike Evemy - Deputy Leader and Cabinet Member for Finance Email: mike.evemy@cotswold.gov.uk
Accountable officer	Jenny Poole - Chief Finance Officer Tel: 01285 623313 Email: jenny.poole@cotswold.gov.uk
Summary/Purpose	To receive and discuss the Council's Treasury Management performance for the period 1 April to 20 September 2020.
Annexes	None
Recommendation/s	*That the Treasury Management mid-year performance be considered and recommended to Council for approval.*
Corporate priorities	The Council's Treasury Management Strategy underpins all of the Council Priorities and is relevant to the Council principle of "Value for money – we will use the council's resources wisely, but will invest in the fabric and future of the district".
Key Decision	NO
Exempt	NO
Consultees/ Consultation	NONE

1. BACKGROUND

1.1 In February 2011 the Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports on treasury activities the authority has carried out.

1.2 This report covers the treasury management activity and performance of Cotswold District Council for the period 1st April to 30th September 2020.

1.3 The Council's treasury management strategy for 2020/21 was approved at a meeting on 26 February 2020. The Council has 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 and other market conditions. The successful identification, monitoring and control of risk are therefore central to the council's Treasury Management Strategy.

2. ECONOMIC BACKGROUND

2.1 The spread of the coronavirus pandemic dominated during the period as countries around the world tried to manage the delicate balancing act of containing transmission of the virus while easing lockdown measures and getting their populations and economies working again. After a relatively quiet few months of Brexit news it was back in the headlines towards the end of the period as agreement between the UK and EU on a trade deal was looking difficult and the Government came under fire, both at home and abroad, as it tried to pass the Internal Market Bill which could override the agreed Brexit deal, potentially breaking international law.

2.2 The Bank of England (BoE) maintained Bank Rate at 0.1% and its Quantitative Easing programme at £745 billion. The potential use of negative interest rates was not ruled in or out by BoE policymakers, but then a comment in the September Monetary Policy Committee meeting minutes that the central bank was having a harder look at its potential impact than was previously suggested took financial markets by surprise.

2.3 Government initiatives continued to support the economy, with the furlough (Coronavirus Job Retention) scheme keeping almost 10 million workers in jobs, grants and loans to businesses and 100 million discounted meals being claimed during the 'Eat Out to Help Out' (EOHO) offer.

2.4 GDP growth contracted by 19.8% (revised from first estimate -20.4%) in Q2 2020 (Apr-Jun) according to the Office for National Statistics, pushing the annual growth rate down to -21.5% (first estimate -21.7%). Construction output fell by 35% over the quarter, services output by almost 20% and production by 16%. Recent monthly estimates of GDP have shown growth recovering, with the latest rise of almost 7% in July, but even with the two previous monthly gains this still only makes up half of the lost output. The headline rate of UK Consumer Price Inflation (CPI) fell to 0.2% year/year in August, further below the Bank of England's 2% target, with the largest downward contribution coming from restaurants and hotels influenced by the EOHO scheme.

2.5 The US economy contracted at an annualised rate of 31.7% in Q2 2020 (Apr-Jun). The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% but announced a change to its inflation targeting regime. The move is to a more flexible form of average targeting which will allow the central bank to maintain interest rates at low levels for an extended period to support the economy even when inflation is 'moderately' above the 2% average target, particularly given it has been below target for most of the last decade.

2.6 The European Central Bank maintained its base rate at 0% and deposit rate at -0.5%.

3. FINANCIAL MARKETS

3.1 Equity markets continued their recovery, with the Dow Jones climbing to not far off its pre-crisis peak, albeit that performance being driven by a handful of technology stocks including Apple and Microsoft, with the former up 75% in 2020. The FTSE 100 and 250 have made up around half of their losses at the height of the pandemic in March. Central bank and government stimulus packages continue to support asset prices, but volatility remains.

3.2 Ultra-low interest rates and the flight to quality continued, keeping gilts yields low but volatile over the period with the yield on some short-dated UK government bonds remaining negative. The 5-year UK benchmark gilt yield started and ended the June–September period at -0.06% (with much volatility in between). The 10-year gilt yield also bounced around, starting at 0.21% and ending at 0.23% over the same period, while the 20-year rose from 0.56% to 0.74%. 1-month, 3-month and 12-month bid rates averaged 0.02%, 0.06% and 0.23% respectively over the period.

