COTSWOLD
DISTRICT COUNCIL

Council name	**COTSWOLD DISTRICT COUNCIL**
Name and date of Committee	**AUDIT COMMITTEE – 21 OCTOBER 2021**
Report Number	**AGENDA ITEM 08**
Subject	**TREASURY MID-TERM REPORT 2021-22**
Wards affected	N/A
Accountable member	Cllr Mike Evemy, Cabinet Member for Finance Email: mike.evemy@cotswold.gov.uk
Accountable officer	Jenny Poole, Chief Finance Officer Email: jenny.poole@cotswold.gov.uk
Summary/Purpose	To receive and discuss details of the Council's Treasury Management performance for the period 1 April to 30 September 2021.
Annexes	None
Recommendation	*That the Council's Treasury Management performance for the period 1 April 2021 to 30 September 2021 is 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	N/A

1. BACKGROUND

1.1 In February 2011 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code). The CIPFA Code requires the Council to approve reports on treasury management activities at the end of the first half of the financial year and at the end of the financial year.

1.2 This report covers the treasury management activity and performance of Cotswold District Council for the period 1April to 30 September 2021.

1.3 The Council's Treasury Management Strategy for 2021/22 was approved at the Council meeting on 24 February 2021. 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. The successful identification, monitoring and control of risk are therefore central to the Council's Treasury Management Strategy.

2. ECONOMIC BACKGROUND

2.1 The economic recovery from the coronavirus pandemic continued to dominate the first half of the financial year. By the end of the period, over 48 million people in the UK had received their first dose of a Covid-19 vaccine and almost 45 million their second dose.

2.2 The Bank of England (BoE) held Bank Rate at 0.1% throughout the period and maintained its Quantitative Easing programme at £895 billion, unchanged since the November 2020 meeting. In its September 2021 policy announcement, the BoE noted it now expected the UK economy to grow at a slower pace than was predicted in August, as the pace of the global recovery had shown signs of slowing and there were concerns inflationary pressures may be more persistent. Within the announcement, Bank expectations for GDP growth for the third (calendar) quarter were revised down to 2.1% (from 2.9%), in part reflecting tighter supply conditions. The path of Consumer Price Inflation (CPI) is now expected to rise slightly above 4% in the last three months of 2021, due to higher energy prices and core goods inflation. While the Monetary Policy Committee (MPC) meeting ended with policy rates unchanged, the tone was more hawkish.

2.3 Government initiatives continued to support the economy over the quarter but came to an end on 30 September 2021, with businesses required to either take back the 1.6 million plus workers on the furlough scheme or make them redundant. The latest labour market data showed that in the three months to July 2021 the unemployment rate fell to 4.6%. The employment rate increased, and economic activity rates decreased, suggesting an improving labour market picture. Latest data showed growth in average total pay (including bonuses) and regular pay (excluding bonuses) among employees was 8.3% and 6.3% respectively over the period. However, part of the robust growth figures is due to bases effect from a decline in average pay in the spring of last year associated with the furlough scheme.

2.4 The US economy grew by 6.3% in Q1 2021 (Jan-Mar) and then by an even stronger 6.6% in Q2 as the recovery continued. The Federal Reserve maintained its main interest rate at between 0% and 0.25% over the period but in its most recent meeting made suggestion that monetary policy may start to be tightened soon.

2.5 The European Central Bank maintained its base rate at 0%, deposit rate at -0.5%, and asset purchase scheme at €1.85 trillion.

3. FINANCIAL MARKETS

3.1 Monetary and fiscal stimulus together with rising economic growth and the ongoing vaccine rollout programmes continued to support equity markets over most of the period, albeit with a bumpy ride towards the end. The Dow Jones hit another record high while the UK-focused FTSE 250 index continued making gains over pre-pandemic levels. The more internationally focused FTSE 100 saw more modest gains over the period and remains below its pre-crisis peak.

3.2 Inflation worries continued during the period. Declines in bond yields in the first quarter of the financial year suggested bond markets were expecting any general price increases to be less severe, or more temporary, that was previously thought. However, an increase in gas prices in the UK and EU, supply shortages and a lack of HGV and lorry drivers with companies willing to pay more to secure their services, has caused problems for a range of industries and, in some instance, leading to higher prices.

3.3 Credit default swap spreads were constantly flat over the most of period and are broadly in line with their pre-pandemic levels. In late September spreads rose by a few basis points due to concerns around Chinese property developer Evergrande defaulting but are now falling back.

3.4 Over the period Fitch and Moody's upwardly revised to stable the outlook on a number of UK banks and building societies on the Council's counterparty list, recognising their improved capital positions compared to last year and better economic growth prospects in the UK.

