



CORPORATE GOVERNANCE COMMITTEE: 4 JUNE 2021

QUARTERLY TREASURY MANAGEMENT REPORT

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

Purpose of report

1. The purpose of this report is to update the Committee on the actions taken in respect of treasury management for the quarter ending 31 March 2021 (Quarter 4).

Policy Framework and Previous Decisions

2. The annual investment strategy for 2020/21 forms part of the Council's medium term financial strategy (MTFS) and was approved by full council in February 2020.
3. An update in respect of Quarter 3 2020/21 was provided to the committee on 29th January 2021.

Background

4. Treasury Management is defined as:

“The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks”.

5. A quarterly report is produced for the Committee to provide an update on any significant events in treasury management.

Economic Background

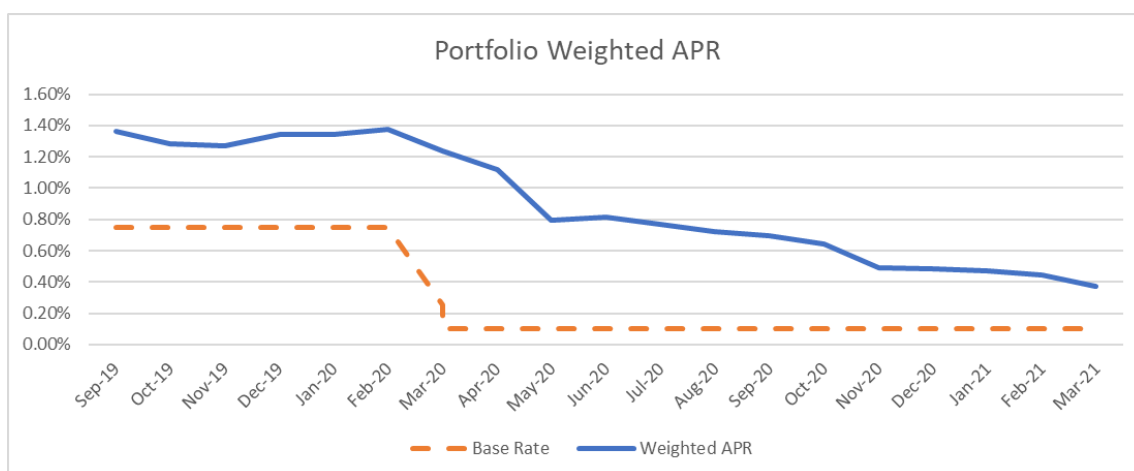
6. The Council's treasury management adviser, Link Asset Management (Link), provides a quarterly update outlining the global economic outlook and monetary policy positions. An extract from this report is attached as Appendix A to this report. The key points are summarised below.
7. The Bank of England's (BoE) Monetary Policy Committee (MPC) left the base rate and levels of quantitative easing unchanged at its 18th March meeting. However, it did revise its economic forecasts to take account of the third national lockdown which started on 5th January 2021. This third lockdown has worsened short-term forecasts,

but medium-term forecasts are more optimistic and it is expected that the UK economy will recover to pre-pandemic levels by Q1 2022.

8. Consumer Price Index (CPI) inflation is forecast to rise quite sharply towards the 2% target in the first half of 2021 due to some temporary factors, (e.g. the reduction in VAT for certain services comes to an end) and given developments in energy prices. CPI inflation is projected to be close to 2% in 2022 and 2023.
9. The MPC reiterated its previous guidance that Base Rate would not rise until inflation was sustainably above 2%. This means that it will tolerate inflation running above 2% from time to time to balance out periods during which inflation is below 2%. This is termed average inflation targeting.
10. The BoE removed negative interest rates as a possibility for at least six months as financial institutions were not ready to implement them. As in six months' time the economy should be starting to grow strongly, this effectively means that negative rates occurring are unlikely during the current downturn.