3.3 Credit default swap spreads eased over most of the period but then started to tick up again through September. In the UK, the spreads between ring-fenced and non-ring-fenced entities remains, except for retail bank Santander UK whose CDS spread remained elevated and the highest of those we monitor at 85bps while Standard Chartered was the lowest at 41bps. The ring-fenced banks are currently trading between 45 and 50bps.

3.4 After a busy second quarter of the calendar year, the subsequent period has been relatively quiet for credit changes for the names on our counterparty list. Fitch assigned a AA- deposit rating to Netherlands lender Rabobank with a negative outlook and prior to that, while not related to our counterparty list but quite significant, revised the outlook on the US economy to Negative from Stable while also affirming its AAA rating.

3.5 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 our 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. TREASURY MANAGEMENT- SUMMARY POSITION 1/4/20 to 30/6/20

4.1 On 31st March 2020, the Council had net investments of £24.987m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while useable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below:

Table 1: Balance Sheet Summary

	31/3/20 Actual£m
General Fund CFR	0
Less: External borrowing	0
Less: Usable reserves	(22.309)
Less: Working capital	(2.678)
Net Investments	**(24.987)**

4.2 The Council's current strategy is to maintain investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk. Lower official interest rates have reduced the cost of short term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing.

4.3 The Council's strategy has been to diversify investments into pooled funds in order to reduce risk and increase returns. The treasury management position as at 31st March 2020 and the mid-year change is shown in Table 2 below:

Table 2: Treasury Management Summary

	31/3/2020 Actual £m	**2020/21 Movement £m**	**30/9/2020 Balance £m**	**30/9/2020 Rate %**
Short-term borrowing	0	0	0	-
Total borrowing	**0**	**0**	**0**	**-**
Long-term investments	11.192	0.261	11.453	3.79
Short-term investments	8.108	(6.108)	2.000	0.61
Cash and cash equivalents	5.687	3.340	9.027	0.20
Total investments	**24.987**	**(2.507)**	**22.480**	**1.84**

4.4 As at 30 September 2020 this council was debt free however there are plans to borrow in the future to fund the capital programme. Any borrowing undertaken will be report back to members of this committee.

5. INVESTMENT PERFORMANCE AND PROJECTIONS

5.1 On 1st April 2020 the Council received central government funding to support small and medium businesses during the coronavirus pandemic through grant schemes. £37.46m was received, temporarily invested in short-dated, liquid instruments such as call accounts, Money Market Funds and the DMADF account. Due to the unusual size of the large credit received the Lloyds current account closing balance for one day was over its £6m limit (£17.31m). All of £37.4m was disbursed by the end of September 2020.

5.2 The Council invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances ranged between £60m and £18m million due to timing differences between income and expenditure. The investment position is shown in table 3 below.

Table 3: Treasury Investment Position

	31.3.20 Balance £m	Net Movement £m	30.9.20 Balance £m	30.9.20 Return %
Banks & Building Societies (unsecured)	6.000	(6.000)	0	-
Local Authorities	2.000	0	2.000	1.00
Money Market Funds/ Call Accounts	5.687	3.340	9.027	0.20
Pooled Funds	11.300	0.153	11.453	3.79
Total Investments	**24.987**	**(2.507)**	**22.480**	**1.84**

5.3 Both the CIPFA Code and Government guidance require the Authority 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 Authority'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.

5.4 On 25th September the overnight, 1- and 2-week deposit rates on Debt Management Account Deposit Facility (DMADF) deposits dropped below zero percent to -0.03%, the rate was 0% for 3-week deposits and 0.01% for longer maturities. The return on Money Market Funds net of fees also fell over the six months and for many funds net returns range between 0% and 0.5%. In many instances, the fund management companies have temporarily lowered or waived fees to maintain a positive net return.

