

TREASURY MANAGEMENT - INTERIM REPORT 2020/21

Head of Service:	Lee Duffy, Chief Finance Officer
Wards affected:	(All Wards);
Urgent Decision?	No
If yes, reason urgent decision required:	N/A
Appendices (attached):	None

Summary

This report provides an update on treasury management performance for the first six months of 2020/21.

Recommendation (s)

The Panel is asked to:

- (1) Receives the presentation from Link Asset Services – Treasury Solutions;**
- (2) Notes the performance on return of investments for the first six months of 2020/21;**
- (3) Notes the current investment decisions being made within the terms sets out in the Treasury Management Strategy.**

1 Reason for Recommendation

- 1.1 The 2020/21 Treasury Management Strategy, agreed by Council in February, aims to ensure maximum return on investments for the Council within reasonable risk constraints. The Strategy requires a mid-year treasury management performance report to be brought before Financial Policy Panel – the recommendations ensure this requirement is met.

2 Background

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- 2.1 The Council's Treasury Management Strategy ("the Strategy") is consistent with the Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice on Treasury Management in the Public Services. It supports the achievement of the Council's Medium Term Financial Strategy.
- 2.2 The Strategy requires officers to produce an interim report on investment performance to a meeting of the Financial Policy Panel. This report covers the performance of the treasury management function for the period 01 April 2020 to 30 September 2020.
- 2.3 The CIPFA Code also requires that adequate training be provided to members with responsibility for treasury management. To meet this requirement, an officer from Link Asset Services – Treasury Solutions will attend the meeting to provide a presentation to members on current treasury management issues.
- 2.4 The treasury function deals with the management of cash funds held by the Council. The level of funds held during the year will vary but, on average, currently amounts to around £18 million at September 2020 (£19m at September 2019).
- 2.5 The current average balance is significantly lower than 2017 levels, because the Council has deployed £26m of its cash balances to reduce the borrowing requirement associated with commercial property investments since 2017. By deploying cash balances in this way, the Council has minimised its borrowing with the Public Works Loan Board, which typically attracts interest payable at circa 2.8% in the current environment.
- 2.6 The aim of treasury management is to ensure that funds are invested with institutions that balance the need to maximise investment returns with that of minimising risk on the monies invested. This means not investing in banks/building societies that are offering high investment returns but are at high risk of defaulting (for example the Icelandic Banks in 2008).
- 2.7 Before an investment decision is made, officers will investigate any proposed counterparty to ensure its financial rating makes it eligible for investment. Even if the institution meets the criteria as set out in the financial strategy, independent advice will be sought from our external financial advisors before the investment is made.

3 Security, Liquidity and Yield

- 3.1 The Council's investment strategy and practice is to put security of investment at a higher priority than rate of return/yield. The day to day practice continues to be reviewed and refined, within the boundaries of the approved policy, in response to challenging market conditions. The cornerstones of current policy/practice are:

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- 3.1.1 to restrict lending to only those institutions which fit the Council's policy in terms of financial standing, credit ratings etc;
- 3.1.2 generally, to restrict lending to the short-term (typically 3 to 6 months or less) or to cover precept dates for the remainder of the year;
- 3.1.3 to update financial limits to each institution depending the quality of their financial ratings.

4 Current Performance

- 4.1 The average return from investments for 2020/21 was budgeted at 1.0%. This amounted to total budgeted income for the year of £150,000, generated on reserves, working balances and cash flow.
- 4.2 The performance for the first six months of 2020/21 on the Council's investments were as follows;

	Average Investment (Apr-Sept) £'m	Interest Received (Apr-Sept) £'000	Average Rate of Return %
Internally Managed Funds			
Money Market Funds	14.4	10.5	0.15
Fixed Rate Deposits	3.3	21.7	1.30
Interest Bearing Account	0.4	0.3	0.18
Total Internally Managed	18.1	32.5	0.36
Externally Managed Funds			
Aberdeen Asset Management	0.0	0.0	0.00
Grand Total	18.1	32.5	0.36

- 4.3 By the end of September, £32,500 interest had been earned, which falls short of the profiled budgeted income of £75,000 for the same period. Officers currently anticipate that it will be difficult to achieve the budgeted income over the second half of the year, as the Bank of England base rate remains at all-time lows of just 0.10% across the year to date.

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- 4.4 However, the average return achieved for the first six months of 2020/21 of 0.36% compares favourably with the benchmark average seven day London Interbank Bid (LIBID) rate of -0.055% (minus 0.055%).
- 4.5 Should interest income remain under budget at year end, a contribution from the Interest Equalisation Reserve to the General Fund may be required.

5 Internally Managed Funds

Money Market Funds

- 5.1 Money market funds are pooled investments that allow instant access to these monies. The benefit of MMFs is that the risk on the investment is very low as the money invested in the fund is spread across a range of counterparties, which limits the exposure of a significant sum being invested with a defaulting counterparty.
- 5.2 The return made on money market funds of 0.15% is higher than the benchmark of -0.055%. Investment in money market funds has been limited to short term investments from surplus funds which will need to be called back with no notice required.