3.5 The successful vaccine rollout programme is credit positive for the financial services sector in general and the improved economic outlook has meant some institutions have been able to reduce provisions for bad loans. While there is still uncertainty around the full extent of the losses banks and building societies will suffer due to the pandemic-related economic slowdown, the sector is in a generally better position now compared to earlier this year and 2020.

3.6 At the end of the period Arlingclose had completed its full review of its credit advice on unsecured deposits. The outcome of this review included the addition of NatWest Markets plc to the Council's counterparty list together with the removal of the suspension of Handelsbanken plc. In addition, the maximum duration for all recommended counterparties was extended from 36 days to 100 days.

4. TREASURY MANAGEMENT- SUMMARY POSITION - 1 APRIL 2021 to 30 SEPTEMBER 2021

4.1 On 31 March 2021, the Council had net investments of £23.577m 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

	31/3/21 Actual £m
General Fund CFR	0
Less: External borrowing	0
Less: Usable reserves	(25.903)
Less: Working capital	2.326
Net Investments	**(23.577)**

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. If interest rates were to rise by 1%, then investment income would average 1.07%, whilst borrowing costs (based on 20 year PWLB Loan) would be 2.03%. For every £1m borrowed the cost of carry would cost an additional £9,600 per annum.

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 31 March 2021 and the mid-year change is shown in Table 2 below. The value of investments held has increased significantly as a result of government funding provided in advance of need to support small and medium businesses during the coronavirus pandemic, through grant schemes.

Table 2: Treasury Management Summary

	31/3/2021 Actual £m	2021/22 Movement £m	30/9/2021 Balance £m	30/9/2021 Rate %
Short-term borrowing	0	0	0	-
Total borrowing	**0**	**0**	**0**	**-**
Long-term investments	12.134	0.366	12.500	3.95
Short-term investments	0.075	5.925	6.000	0.05
Cash and cash equivalents	11.368	3.172	14.540	0.04
Total investments	**23.577**	**9.463**	**33.040**	**1.22**

5. BORROWING UPDATE

5.1 Local authorities can borrow from the Public Works Loan Board (PWLB) provided they can confirm they are not planning to purchase 'investment assets primarily for yield' in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 Officer. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to re-finance existing loans or externalise internal borrowing.

5.2 Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, re-financing debt and treasury management.

5.3 Competitive market alternatives are available for authorities with or without access to the PWLB. However, the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders. Further changes to the CIPFA Prudential Code expected in December 2021 may prohibit borrowing for the primary purpose of commercial return even where the source of borrowing is not the PWLB. Consultation is currently taking place on the proposed changes.

5.4 The Council is not planning to purchase any investment assets primarily for yield within the next three years and so is able to fully access the PWLB.

5.5 As at 30 September 2021 the Council was debt free, however there are plans to borrow in the future to fund the Capital Programme and the Recovery Investment Strategy. Any borrowing undertaken will be reported back to members of this Committee and will be subject to consideration by the Capital Programme Investment Board and approval by either Cabinet or Council as appropriate.

6. INVESTMENT PERFORMANCE AND PROJECTIONS

6.1 On 6 April 2021, the Council received Government funding to support small and medium businesses during the coronavirus pandemic. £13.326m was received and temporarily invested in short-dated, liquid instruments such as call accounts, Money Market Funds and the Debt Management Office's Debt Management Account Deposit Facility Account.

6.2 The Council invested funds, representing income received in advance of expenditure plus balances and reserves held. During the first-half of the year, the Council's investment balances ranged between £45m and £23m million due to timing differences between income and expenditure. The investment position is shown in table 3 below:

Table 3: Treasury Investment Position

	31.3.21 Balance £m	Net Movement £m	30.9.21 Balance £m	30.9.21 Return %
Banks & Building Societies (unsecured)	0	-	0	-
Local Authorities	0	6.000	6.000	0.05
Money Market Funds/ Call Accounts	11.365	3.175	14.540	0.04
Pooled Funds (1)	12.212	0.288	12.500	2.88
Total Investments	**23.577**	**9.463**	**33.040**	**1.22**

(1) *See breakdown at Table 4 below.*

6.3 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.

6.4 Due to the impact of the payment of the Government's Covid-19 grants to businesses on cash flow, the Council 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. Now that cash flow has stabilised, and is more predictable, alternative investment opportunities are being considered.

6.5 Investment income was budgeted to be £402,668 in the Council's 2021/22 budget set in February 2021. The Council has reviewed its expectations for investment income in 2021/22 and has assumed after looking at the returns over the first 6 months that the income could exceed budget by £29,000 by year end due to the Council's Pooled Funds achieving higher returns than estimated when the budget was set. Further details are included in section 7 of this report.