Action Taken During Quarter 4 to March 2021

11. The balance of the investment portfolio increased from £287.4m to £308.2m. Within the portfolio, £150.3m of investment loans matured at an average rate of 0.36% (excluding Private Debt), and £172.9m of new loans were placed, at an average rate of 0.13%. The Council also received capital receipts for the partners private debt investment totalling £1.8m.
12. To date the Council has received seven distributions from the private debt investment totalling £5.8m. Of this £4.7m represents return of invested capital, with the remaining £1.1m representing interest received. This means from an initial investment of £20m the Council has £15.2m remaining capital committed. The private debt investment represents only a small portion of the total portfolio, but, with a current internal rate of return (IRR) of 4.3%, is contributing significantly to the total portfolio annual percentage rate (APR). The APR including private debt is 0.37% versus a loans only APR of 0.17%.
13. The average rate achieved on new loans continues to fall short of the average rate of loans maturing. This was expected due to the reduction in base rates and the trend is likely to continue, as the markets do not foresee an increase in rates any time soon. As a result, the portfolio weighted APR reduced from 0.48% in Q3 20-21 to 0.37% in Q4 20-21.
14. The chart below shows the weighted APR achieved by the treasury portfolio compared to the BoE base rate:



15. The loan portfolio at the end of December was invested with the counterparties shown in the table below, listed by original investment date:

	£m	Maturity Date
Instant Access		
Money Market Funds	62.9	April 2021
6 Months		
Close Brothers	10.0	April 2021
Santander	5.0	May 2021
Goldman Sachs	25.0	May 2021
Nationwide Building Society	10.0	May 2021
Australia and New Zealand Bank	20.0	July 2021
HSBC	30.0	July 2021
Nationwide Building Society	15.0	July 2021
Lloyds (Bank of Scotland)	5.0	July 2021
HSBC	10.0	April 2021
Santander	20.0	September 2021
Close Brothers	10.0	September 2021
9 Months		
National Westminster Bank Plc	20.0	October 2021
12 Months		
National Westminster Bank Plc	10.0	August 2021
Lloyds (Bank of Scotland)	20.0	September 2021
National Westminster Bank Plc	10.0	November 2021
Beyond 12 Months		
Partners Group (Private Debt)	15.2	Estimated 2024
Danske Bank	10.0	September 2027
Total Portfolio Balance at 31 March 2021	308.2	

16. Market conditions remain challenging, as outlined in last quarter's update. Yields continue to fall and demand for capital has not picked up. The Council will continue its low risk approach to treasury management whilst trying to be mindful of rates earned.
17. Link's interest rate forecast for the period 2021-2024 has been attached as Appendix B. As this shows, it is now impossible to earn the level of interest rates commonly seen in previous decades as all short-term money market investment rates are below or little above the BoE base rate at 0.10%. Given this environment and the fact that increases in Bank Rate are unlikely to occur before the end of the current forecast horizon of 31st March 2024, investment returns are expected to remain low.

Creditworthiness

18. Although the credit rating agencies changed their Outlook on many financial institutions from Stable to Negative during the quarter ended 30th June 2020, the majority of ratings were affirmed due to the continuing strong credit profiles and wider government support provided to financial markets and economies in general. During Q1 and Q2 2020, banks made provisions for expected credit losses, while since then, a number of entities have revised down provisions in light of better economic outlooks. Over the next couple of quarters, more information will emerge on actual levels of credit losses (quarterly performance is normally announced in the second half of the month following the end of the quarter.) This has the potential to cause rating agencies to revisit their initial rating adjustments if they are found to be misaligned. These adjustments could be negative or positive, although it should also be borne in mind that UK banks, among others, went into this pandemic with strong balance sheets.

Loans to Counterparties that breached authorised lending list

19. There were no loans active during the period that breached the authorised counterparty list at the time that the loan was made.

Resource Implications

20. The interest earned on revenue balances and the interest paid on external debt will impact directly onto the resources available to the Council. For 2020/21 the interest generated by treasury management activities (including private debt and pooled property investments) totaled £3.1m. This compares to budgeted income of £2.8m. The excess income is mainly due to the Council's private debt investment returning income sooner than forecasted.

Recommendations

21. The Committee is asked to note this report

Background papers

22. None

Circulation under the Local Issues Alert Procedure

23. None

Equality and Human Rights Implications

24. There are no discernible equality and human rights implications

Appendices

25. Appendix A – Economic Overview (March 2021)

26. Appendix B – Interest Rate Forecast

Officer to Contact

Mr C Tambini, Director of Corporate Resources,
Corporate Resources Department,
☎0116 305 6199 E-mail Chris.Tambini@leics.gov.uk

Mr D Keegan, Assistant Director (Strategic Finance and Property),
Corporate Resources Department,
☎0116 305 7668 E-mail Declan.Keegan@leics.gov.uk

This page is intentionally left blank