Fixed Rate Term Deposits

- 5.3 The Council had one fixed term deposit of £5,000,000 which matured in July 2020 at a rate of 1.3%.
- 5.4 The market rate for fixed term deposits (up to one year in duration) would currently be around 0.45%. However, the current strategy is to hold cash balances in the more liquid Money Market Funds, to ensure the Council can access its cash balances quickly if required in the current uncertain environment.

Interest Bearing Accounts

- 5.5 Interest bearing accounts offer the same instant access as the money market funds and deliver a rate of return linked to base rate set by the Bank of England.
- 5.6 Rates achievable on this account have been cut significantly in recent years and it is generally now only used for small daily surpluses, or if other investments have reached their counterparty limits. The risk on these investments is higher than the money market funds as money is deposited with one counterparty. Funds invested in this type of investment tend to be surpluses of daily cash flows which need to be called back at short notice.
- 5.7 The return made on interest bearing accounts of 0.18% compared favourably to the benchmark of -0.055%.

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6 Externally Managed Funds

- 6.1 Aberdeen Asset Management plc, previously Scottish Widows, has been the Council's external fund manager since October 2007.
- 6.2 Initially, the external fund manager produced some exceptional returns for the Council. Since October 2009 returns have reduced as opportunities to deliver significant returns have become very limited due to difficult market conditions such as the Bank of England base rate remaining at (or very close to) historic lows.
- 6.3 During the pandemic, officers have been using money market funds to hold cash balances instead of the external fund manager, as the money market funds allow the Council to access cash balances more quickly if required to in the current uncertain environment.
- 6.4 Beyond the pandemic, due to its reliable performance over the past thirteen years, officers expect to continue to utilise Aberdeen Asset Management plc as the external fund manager when required.

7 Treasury Management Strategy

- 7.1 In previous years the Council has recognised the increased levels of risk due to the uncertainty in the financial markets and consequently restricted the number of investments held over a fixed term.
- 7.2 The current strategy is to hold cash balances in the more liquid money market funds, to ensure the Council can access its cash balances quickly if required to in the current uncertain environment.
- 7.3 Should a commercial property acquisition, funded through borrowing, materialise during the current year, officers will explore the option of using cash balances to reduce the external borrowing requirement. External borrowing typically attracts interest payable at circa 2.8% in the current environment.
- 7.4 The Council continues to use money market funds for internal investments as they minimise exposure to counterparty risk. These funds also allow for maximising investment of short term cash surpluses during the year and also improve the efficiency of cash flow management.

8 Interest Equalisation Reserve

- 8.1 The interest equalisation reserve was established to enable variations in investment returns to be accommodated within the general fund budget without having an adverse effect on the levels of funds available for the delivery of services in year.

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- 8.2 The balance on this reserve at 30 September was £400,000.
- 8.3 Should interest income remain under budget at year end, a compensating contribution from this reserve to the General Fund may be required.
- 8.4 With base rates and investment returns remaining at relatively low levels, and with the Council's cash balances lower than prior years, the funds in this reserve may also be needed to achieve budgeted general fund income in the coming years.

9 Risk Assessment

Legal or other duties

9.1 Impact Assessment

- 9.1.1 The Treasury Management Strategy sets out that investment decisions must be based first and foremost on security, then liquidity and finally yield, in order to minimise risk.

Investments with our external fund manager are considered low risk as the money invested in the fund is spread across a range of counterparties, this limits the exposure of a significant sum being invested with a defaulting counterparty.

9.2 Crime & Disorder

- 9.2.1 None.

9.3 Safeguarding

- 9.3.1 None.

9.4 Dependencies

- 9.4.1 None.

9.5 Other

- 9.5.1 None.

10 Financial Implications

- 10.1 The Council's budget anticipates the equivalent of £92,000 of interest to help fund services in 2020/21 calculated as follows:

	Budgeted £	Forecast £
Interest earned in year	150,000	65,000

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Total Interest Available	150,000	65,000
Less Interest credited to specific provisions	58,000	58,000
Interest used to fund General Fund services	92,000	7,000

10.2 The forecast interest at the end of 2020/21 is anticipated to underperform the budgeted income by £85,000. It is therefore anticipated that a contribution from the interest equalisation reserve will be required to fund the deficit in 2020/21.

10.3 **Section 151 Officer's comments:** Financial implications are set-out in the body of the report. The 2021/22 income budget will need to be set to take account of post-Covid economic conditions and market returns.

11 Legal Implications

11.1 There are no particular equalities or other legal implications for the purpose of this report.

11.2 **Monitoring Officer's comments:** None for the purposes of this report.

12 Policies, Plans & Partnerships

12.1 **Council's Key Priorities:** The following Key Priorities are engaged:
Effective Council

12.2 **Service Plans:** The matter is included within the current Service Delivery Plan.

12.3 **Climate & Environmental Impact of recommendations:** None.

12.4 **Sustainability Policy & Community Safety Implications:** None.

12.5 **Partnerships:** There is partnership working with the external fund manager and the treasury consultants, but no particular implications arise from this report.

13 Background papers

13.1 The documents referred to in compiling this report are as follows:

Previous reports:

- 2019-20 Treasury Management Year-End Performance – Strategy & Resources Committee, 28 July 2020
- Budget Report 2020/21 – Full Council, 13 February 2020

Other papers:

- Treasury Management Strategy 2020/21

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- CIPFA Prudential Code
- Code of Practice for Treasury Management in Local Authorities (CIPFA)