Treasury Management and Investment Sub Committee

17th October 2022

Treasury Management Mid-Year Review 2022/23

Report by:
Section 151 Officer

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Purpose

To inform members of the Treasury Management (TM) activities undertaken in the first part of 2022/23 and to report on compliance with the approved TM Strategy.

Options

1. Accept the recommendations contained within the report
2. Recommend changes to the way the Council's investments are to be managed

Preferred option and reasons

Recommend the report to Cabinet and Council without amendment for consideration and thereby meet statutory obligations

Recommendations

That Treasury Management and Investment Sub Committee (TMISC) and Cabinet note the contents of this report and request that Full Council review the report and approve that no changes to the 2022/23 Treasury Strategy are required.

1. Background

1.1. The Council has cash to invest arising from its revenue activities, capital balances and the collection of Council Tax and Business Rates. The Council can fund its capital programme from borrowing. The activities around the management of Council cash and external borrowing are known as Treasury Management.

1.2. Under statute and the CIPFA Code of Practice on Treasury Management (“the Code”), members are required to receive reports on the Council’s Treasury Management (TM) activities. The report in Appendix 1 complies with the CIPFA Code of Practice and relevant Government regulations.

1.3. Full Council has overall responsibility for Treasury Strategy but delegates to the Treasury Management and Investment Sub Committee (TMISC) responsibility to monitor and recommend changes to the strategy. The Section 151 Officer of the Council is delegated responsibility to manage operational TM activities within the approved strategy.

1.4. Members of TMISC are asked to review the contents of the report and recommend that the Cabinet note its contents and seek Council approval for it.

2. Executive Summary

- No breaches of the 2022/23 Treasury Management Strategy have occurred.
- Interest Rates have continued to increase leading to projected income being higher than budgeted with volatility in rates at the time of drafting.
- Investments in three Diversified Income Funds as a whole have improved yields.
- The Council remains internally borrowed to fund its capital investment and does not expect in 2022/23 to externalise any debt, though forecasts will be updated as part of the 2023/24 budget process.
- CCLA Property fund holding is approaching the limit of £8m set as part of the Treasury Strategy.
- No change to the TM Strategy is recommended for 2022/23.

3. Conclusion

3.1. Cabinet will be asked to accept the review of the Treasury Management activity for the period to the end of August as endorsed by TMISC. No changes to the 2022/23 Treasury Management Strategy are recommended.

List of appendices:

Appendix 1 – Review of Treasury Management Activity (2022/23)

Background papers:
Nil

Corporate Implications
Legal/Constitutional: The report meets statutory obligations on reporting Treasury Management activity.

Financial: As detailed in the report

Potential impact on climate change and the environment:

Any fund managers will be required to consider ESG (Environmental, Social and Governance) factors in their investment process. All the fund managers would be expected to have signed up to the UN Principles for Responsible Investment (PRI). PRI argues that active participation in ESG and exercising shareholder rights on this basis can help to improve the performance of companies which may otherwise not address such concerns and so being an engaged corporate stakeholder is a more effective way to bring about change in corporate behaviour on ethical issues.

Further requirements from those identified above are not practical given the limited ability to directly influence any immediate change in the financial markets.

Contribution toward achieving a net zero carbon position by 2030: N/A

Personnel: N/A

Risk Management:

The report is part of the Council's approach to managing risks arising from Treasury. Management

Equality and Diversity: N/A

Health and Safety: N/A

Digital: N/A

Other: N/A

Consultees:

Relevant Policies and Strategies:
Treasury Management Strategy 2022/23

1 **Treasury Management Activity during the period 1st April 2022 – 31st August 2022**

This report complies with the CIPFA Code by identifying the Council's investments and external borrowings as at 31/08/2022 and compares treasury activity to the approved strategy.