7. EXTERNALLY MANAGED POOLED FUNDS

7.1 Of the Council's investments, £11.5m are held in externally managed strategic pooled cash, 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 £174,947 (2.88% annualised) in the first 6 months of this financial year, which is used to support services in year, and £242,717 (2% annualised) of capital growth since 31 March 2021.

7.2 Table 4 below shows the current valuations of the Pooled Funds portfolio at 30 September 2021, compared with the opening balances of 1 April 2021.

Table 4: Pooled Funds

FUND NAME	Initial Investment	1 April Fund Value	30th Sept Fund Value	Dividends in 2021/22 (as at 30 Sept)	Gain / (Loss) for 2021/22	Gain / (Loss) to Initial Principal	% Return Capital & Dividend 201/22
	£	£	£	£	£	£	%
CCLA Property Fund	500,000	489,733	523,887	9,089	34,154	23,887	8.83
CCLA Property Fund	2,000,000	1,793,022	1,918,064	33,278	125,042	(81,936)	8.83
Schroders Income Maximiser Fund (E)	1,000,000	764,342	787,106	30,537	22,764	(212,894)	6.97
CCLA Diversified Income Fund (M)	1,000,000	985,600	1,041,928	8,201	56,328	41,928	6.55
M&G UK Income Fund (E)	2,000,000	1,831,782	1,881,089	27,981	49,307	(118,911)	4.22
Investec Diversified Fund (M)	2,000,000	2,018,818	1,961,972	35,797	(56,846)	(38,028)	(1.04)
Columbia Threadneedle Bond Fund (B)	2,000,000	2,148,990	2,160,560	18,904	11,570	160,560	1.42
Federated Cash + Fund (C)	1,000,000	1,071,595	1,071,993	-	398	71,993	0.04
Fundamentum Housing REIT	1,000,000	1,030,000	1,030,000	11,250	-	30,000	1.09
Total	**12,500,000**	**12,133,882**	**12,376,599**	**175,037**	**242,717**	**(123,401)**	**3.44%**

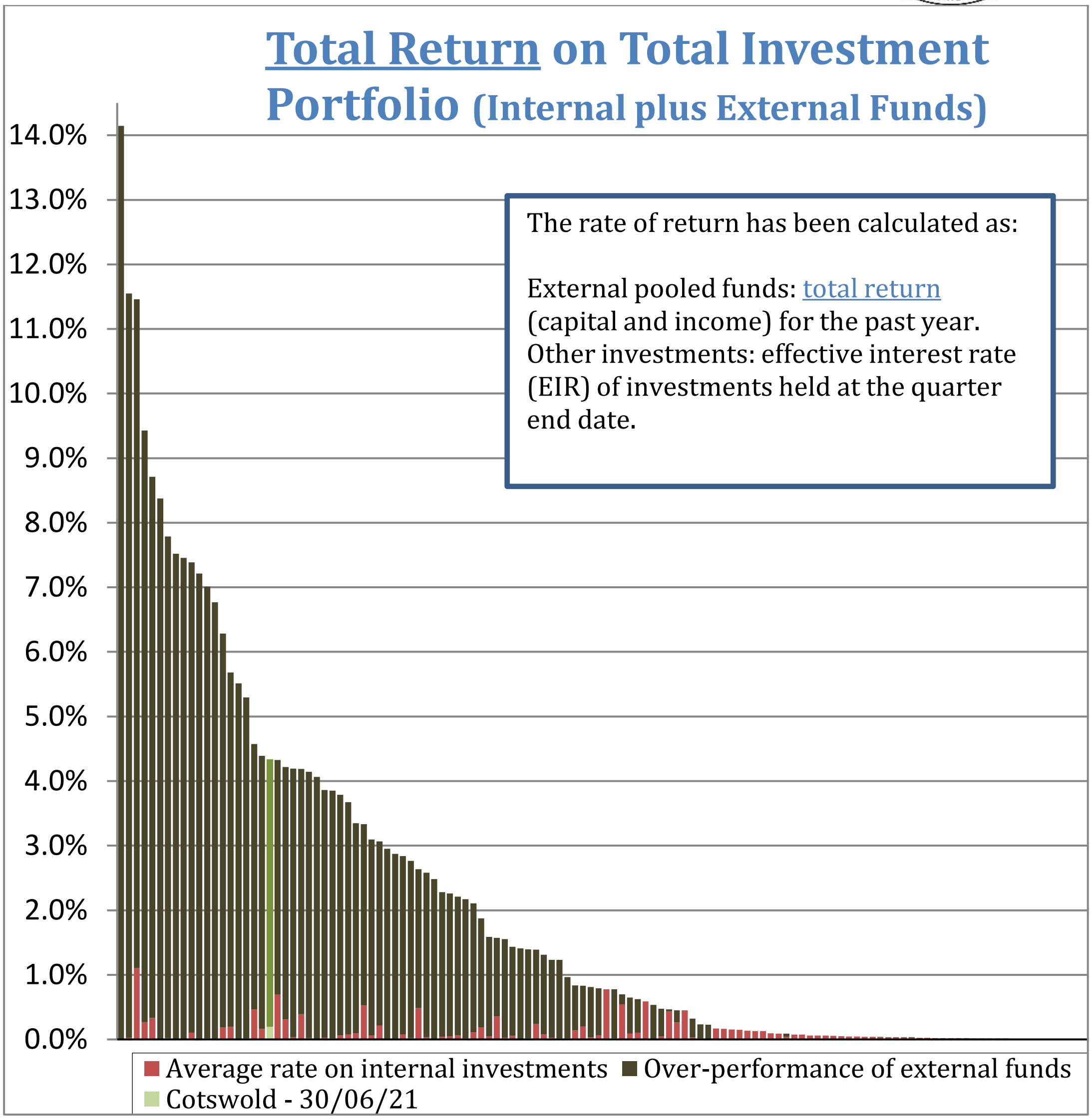
Key: E- Equity, M – Multi asset, B –Bond, C - Cash