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

5.6 Investment income in the Authority's 2020/21 budget was set against a very different economic backdrop. In February 2020 the Council's Investment income for 2020/21 was budgeted to be £545,000. Bank Rate, which was 0.75% in February 2020, now stands at 0.1%. Interest earned from short-dated money market investments will be significantly lower. 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.

5.7 Investment income in 2020/21, after looking at the returns over the first 6 months, could be down by £140,000 by year end.

6. EXTERNALLY MANAGED POOLED FUNDS

6.1 £11.5m of the Council's investments are held in externally managed strategic pooled bond, equity, multi-asset and property funds and a further £1m is invested in a Housing Real Estate Investment Trust where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds have generated a revenue return of £150,191 (2.78%) in the first 6 months of this financial year, which is used to support services in year, and £260,886 (2.28%) of capital growth since 31 March 2020.

6.2 Table 4 below shows the current valuations of the Pooled Funds portfolio at 30th September 2020, compared with the opening balances of 1st April 2020.

Table 4: Pooled Funds

FUND NAME	Initial Investment	1 April Fund Value	30th Sept Fund Value	Dividends in 2020/21 (as at 30 Sept)	Gain / (Loss) for 2020/21	Gain / (Loss) to Initial Principal
	£	£	£	£	£	£
CCLA Property Fund	500,000	493,240	472,725	4,749	(20,515)	(27,275)
CCLA Property Fund	2,000,000	1,805,861	1,730,741	17,386	(75,120)	(269,259)
Schroders Income Maximiser Fund (E)	1,000,000	621,563	597,705	11,885	(23,858)	(402,296)
CCLA Diversified Income Fund (M)	1,000,000	909,165	971,685	9,888	62,520	(28,315)
M&G UK Income Fund (E)	2,000,000	1,561,084	1,580,882	33,586	19,798	(419,118)
Investec Diversified Fund (M)	2,000,000	1,837,499	1,954,915	34,887	117,416	(45,085)
Columbia Threadneedle Bond Fund (B)	2,000,000	1,915,356	2,103,928	31,310	188,572	103,928
Federated Cash + Fund (C)	1,000,000	1,068,604	1,070,677	-	2,073	70,677
Fundamentum Housing REIT	1,000,000	980,000	970,000	6,500	(10,000)	(30,000)
Total	**12,500,000**	**11,192,372**	**11,453,258**	**150,191**	**260,886**	**(1,046,742)**

6.3 In a relatively short period since the onset of the COVID-19 pandemic in March and the ensuing enforced lockdown in many jurisdictions, the global economic fallout has been sharp and large. Market reaction was extreme with large falls in equities, corporate bond markets and, to some extent, real estate echoing lockdown-induced paralysis and the uncharted challenges for governments, business and individuals.

6.4 The Council is invested in bond, equity, multi-asset and property funds. 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 every fund / 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 of the short-dated, strategic bond and multi-asset income funds and all of the equity income funds in the Council's portfolio.

6.5 Similar to many other property funds, dealing (i.e. buying or selling units) in the CCLA Local Authorities Property Fund was suspended by the fund 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 dealing suspension was lifted in September 2020. There has also been a change to redemption terms for the CCLA Local Authorities Property Fund; from September 2020 investors are required to give at least 90 calendar days' notice for redemptions.

6.6 Because the Authority's externally managed funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives are regularly reviewed. 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.

7. COMPLIANCE

7.1 The Chief Finance Officer reports that all treasury management activities undertaken during the quarter complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Please note the comment in paragraph 5.1 in reference to the Council's current account exceeding its limit on the 1st April 2020 for one day.

8. LEGAL IMPLICATIONS

8.1 There are no legal implications arising from this report.

9 RISK ASSESSMENT

9.1 This report discusses the impact of economic risk on the value and returns associated with the Council's investment portfolio together with the risk of low interest rates on the Council's revenue budget.

9.2 The Council's treasury advisors, Arlingclose, will attend the meeting to support Members and Officers when considering this report.

10 CLIMATE CHANGE IMPLICATIONS

10.1 None directly arising from this report. The Audit Committee will consider separately the implications of the Council's climate emergency declaration on its investment portfolio. Arlingclose are attending this meeting and will be providing a verbal update to Members at item 12.

11 BACKGROUND PAPERS

11.1 None