Southend-on-Sea Borough Council

Agenda Item No.

Report of Executive Director (Finance & Resources)
to
Cabinet
on
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Treasury Management Report – Quarter One 2020/21
Policy and Resources Scrutiny Committee
Cabinet Member: Councillor Ron Woodley
A Part 1 Public Agenda Item

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1. Purpose of Report

1.1. The Treasury Management Report for Quarter One covers the treasury management activity for the period from April to June 2020 and compliance with the treasury management strategy for that period.

2. Recommendations

That the following is approved:

1.1. The Treasury Management Report for Quarter One 2020/21.

That the following is noted:

1.2. Treasury management activities were carried out in accordance with the CIPFA (The Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management in the Public Sector during the period from April to June 2020.

1.3. The loan and investment portfolios were actively managed to minimise cost and maximise interest earned, whilst maintaining a low level of risk.

1.4. £0.412m of interest and income distributions for all investments were earned during this three month period at an average rate of 1.05%. This is 1.09% over the average 7 day LIBID (London Interbank Bid Rate) and 0.95% over the average bank rate. Also the value of the externally managed funds decreased by a net of £0.589m due to changes in the unit price, giving a combined overall return of (0.45)%. (Section 8).

1.5. The level of borrowing from the Public Works Loan Board (PWLB) (excluding debt relating to services transferred from Essex County Council on 1st April 1998) remained at £310.3m (HRA: £75.0m, GF: £235.3m) during the period from April to June 2020.

1.6. During the quarter the level of financing for 'invest to save' schemes decreased from £8.64m to £8.63m.

3. Background

3.1. This Council has adopted the 'CIPFA Code of Practice for Treasury Management in the Public Sector' and operates its treasury management service in compliance with this code. The code recommends that local authorities submit reports regularly as part of its Governance arrangements.

3.2. Current guidance is that authorities should report formally at least twice a year and preferably quarterly. The Treasury Management Policy Statement for 2020/21 set out that reports would be submitted to Cabinet quarterly on the activities of the treasury management operation. This is the first quarterly report for the financial year 2020/21.

3.3. Appendix 1 shows the treasury management position at the end of quarter one of 2020/21.

3.4. Appendix 2 shows the treasury management performance specifically for quarter one of 2020/21.

4. National Context

4.1. With the UK economy gradually emerging from lockdown the impact of the "new normal" remains to be seen. The Government furlough schemes and other business support mechanisms have slowed the rate of unemployment during the restrictions but it seems inevitable that more jobs will be cut once furlough support is ended. All sectors of the economy were impacted, with GDP falling by 20.4% for the quarter April to June, the second consecutive quarterly decline after it fell by 2.2% in the previous quarter. There have been record quarterly falls in services, production and construction output during the quarter, which have been particularly prevalent in those industries that have been most exposed to government restrictions.

4.2. CPI was at 0.9% in April, at 0.7% in May and 0.8% in June. Post-pandemic inflation is likely to prove volatile, with possibly sub-zero inflation in the short term, before a similarly temporary boost back to near 2%. Longer term, economists expect inflation to level off at 1%.

4.3. The Bank of England kept the bank base rate at the historically low value of 0.10% throughout the quarter but increased their Quantitative Easing (QE) programme from £645bn in March to £745bn in June to help the economy during the Covid-19 pandemic.

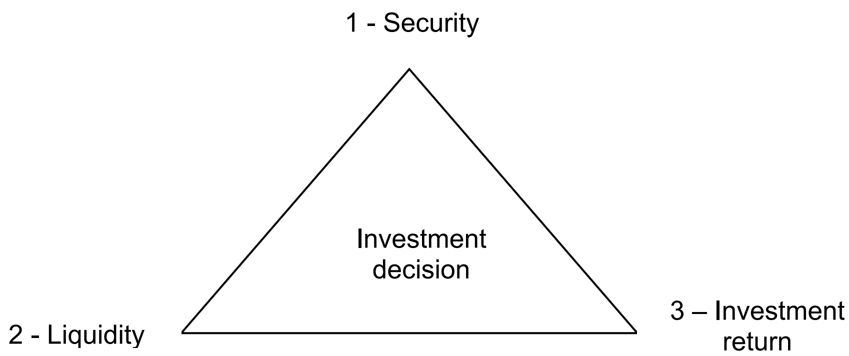
4.4. The economic situation together with the financial market conditions prevailing throughout the quarter continued to provide challenges for treasury management activities. All prevailing rates have fallen, whether for instant access, notice or fixed term deposit accounts. The Council's current fixed term deposits, that were taken out in 2019/20 whilst rates were higher, continue to provide a boost to investment income. However, as they start to mature (August 2020 and February 2021) they can only be replaced at prevailing rates which are much lower.