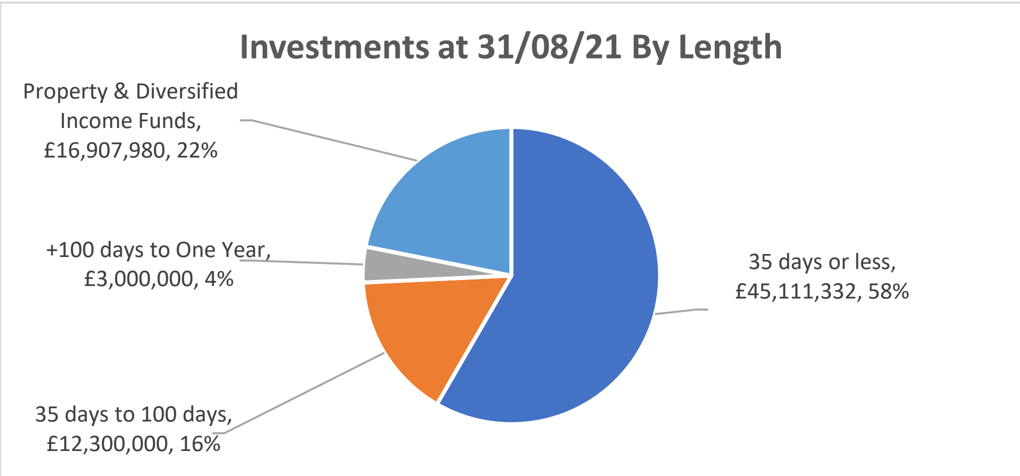
2 **Liquidity Management and borrowing**

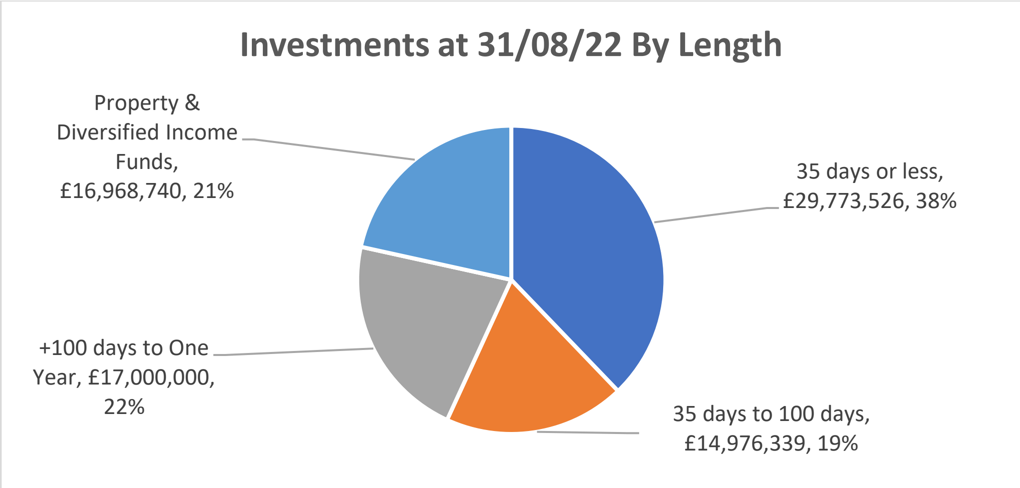
2.1 The Council has continued to keep a significant proportion of its portfolio available for instant access and within notice accounts. This reflects the uncertainty of projecting cashflow balances during and following the pandemic. Investment returns until this financial year for longer duration investments have not justified the lengthening of maturities, however, officers are now engaged in seeking appropriate longer-term investments of up to 1 year. The Section 151 officer will consult with the Cabinet Member for Fairer Chelmsford should a 2-year investment be considered appropriate.

To assist in managing liquidity, the Council set the following target in its Treasury Management Strategy.

A minimum of £15m of all investments must be invested for periods of 35 days or Less

Outcome: The target was achieved, and officers will continue to keep the average durations of investments short until longer investment durations become worthwhile in terms of returns.





