Financial Policy Panel
30 November 2021

TREASURY MANAGEMENT - INTERIM REPORT 2021/22

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 2021/22.

Recommendation (s)

The Panel is asked to:

(1) Receive the presentation from Link Asset Services – Treasury Solutions;

(2) Note the performance on return of investments for the first six months of 2021/22;

(3) Note the current investment decisions being made within the terms sets out in the Treasury Management Strategy.

1 Reason for Recommendation

1.1 The 2021/22 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

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 2021 to 30 September 2021.

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 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 £24 million at September 2021 (£18m at September 2020).

2.5 Since 2017, the Council has deployed £26m of its cash balances to reduce the borrowing requirement associated with commercial property investments. 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 1.7% 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:

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 on the quality of their financial ratings.

4 Current Performance

4.1 The average return from investments for 2021/22 was budgeted at 0.75%. This amounted to total budgeted income for the year of £115,000, generated on reserves, working balances and cash flow.

4.2 The performance for the first six months of 2021/22 on the Council's investments is as follows;

	Average Investment (Apr-Sept) £'m	Interest Received (Apr-Sept) £'000	Average Rate of Return %
Internally Managed Funds			
Money Market Funds	19.3	0.3	0.003
Fixed Rate Deposits	0.0	0.0	0.000
Interest Bearing Account	4.9	0.2	0.010
Total Internally Managed	**24.2**	**0.5**	**0.005**
Externally Managed Funds			
Abrdn/Aberdeen Asset Management	0.0	0.0	0.000
Grand Total	**24.2**	**0.5**	**0.005**

4.3 By the end of September, only £500 interest had been earned, which falls significantly short of the profiled budgeted income of £57,500 for the same period. The shortfall is because the Bank of England base rate has remained at all-time lows of just 0.10% throughout the period, which has limited returns available in the market. Officers anticipate that it will be difficult to achieve the budgeted income over the second half of the year.

4.4 Despite the shortfall in budgeted income, the average return achieved for the first six months of 2021/22 of 0.005% compares favourably with the benchmark average seven day London Interbank Bid (LIBID) rate of -0.083% (minus 0.083%).

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 0.003% is higher than the benchmark of -0.083%. Investment in money market funds has meant that cash balances could be called back with no notice required.

Fixed Rate Term Deposits

5.3 The Council had no fixed term deposits to September 2021. The current strategy has been to hold cash balances in more liquid Money Market Funds, to ensure the Council can access its cash balances quickly if required to in the current uncertain environment.

5.4 The market rate for fixed term deposits (up to one year in duration) is starting to increase, with rates around 0.25%. Officers are currently looking to make a 6 month fixed term sustainable deposit in line with guidance obtained from our independent advisors.

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 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 0.01% compared favourably to the benchmark of -0.083%.

6 Externally Managed Funds

6.1 Abrdn/Aberdeen Asset Management has been the Council's external fund manager since October 2007.

6.2 The main benefit to the Council of using external fund managers is to minimise the Council's risk, as the funds invested are spread across a wide portfolio of financial institutions. This results in the overall exposure to a potential defaulting bank being limited to a small percentage of the overall holding.

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 fourteen years, officers expect to continue to utilise Aberdeen Asset Management as the external fund manager when required.

7 Sustainable Investments

7.1 The EU Sustainable Financial Disclosure Regulation (SFDR) came into force on 10 March 2021.

7.2 This requires asset managers and financial advisors to be more transparent about the way they integrate sustainability risks and opportunities within their investment processes and provide greater disclosure on a funds environmental and social features.

7.3 The EU has devised a classification system, which labels funds as either:

- Article 6 – Explains how sustainability risks are integrated in investment processes
- Article 8 – Specifically promotes sustainability characteristics, such as environmental and social characteristics, along with good governance
- Article 9 – Generating sustainable outcomes is the primary investment objective

7.4 The money market funds invested in by the Council are compliant with Article 8, apart from one. This fund is currently working towards Article 8 compliance with the aim of being fully compliant by the end of the year.

8 Treasury Management Strategy

8.1 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.

8.2 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.

8.3 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 3.0% in the current environment.

8.4 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.

9 Interest Equalisation Reserve

9.1 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.

9.2 The balance on this reserve at 30 September was £400,000.

9.3 Should interest income remain under budget at year end, a compensating contribution from this reserve to the General Fund may be required.

9.4 With base rates and investment returns remaining at very low levels, the funds in this reserve may also be needed to achieve budgeted general fund income in the coming years.

10 Risk Assessment

Legal or other duties

10.1 Impact Assessment

10.1.1 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.

10.2 Crime & Disorder

10.2.1 None.

10.3 Safeguarding

10.3.1 None.

10.4 Dependencies

10.4.1 None.

10.5 Other

10.5.1 None.

11 Financial Implications

11.1 The Council's budget anticipates the equivalent of £57,000 of interest to help fund services in 2021/22, calculated as follows:

	Budgeted £	**Forecast £**
Interest earned in year	115,000	8,000
Total Interest Available	**115,000**	**8,000**
Less Interest credited to specific provisions	58,000	58,000
Interest used to fund General Fund services	**57,000**	**-50,000**

11.2 The forecast interest at the end of 2021/22 is anticipated to underperform the budgeted income by £107,000. It is therefore anticipated that a contribution from the interest equalisation reserve may be required to fund the deficit in 2021/22.

11.3 **Section 151 Officer's comments**: Financial implications are set-out in the body of the report. The 2022/23 income budget will need to be set to take account of post-Covid economic conditions and market returns.

12 Legal Implications

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

12.2 **Legal Officer's comments**: None for the purposes of this report.

13 Policies, Plans & Partnerships

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

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

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

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

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

14 Background papers

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

Previous reports:

- 2020-21 Treasury Management Year-End Performance – Strategy & Resources Committee, 27 July 2021
- Budget Report 2021/22 – Full Council, 16 February 2021

Other papers:

- Treasury Management Strategy 2021/22
- CIPFA Prudential Code
- Code of Practice for Treasury Management in Local Authorities (CIPFA)