4.5. Low interest rates prevailed throughout the quarter from April to June 2020 and this led to low investment income earnings from in-house investments.

5. Investments

5.1. A prime objective of our investment activities is the security of the principal sums invested. To ensure this security before an in-house deposit is made an organisation is tested against a matrix of credit criteria and then other relevant information is considered. During the period from April to June 2020 investment deposits were limited to those who met the criteria in the Annual Treasury Management Investment Strategy when the deposit was placed.

5.2. Other investment objectives are to maintain liquidity (i.e. adequate cash resources to allow the council to operate) and to optimise the investment income generated by surplus cash in a way that is consistent with a prudent level of risk. Investment decisions are made with reference to these objectives, with security and liquidity being placed ahead of the investment return. This is shown in the diagram below:



Security:

5.3. To maintain the security of sums invested, we seek to lower counterparty risk by investing in financial institutions with good credit ratings, across a range of sectors and countries. The risk of loss of principal of all monies is minimised through the Annual Treasury Management Investment Strategy.

5.4. Pie chart 1 of Appendix 1 shows that at the end of quarter one; 49% of our in-house investments were placed with financial institutions with a long term credit rating of AAA, 20% with a long term rating of A+ and 31% with a long term rating of A.

5.5. As shown in pie chart 2 of Appendix 1 these monies were with various counterparties, 51% being placed directly with banks and 49% placed with a range of counterparties via money market funds.

5.6. Pie chart 3 of Appendix 1 shows the range of countries where the parent company of the financial institution with which we have monies invested is registered. For money market funds there are various counterparties spread across many countries.

Liquidity:

5.7. At the end of quarter one £65m of our in-house monies were available on an instant access basis and £35m was invested in fixed term deposits. The table below shows the fixed term deposits during the period April to June 2020.

Table 1: Fixed Term Deposits

Counterparty	Date of Deposit	Return Date	Number of days	Interest rate (%)	Amount (£m)
Santander UK plc	14/08/2019	14/08/2020	366	1.15	10
Lloyds Bank plc	14/08/2019	14/08/2020	366	1.10	20
Santander UK plc	27/02/2020	27/02/2021	366	1.10	5

5.8. The maturity profile of our investments is shown in pie chart 4 of Appendix 1.

Investment return:

5.9. During the quarter the Council used the enhanced cash fund manager Payden & Rygel to manage monies on its behalf. An average balance of £5.0m was invested in these funds during the quarter. The table below shows the movement in the fund value over the quarter, the income distributions for that quarter, the returns both for each element and the combined return. See also Table 3 of Appendix 2.

Table 2: Payden Sterling Reserve Fund

Quarter 1	**£m**	**Investment return (%)**
Value of fund at start of quarter	4.990	
Increase/decrease in fund due to value of unit price	0.087	6.96
Value of fund at end of quarter	5.077	
Income distributions	0.010	0.77
Combined investment income (income distribution plus change in fund value due to unit price)	0.097	7.73

5.10. The Council had an average of £110.1m of investments managed in-house over the period from April to June 2020, and these earned an average interest rate of 0.45%. Of the in-house managed funds:

- an average of £46.9m was held in the Council's main bank account. Over the quarter no interest was earned as the rate is at a margin below the base rate of 0.10%. This average balance was higher than normal as a result to the volatile nature of the cash flows during the quarter due to the pandemic;
- an average of £35.0m was held in fixed term deposits and earned an average return of 1.11% over the quarter;
- an average of £28.2m was held in money market funds earning an average of 0.38% over the quarter. These work in the same way as a deposit account

but the money in the overall fund is invested in a number of counterparties, therefore spreading the counterparty risk.