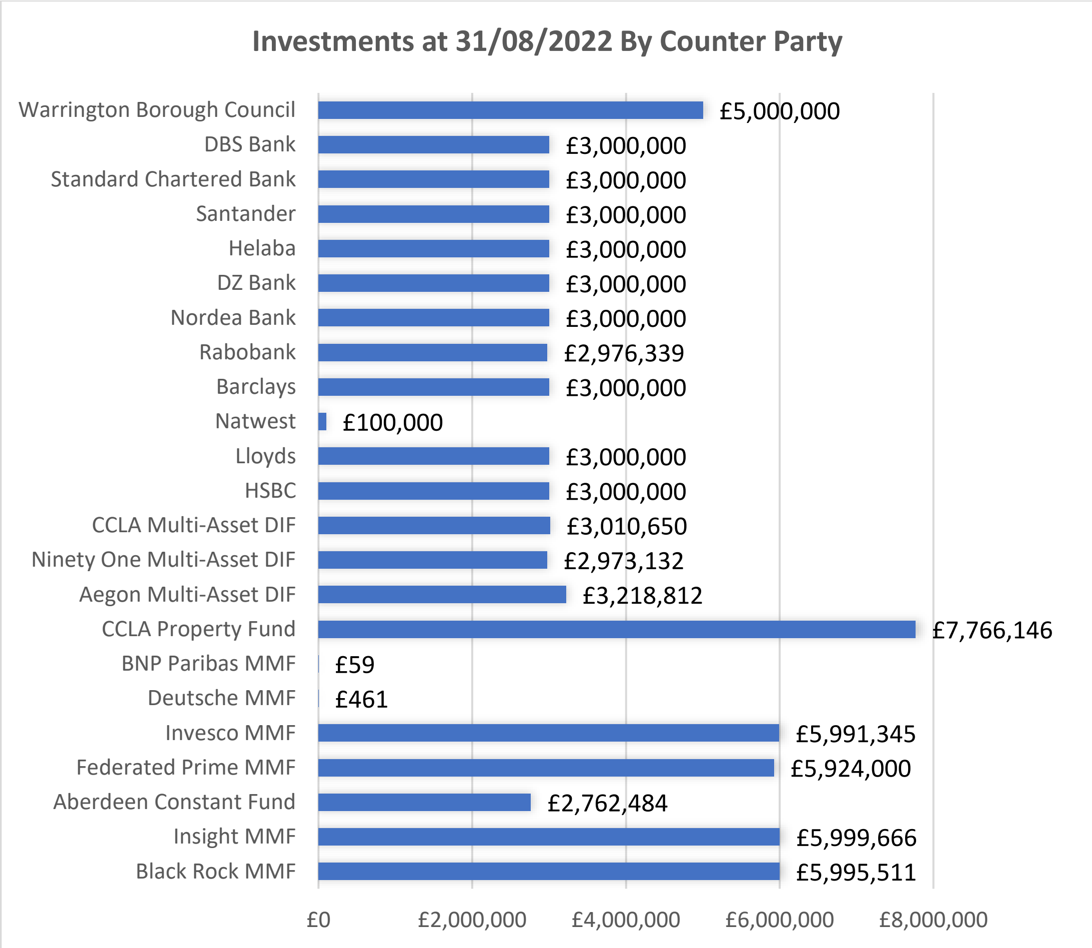
Investments at:	31/08/21	%
35 days or less	£45,111,332	58
35 to 100 days	£12,300,000	16
+100 days to 1 yr	£3,000,000	4
Over 1 yr	£0	0
Property & Diversified Monthly Income Fund	£16,907,980	22
Total	**£77,319,312**	**100**

Investments at:	31/08/22	%
35 days or less	£29,773,526	38
35 to 100 days	£14,976,339	19
+100 days to 1 yr	£17,000,000	22
Over 1 yr	£0	0
Property & Diversified Monthly Income Fund	£16,968,740	21
Total	**£78,718,605**	**100**

2.2 The Council's Treasury strategy set the following
No fixed duration investments over 365 days are proposed for 2022/23; Subject to being reviewed during 2022/23 depending on cashflow and counterparty risk. It is recommended that any investments beyond 365 days are at the discretion of the Section 151 Officer.

Outcome: The limit has not been exceeded. Currently, none are proposed but officers are looking at options based on reviewing the Council's cashflow and interest forecast.

2.3 **No breaches of counter -party limits have occurred**. The investments held by the Council are noted below.



The Council's investments with local authorities and banks are mostly fixed maturity dates and of a duration of less than one year. The investments with HSBC and Barclays are 31-day and 95-day notice accounts respectively, which both achieve a higher return to the Council than Money Market Funds.

2.4 **The Council has not undertaken any external borrowing in the year to date.** The funding of the approved Capital programme requires borrowing but that has been internal borrowing which reduces the amount the Council has to invest. The Council operates two borrowing limits, the Authorised (maximum) limit which cannot be exceeded without Council agreement and an Operational boundary (which provides an expected level of external debt). The current limits are noted below.

	Limit
Authorised Limit of Borrowing	**£37m**
Operational Boundary of Borrowing	**£1.8m**

2.5 The Council cash balances will fall as the year progresses due to the normal outflow of Council Tax to other precepting bodies and capital programme spend. Cash balances are expected to fall significantly compared to previous years due to the capital programme. It is thought unlikely that short-term external borrowing will occur in 2022/23 and a full review of the Council's forecast cashflow is taking place as part of the 2023/24 budget which will estimate when the Council will have a need to undertake external borrowing.

