Agenda Item 14

Leicestershire County Council

CORPORATE GOVERNANCE COMMITTEE: 28 JANUARY 2022

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 December 2021 (Quarter 3).

Policy Framework and Previous Decisions

2. The Annual Investment Strategy for 2021/22 forms part of the Council's medium term financial strategy (MTFS) and was approved by full council in February 2021.

3. An update in respect of Quarter 2 2021/22 was provided to the Committee on 5th November 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 an Appendix to this report. The key points are summarised overleaf.

7. The Bank of England's (BoE) Monetary Policy Committee (MPC) surprised markets in successive months during this quarter. Firstly, by not raising interest rates as expected at its meeting in November 2021. Then, in December, by raising rates from 0.10% to 0.25%.

8. During its meeting on 16th December, the MPC voted 8-1 in favour of an interest rate rise. This, coupled with a hawkish tone of comments, indicates the MPC is now concerned that inflationary pressures are building and that concerted action will be needed to counter these pressures. This suggestion of more increases to come has financial markets predicting a rise to 1% by the end of 2022.

9. However, the MPC also commented to the threat of the Omicron variant of Covid-19 to short term economic activity and retained its guidance that only a 'modest tightening' in policy will be required. This action therefore suggests that it is possible that markets have gone too far in expecting a 1% interest rate rise by the end of 2022 and that the likelihood of the MPC raising base rate at its next meeting (on 3 February 2022) will depend on how adversely the Omicron variant has affected the economy.

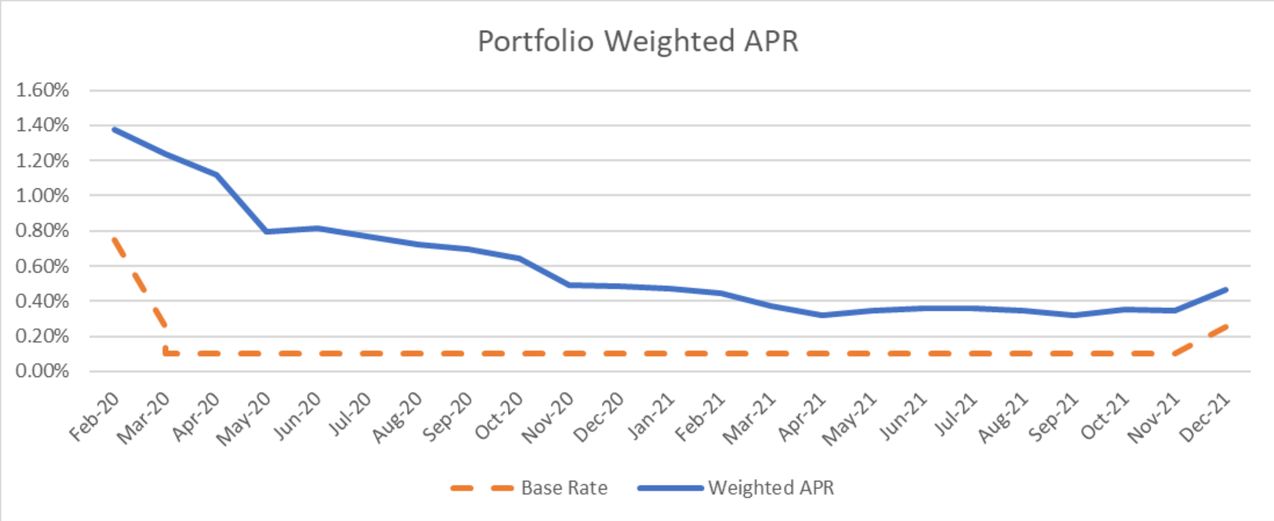
Action Taken During Quarter 3 to December 2021

10. The balance of the investment portfolio decreased from £369.5m to £356.8m. Within the portfolio, £212.1m of investment loans matured at an average rate of 0.15% (excluding Private Debt), and £192.4m of new loans were placed, at an average rate of 0.30%. The Council also received principal repayments for the partners private debt investment totalling £1.3m, whilst £8.2m was invested in the new partners private debt vintage.

11. To date the Council has received fourteen distributions from the private debt investment totalling £11.5m. Of this £8.8m represents return on invested capital, with the remaining £2.7m representing interest received. This means from an initial investment of £20m the Council has £11.2m remaining capital committed and the current market value of the investment is £11.5m. The private debt investment represents only a small portion of the total portfolio, but, with a current internal rate of return (IRR) of 4.58%, it is contributing significantly to the total portfolio annual percentage rate (APR). The APR including private debt is 0.47% versus a loans only APR of 0.24%.

12. The average rate achieved on new loans was higher than the average rate of loans maturing, reflecting market expectations of the base rate rise. As a result, the portfolio weighted APR increased from 0.32% in Q2 21-22 to 0.47% in Q3 21-22.