5.11. In accordance with the Treasury Management Strategy the performance of investments managed in-house during the quarter is compared to the average 7-day LIBID. Throughout the quarter performance was higher than the average 7 day LIBID (London Interbank Bid Rate). The bank base rate remained at 0.10% throughout the period from April to June 2020, and the 7 day LIBID rate fluctuated between (0.071)% and 0.005%. Performance is shown in Graph 1 of Appendix 2.

5.12. As investment balances fluctuate, all investment returns quoted in this report are calculated using the average balance over the period and are quoted as annualised returns.

6. Short Dated Bond Funds

6.1. During the quarter two short dated bond funds were used for the investment of medium term funds: Royal London Investment Grade Short Dated Credit Fund and the AXA Sterling Credit Short Duration Bond Fund.

6.2. The monies are invested in units in the fund, the fund is then invested as a whole by the fund managers into corporate bonds in the one to five year range. An income distribution will be generated from the coupon on the bond and income distributions are paid to the Council. The price of units can rise and fall, depending on the price of bonds in the fund so these funds are invested over the medium term with the aim of realising higher yields than short term investments.

6.3. In line with the capital finance and accounting regulations the Council's Financial Instrument Revaluation Reserve will be used to capture all the changes in the unit value of the funds. Members should be aware that investment returns in some quarters will look very good and in other quarters there may be losses reported, but these will not impact the revenue account as only the distributions paid to the Council will impact that and not the change in the unit price.

6.4. An average of £7.5m was managed by AXA Investment Managers UK Limited. The table below shows the movement in the fund value over the quarter, the income distributions for that quarter, the returns both for each element and the combined return. See also Table 2 of Appendix 2.

Table 3: AXA Sterling Credit Short Duration Bond Fund

Quarter 1	£m	Investment return (%)
Value of fund at start of quarter	7.437	
Increase/decrease in fund due to value of unit price	0.199	10.69
Value of fund at end of quarter	7.636	
Income distributions*	0.028	1.49
Combined investment income (income distribution plus change in fund value due to unit price)	0.227	12.18

* This income distribution is an estimate and will be confirmed and distributed in quarter 2.

6.5. An average of £7.6m was managed by Royal London Asset Management. The table below shows the movement in the fund value over the quarter, the income distributions for that quarter, the returns both for each element and the combined return. See also Table 2 of Appendix 2.

Table 4: Royal London Investment Grade Short Dated Credit Fund

Quarter 1	**£m**	**Investment return (%)**
Value of fund at start of quarter	7.555	
Increase/decrease in fund due to value of unit price	0.182	9.56
Value of fund at end of quarter	7.737	
Income distributions	0.045	2.38
Combined investment income (income distribution plus change in fund value due to unit price)	0.227	11.94

7. Property Funds

7.1. Throughout the quarter long term funds were invested in two property funds: Patrizia Hanover Property Unit Trust and Lothbury Property Trust.

7.2. The monies are invested in units in the fund, the fund is then invested as a whole by the fund managers into properties. An income distribution is generated from the rental income streams from the properties in the fund. Income distributions are paid to the Council. There are high entrance and exit fees and the price of the units can rise and fall, depending on the value of the properties in the fund, so these funds are invested over the long term with the aim of realising higher yields than other investments.

7.3. In line with the capital finance and accounting regulations the Council's Financial Instrument Revaluation Reserve will be used to capture all the changes in the unit value of the funds. Members should be aware that investment returns in some quarters will look very good and in other quarters there may be losses reported, but these will not impact the revenue account as only the distributions paid to the Council will impact that and not the change in unit price.

7.4. An average of £14.5m was managed by Patrizia Property Investment Managers LLP. The table on the next page shows the movement in the fund value over the quarter, the income distributions for that quarter, the returns both for each element and the combined return. See also Table 1 of Appendix 2.