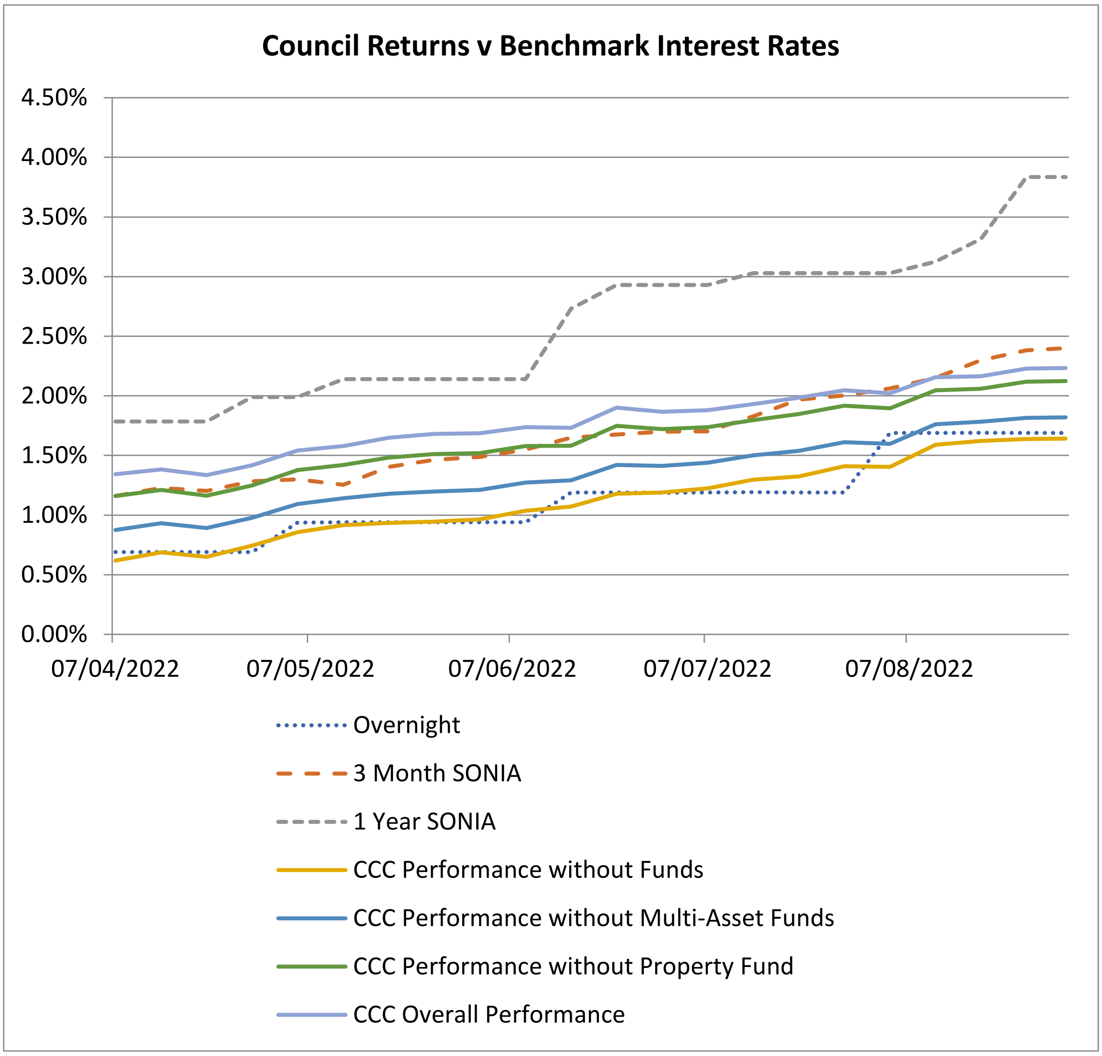
3. **Rate of Return**

3.1 The Bank of England Base rate stands at 2.25% after the 0.5% rate rise in September, with market expectations of further future rises to control inflation and deal with tight labour market conditions.

As at 27th September, one-month local authority loans are 1.80% and one-year loans have risen to 4%, however there is a great deal of volatility in the market. Money Market Funds are currently running between 1.80% to 2.08% (likely to rise further) with other cash investments with building societies offering around the base rate and some banks offering higher than the base rate in general for three-month investments.

The Council continues to invest in three multi-asset diversified income funds as part of its long-term strategy for returns and diversified portfolio. The returns are discussed in paragraphs 3.2 to 3.6.