7.3 Pooled funds fell in value at the start of the pandemic and have now returned to pre pandemic levels. The improved market sentiment in the past 6 months is reflected in equity, property and multi-asset fund valuations and, in turn, in the capital values of the Council's equity and multi-asset income funds in the Council's portfolio. The prospect of higher inflation and rising bond yields resulted in muted bond fund performance. The change in capital values and income earned is shown in Table 4.

7.4 Because the Council'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.

7.5 Table 5 below shows that as at 30 June 2021, Cotswold District Council (green bar) achieved the 20th highest average rate on investments from the 124 local authorities that Arlingclose support.

<u>Table 5 Cotswold's investment returns v Arlingclose clients (124) as at 30 June 2021.</u>



8. ARLINGCLOSE'S ECONOMIC OUTLOOK FOR THE REMAINDER OF 2021/22

8.1

	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24
Official Bank Rate													
Upside risk	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.40	0.40	0.40	0.40	0.40	0.40
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	0.10	0.10	0.10	0.10	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15

8.2 Arlingclose expects Bank Rate to rise in Q2 2022. Arlingclose believe this is driven as much by the Bank of England's desire to move from emergency levels as by fears of inflationary pressure.

8.3 Investors have priced in multiple rises in Bank Rate to 1% by 2024. While Arlingclose believes Bank Rate will rise, it is by a lesser extent than expected by markets.

8.4 The global economy continues to recover from the pandemic but has entered a more challenging phase. The resurgence of demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. This is particularly apparent in the UK due to the impact of Brexit.

8.5 While Q2 UK GDP expanded more quickly than initially thought, the 'pingdemic' and more latterly supply disruption will leave Q3 GDP broadly stagnant. The outlook also appears weaker. Household spending, the driver of the recovery to date, is under pressure from a combination of retail energy price rises, the end of Government support programmes and soon, tax rises. Government spending, the other driver of recovery, will slow considerably as the economy is taken off life support.

8.6 Inflation rose to 3.2% in August. A combination of factors will drive this to over 4% in the near term. While the transitory factors affecting inflation, including the low base effect of 2020, are expected to unwind over time, the MPC has recently communicated fears that these transitory factors will feed longer-term inflation expectations that require tighter monetary policy to control. This has driven interest rate expectations substantially higher.

8.7 The supply imbalances are apparent in the labour market. While wage growth is currently elevated due to compositional and base factors, stories abound of higher wages for certain sectors, driving inflation expectations. It is uncertain whether a broad-based increased in wages is possible given the pressures on businesses.

8.8 Government bond yields increased sharply following the September Federal Open Market Committee (FOMC) and the Monetary Policy Committee (MPC) minutes, in which both central banks communicated a lower tolerance for higher inflation than previously thought. The MPC in particular has doubled down on these signals in spite of softer economic data. Bond investors expect higher near-term interest rates but are also clearly uncertain about central bank policy.

8.9 The MPC appears to be playing both sides, but has made clear its intentions to tighten policy, possibly driven by a desire to move away from emergency levels. While the economic outlook will be challenging, the signals from policymakers suggest Bank Rate will rise unless data indicates a more severe slowdown.

9. COMPLIANCE

9.1 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.

10. LEGAL IMPLICATIONS

10.1 There are no legal implications arising from this report.

11. RISK ASSESSMENT

11.1 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.

12. CLIMATE CHANGE IMPLICATIONS

12.1 None directly arising from this report.

13. BACKGROUND PAPERS

13.1 None

(END)