Table 5: Patrizia Hanover Property Unit Trust

Quarter 1	£m	Investment return (%)
Value of fund at start of quarter	14.454	
Increase/decrease in fund due to value of unit price	(0.739)	(20.50)
Value of fund at end of quarter	13.715	
Income distributions*	0.127	3.53
Combined investment income (income distribution plus change in fund value due to unit price)	(0.612)	(16.97)

* This is an estimate and may change due to the high level of uncertainty in the property market as a result of the Covid-19 pandemic. The income Distribution will be confirmed in quarter 2.

7.5. An average of £13.0m was managed by Lothbury Investment Management Limited. The table below shows the movement in the fund value over the quarter, the income distributions for that quarter, the returns both for each element and the combined return. See also Table 1 of Appendix 2.

Table 6: Lothbury Property Trust

Quarter 1	£m	Investment return (%)
Value of fund at start of quarter	13.100	
Increase/decrease in fund due to value of unit price	(0.318)	(9.80)
Value of fund at end of quarter	12.782	
Income distributions	0.078	2.40
Combined investment income (income distribution plus change in fund value due to unit price)	(0.240)	(7.40)

8. Overall Investment Position

8.1. An average of £110.1m of investments were managed in-house. These earned £0.124m of interest during this three month period at an average rate of 0.45%. This is 0.49% over the average 7-day LIBID and 0.35% over the average bank base rate.

8.2. An average of £5.0m was managed by an enhanced cash fund manager. During this three month period this earned £0.010m from income distributions at an average rate of 0.77% and the value of the fund increased by £0.087m giving a combined overall return of 7.73%

8.3. An average of £15.1m was managed by two short dated bond fund managers. During this three month period these earned £0.073m from income distributions at an average rate of 1.94% and the value of the funds increased by £0.381m giving a combined overall return of 12.06%

8.4. An average of £27.5m was managed by two property fund managers. During this three month period these earned £0.205m from income distributions at an average rate of 3.00% and the value of the funds decreased by £1.057m giving a combined overall return of (12.44)%.

8.5. The total for interest and income distributions in paragraphs 8.1 to 8.4 above is £0.412m and the total change in external fund values due to the unit price is a net decrease of £0.589m.

9. Borrowing

PWLB and short term borrowing

9.1. The Capital Financing Requirement (CFR) is the Council's theoretical need to borrow but the Section 151 Officer can manage the Council's actual borrowing position by either:

1 - borrowing to the CFR;
2 – choosing to use temporary cash flow funds instead of borrowing (internal borrowing) or;
3 - borrowing for future increases in the CFR (borrowing in advance of need).

9.2. The Council began 2020/21 in the second of the above scenarios, with actual borrowing below CFR.

9.3. This, together with the Council's cash flows, the prevailing Public Works Loans Board (PWLB) interest rates and the future requirements of the capital investment programme, were taken into account when deciding the amount and timing of any loans. During the quarter no new PWLB loans were taken out, no loans matured and no debt restructuring was carried out..

9.4. The level of PWLB borrowing (excluding debt relating to services transferred from Essex County Council on 1st April 1998) remained the same at £310.3m during quarter one. The average rate of borrowing at the end of the quarter was 3.77%. A profile of the repayment dates is shown in Graph 2 of Appendix 2.

9.5. The table below summarises the PWLB activities during the quarter:

Table 7: PWLB borrowing during quarter 1

Quarter	Borrowing at beginning of quarter (£m)	New Borrowing (£m)	Re-financing (£m)	Borrowing repaid (£m)	Borrowing at end of quarter (£m)
April to June 2020	310.3	0	0	(0)	310.3
Of which:					
General Fund	235.3	0	0	(0)	235.3
HRA	75.0	0	0	(0)	75.0

All PWLB debt held is repayable on maturity.

9.6. The level of PWLB borrowing at £310.3m is in line with the financing requirements of the capital investment programme and the revenue costs of this borrowing are fully accounted for in the revenue budget. The current level of borrowing is also in line with the Council's prudential indicators and is Prudent, Affordable and Sustainable.