3.2 Money market interest rates have increased with bank rate rises over the last six months. The Council returns are shown below alongside some comparable benchmark rates.



3.3 The Council's rate of return in 2022/23 has improved compared to recent years due to the rise in Bank of England base rate which has led to increased rates on any cash or short-notice investments. Three diversified income funds have helped to enhance this return for the Council. Officers are continually reviewing options for longer duration investments.

3.4 The Council had an average yield on its portfolio of 2.23% as at 31st August 2022. The budgeted income for 2022/23 from investment returns is £701k; this is expected to be exceeded for the year by at least £400k, mainly due to rate rises. Further gains will be dependent on the extent of interest rate increases and cash balances which will be affected by the capital programme.

3.5 Some longer duration interest rates are now looking attractive with some banks offering over 5% for one-year investments after the mini budget update. These trends will be monitored throughout the rest of 2022/23 to assess whether returns can be increased, whilst maintaining security for the Council.

3.6 It is expected that interest rates will continue to rise. Arlingclose are forecasting rates to reach 5% from March 2023 but there is a great deal of uncertainty. The Council returns will be maximised wherever possible but only within the approved Treasury Management Strategy.

4 Externally Managed Fund Performance

4.1 The Council is now invested in three Multi Asset Diversified Income Funds alongside its longstanding investment in the CCLA property fund. These are all intended to be longer term investments to generate a secure return for the Council at a higher rate than many other alternatives. Capital values will fluctuate throughout the period of investment. At the time of drafting, the money markets are under stress with significant interest rate increases being assumed. The information provided in this report will therefore become out of date quickly. Additionally, fund valuation information does not reflect the pressures in the financial markets. Members can expect volatility in fund valuations and uncertainty about the upside gains in income yields from the funds. The decreases in capital values mentioned below are unrealised and would only be realised if the funds were sold. We are currently experiencing extremely volatile market conditions, and this has impacted the externally managed funds.

Fund	Initial Investment Value	01/04/2022 Investment Value	31/08/2022 Investment Value	Unrealised Gain/(Loss) (since inception)	Annualised Income Return on 1st April Valuations	Annualised Total Return (2022/23)
CCLA Property Fund	£5,000,000	£7,565,769	£7,766,146	£2,766,146	3.32%	5.97%
CCLA DIF	£3,100,000	£3,089,233	£3,010,650	-£89,350	3.49%	0.95%
Aegon DIF	£3,600,000	£3,584,000	£3,218,812	-£381,188	6.94%	-1.33%
Ninety One DIF	£3,300,000	£3,151,873	£2,973,132	-£326,868	4.34%	-3.26%

- CCLA Property Fund – This investment fund is open only to Local Authority investors. The Council invested at cost of £5m and its current selling value is £7.8m at 31st August. The annualised income yield on the valuation at 1st April is 3.32%
- Aegon Multi-Asset Diversified Income Fund – A £3.6m investment was made into the Aegon DIF in June 2021.
    - Annualised income yield is 6.94% on the valuation at 1st April.
    - Capital Value – 10.59% decrease on initial investment and 10.20% decrease against April valuation.
- Ninety-One Multi Asset Diversified Income Fund – A £3.3m investment was made into the Ninety-One DIF in June 2021.
    - Annualised income yield is 4.34% on the valuation at 1st April.
    - Capital Value – 9.91% decrease on initial investment and 5.67% decrease on April valuation.
- CCLA Multi Asset Diversified Income Fund – A £3.1m investment was made into the CCLA DIF in July 2021.

- Annualised income yield– 3.49%.
- Capital Value – 2.88% decrease on initial investment and 2.54% decrease on April valuation.

The return on all external funds should be looked at as a portfolio, allowing for periods of over- and underperformance for individual funds. If the first few months of performance were to continue, then the annualised income yield from April to August would be 4.28% on April valuation. The unrealised capital gain to date is £2.0m (including CCLA property fund). It is important to note the unrealised capital gain will fluctuate; the main objectives of the investment in funds are spread of risks across asset types and improving annual income (yield).

4.2 As all four of the funds that the Council is invested in are externally managed, the Council benefits from experts who bring expertise and additional data when selecting and managing investments, therefore helping to spread risk across a wider range of counter-parties and assets, whilst maintaining a high yield.

4.3 The value of the different funds the Council invests in can be seen when looking at the returns the Council receives without them. As at 31st August 2022, Council return excluding these funds was 1.64%.