13. The chart overleaf shows the weighted APR achieved by the treasury portfolio compared to the BoE base rate:



14. 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	52.4	January 2022
6 Months		
Nationwide Building Society	15.0	January 2022
Australia and New Zealand Bank	20.0	February 2022
Santander	20.0	February 2022
Nationwide Building Society	15.0	February 2022
Close Brothers	10.0	March 2022
Close Brothers	20.0	April 2022
Landesbank Baden Wurtemberg	10.0	April 2022
Santander	10.0	April 2022
Landesbank Hessen Thuringen	10.0	May 2022
Goldman Sachs	30.0	May 2022
9 Months		
National Westminster Bank Plc	10.0	February 2022
12 Months		
Toronto Dominion Bank	20.0	May 2022
National Westminster Bank Plc	10.0	August 2022
National Westminster Bank Plc	15.0	September 2022
National Westminster Bank Plc	20.0	October 2022
HSBC	40.0	September 2022
Beyond 12 Months		
Partners Group (Private Debt) 2017	11.2	Estimated 2024
Partners Group (Private Debt) 2021	8.2	Estimated 2026
Danske Bank	10.0	September 2027

Total Portfolio Balance at 31 December 2021	**356.8**	

Loans to Counterparties that breached authorised lending list

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

Further Investment - Private Debt

16. Following approval from the Cabinet on 19 November 2021, £20m has been committed to the latest Partners Private Debt Fund (MAC VI). As the fund had reached its final close, the first capital call (£8m) was paid on 17th December 2021. As part of this capital call the Council also paid £147,000 in interest true-up payments. Interest true-up serves to compensate existing investors for the opportunity cost associated with their earlier contributions. The Council was fully aware of this cost prior to commitment and this cost was factored into the investment appraisal.

Transition from LIBOR to SONIA

17. On 5 March 2021 the Financial Conduct Authority (FCA) officially announced that immediately after the 31 December 2021 all Sterling London Inter-Bank Offered Rate (LIBOR) settings will either cease to be provided by any administrator or will no longer be representative.

18. The BoE and the FCA have made it clear over a number of years that the lack of an active underlying market makes LIBOR unsustainable and unsuitable for the widespread reliance that had been placed upon it. Accordingly, both have worked closely with market participants and regulatory authorities around the world to ensure that robust alternatives to LIBOR are available and that existing contracts can be transitioned onto these alternatives to safeguard financial stability and market integrity.

19. The alternative reference rate in the UK for GBP transactions will be SONIA (Sterling Overnight Index Average), which will be published daily by the BoE. SONIA measures the rates paid by banks on overnight funds. It is calculated as a trimmed mean of rates paid on overnight unsecured wholesale funds and is considered very robust because it is anchored in active liquid underlying markets. LIBOR, in contrast, is a forward-looking rate which measures the average rate at which banks are willing to borrow wholesale unsecured funds. The underlying market LIBOR measures is no longer liquid and is inefficient at measuring the general level of interest rates as it includes a term bank credit component.

20. As SONIA is calculated and set differently to LIBOR, historically the rates for each have been at different levels. Historically, SONIA has been set at a lower level than LIBOR, as LIBOR includes a credit risk premium. The FCA has stated that organisations are “not expected to give up the difference between LIBOR and SONIA (or other alternative rates), which results from the term credit risk premium built into the LIBOR rate but not built into other rates such as SONIA.”

21. To ensure the transition from LIBOR is fair for everyone, an adjustment needs to be made to account for the difference between LIBOR and SONIA. This adjustment is known as a Credit Adjustment Spread (CAS).

22. The Council has one loan in its portfolio that uses LIBOR as a reference rate and therefore needs to be transitioned to SONIA. This is the 10 year LOBO offset loan made to Danske in 2017. This loan for £10m has a refixing of interest rate every six months at 0.45% plus six month Average LIBOR.

23. In order to transition the reference rate to SONIA it was necessary for the Council to agree a CAS with Danske Bank. Following recommendations from the Working Group on Sterling Risk-Free Reference Rates, and given that the loan has six years left, it was agreed to use the forward approach and set the CAS at the six year swap rate between the six month SONIA and six month LIBOR rates, this equated to 0.25%.

24. From the next fixing of the loan after March 2022 the rate of this loan will now be 0.70% plus a six month average SONIA.

Resource Implications

25. The interest earned on revenue balances and the interest paid on external debt will impact directly onto the resources available to the Council. The budgeted income for interest generated by treasury management activities (including private debt and pooled property investments) for 2021/2022 is £1.3m. Current forecasting suggests that actual interest earned will be in the region of £2.9m. This overperformance can be entirely explained by the partners private debt investment distributing income sooner than originally anticipated.

Recommendations

26. The Committee is asked to note this report.

Background papers

Report to the Cabinet on 19 November 2021 – Recommended Investment into Partners Group Private Debt Fund and JP Morgan Infrastructure Investment Fund:

https://politics.leics.gov.uk/ieListDocuments.aspx?CId=135&MId=6448&Ver=4

Circulation under the Local Issues Alert Procedure

27. None.

Equality and Human Rights Implications

28. There are no discernible equality and human rights implications.

Appendix

29. Economic Overview (December 2021)

Officers to Contact

Chris Tambini, Director of Corporate Resources,
Corporate Resources Department,
Tel: 0116 305 6199   E-mail: chris.tambini@leics.gov.uk

Declan Keegan, Assistant Director (Finance, Strategic Property and Commissioning)
Corporate Resources Department,
Tel: 0116 305 7668   Email: declan.keegan@leics.gov.uk