9.7. These figures exclude debt held by Essex County Council of £10.7m relating to assets transferred on 1st April 1998, which this Council is responsible for servicing. The debt is recognised as a deferred liability on our balance sheet.

9.8. Interest rates from the PWLB fluctuated throughout the quarter in response to economic events: 10 year PWLB rates between 1.99% and 2.22%; 25 year PWLB rates between 2.40% and 2.69% and 50 year PWLB rates between 2.13% and 2.45%. These rates are after the PWLB 'certainty rate' discount of 0.20%.

9.9. No short term loans for cash flow purposes were taken out or repaid during the quarter. See Table 4 of Appendix 2.

Funding for Invest to Save Schemes

9.10. Capital projects were completed on energy efficiency improvements at the Beecroft Art Gallery, replacement lighting on Southend Pier, draughtproofing of windows, lighting replacements at University Square Car Park and Westcliff Library which will generate on-going energy savings. These are invest-to-save projects and the predicted revenue streams cover as a minimum the financing costs of the project.

9.11. To finance these projects in total the Council has taken out interest free loans of £0.154m with Salix Finance Ltd which is an independent, not for profit company, funded by the Department for Energy and Climate Change that delivers interest-free capital to the public sector to improve their energy efficiency and reduce their carbon emissions. The loans are for a period of four and five years with equal instalments to be repaid every six months. There are no net revenue budget implications of this funding as there are no interest payments to be made and the revenue savings generated are expected to exceed the amount needed for the repayments. £0.009m of these loans were repaid during the period from April to June 2020.

9.12. At the meeting of Cabinet on 23rd June 2015 the LED Street Lighting and Illuminated Street Furniture Replacement Project was approved which was to be partly funded by 25 year reducing balance 'invest to save' finance from L1 Renewables Finance Limited. The balance outstanding at the end of quarter one was £8.54m. There were no repayments during the period from April to June 2020.

9.13. Funding of these invest to save schemes is shown in table 5 of Appendix 2.

10. Compliance with Treasury Management Strategy

10.1. The Council's investment policy is governed by the CIPFA Code of Practice for Treasury Management in the Public Sector, which has been implemented in the Annual Treasury Management Investment Strategy approved by the Council on 20 February 2020. The investment activity during the quarter conformed to the approved strategy and the cash flow was successfully managed to maintain liquidity. See Table 7 of Appendix 2.

11. Other Options

11.1. There are many options available for the operation of the Treasury Management function, with varying degrees of risk associated with them. The Treasury Management Policy aims to effectively control risk to within a prudent level, whilst providing optimum performance consistent with that level of risk.

12. Reasons for Recommendations

12.1. The CIPFA Code of Practice on Treasury Management recommends that Local Authorities should submit reports regularly. The Treasury Management Policy Statement for 2020/21 set out that reports would be submitted to Cabinet quarterly on the activities of the treasury management operation.

13. Corporate Implications

13.1. Contribution to Council's Ambition & Desired Outcomes

Treasury Management practices in accordance with statutory requirements, together with compliance with the prudential indicators acknowledge how effective treasury management provides support towards the achievement of the Council's ambition and desired outcomes.

13.2. Financial Implications

The financial implications of Treasury Management are dealt with throughout this report.

13.3. Legal Implications

The Council has adopted the 'CIPFA Code of Practice for Treasury Management in the Public Sector' and operates its treasury management service in compliance with this Code.

13.4. People Implications

None.

13.5. Property Implications

None.

13.6. Consultation

The key Treasury Management decisions are taken in consultation with our Treasury Management advisers.

13.7. Equalities and Diversity Implications

None.

13.8. Risk Assessment

The Treasury Management Policy acknowledges that the successful identification, monitoring and management of risk are fundamental to the effectiveness of its activities.

13.9. Value for Money

Treasury Management activities include the pursuit of optimum performance consistent with effective control of the risks associated with those activities.

13.10. Community Safety Implications

None.

13.11. Environmental Impact

None.

14. Background Papers

None.

15. Appendices

Appendix 1 – In-house Investment Position as at 30 June 2020

Appendix 2 – Treasury Management Performance for Quarter One - 2020/21