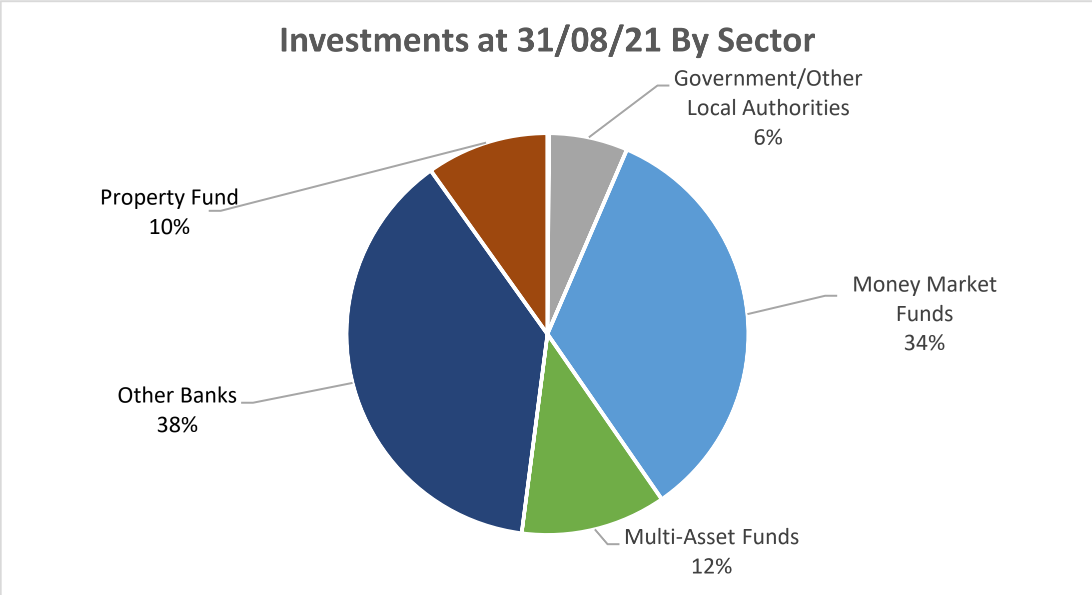
4.4 The CCLA property fund is not far from reaching the limit of £8m that is set in the Treasury Management Strategy and, as a result, the limit of this fund will need to be increased to allow for further unrealised capital gains. However, volatility in the financial markets is likely to have a detrimental impact on its value.

Alternatively, it may be worth considering selling a proportion of this fund to realise some of these gains. Any sale would have a 90-day redemption period where the funds will be redeemed at the first valuation date following the expiry of the notice period. Arlingclose, the Council's treasury advisors, do not necessarily recommend realising some of the CCLA property fund unrealised gain to invest in other bond funds as the Council has a good level of existing exposure to bond funds through the three multi-asset funds. Officers will consider the options in the light of rising interest rate returns and volatility in fund capital value and undertake action as necessary.

5.0 Bail-in Risk

5.1 This is the risk that regulators will step in and enforce losses on depositors in order to recapitalise a failing bank or building society, rather than rely on taxpayer bailouts.

5.2 Overall exposure to bail-in has increased from last financial year to current, predominantly due to banks reacting to rate rises quicker and building in higher expectation of future rate rises than the local authority market and officers have invested to achieve those higher yields.



Exposure	As at 31st August 2021	As at 31st August 2022
Bail-in risk	53%	72%
Exempt from bail-in (including CCLA)	34%	16%
Diversified Income Funds	13%	12%
Total	**100%**	**100%**

The Diversified Income Funds will be partially exposed to Bail-In risk, but it is not possible to identify specific risk due to the changing nature and proportion of their investments in bonds, equities, property etc. They have therefore been split out as a separate line in the table above for clarity.

The treasury management advisor services are with Arlingclose at present and the contract for these services ends on 31st October 2022. A tender process is currently in progress where a decision would be made after 17th October 2022.

6 Conclusion

- No breaches of the Treasury Management Strategy have occurred
- Interest Rates are expected to rise during the financial year resulting in higher returns for cash investments. However, there is considerable uncertainty over the extent of any increases.
- The Council remains internally borrowed to fund its capital investment.
- Investments into three diversified income funds as a whole continue to enhance the returns for the Council.
- CCLA property fund is approaching the £8m limit.
- No change to Strategy is recommended for the rest of 2022/23.