



Basingstoke
and Deane

TREASURY MANAGEMENT QUARTER 3 MONITORING REPORT 2020/21

**Executive Director of Corporate Services (Section 151
Officer), Sue Cuerden**

Report to	Audit and Accounts Committee
Ward(s):	All
Key Decision:	No
Appendix 1:	Treasury Management Investment Holdings
Papers relied on:	None

Recommendation to Committee

It is recommended that this committee notes the Treasury Management Quarter 3 Monitoring Report 2020/21.

Background, corporate objectives and priorities

This report shows the activity within the council's treasury management function from 1 April 2020 up to 31 December 2020 and includes forecasts for the year ending 31 March 2021.

The treasury management function operates within the parameters of the council approved Treasury Management Strategy.

This report does not require a decision but is to be noted in accordance with the council's constitution, treasury management practices and accounting codes of practice.

This report accords with the council's Budget and Policy Framework and supports the development of an effective and efficient council.

GLOSSARY OF TERMS

Term	Definition
Gilts	These are issued by the UK Government in order to finance public expenditure. Gilts are generally issued for a set period and pay a fixed rate of interest. At the end of the set period the investment is repaid (at face value) by the Government. However, during the life of a gilt it will often be traded (bought and sold) at a price decided by the market.
Counterparties	These are the organisations responsible for repaying the council's investment upon maturity and making interim interest payments. The counterparties used by the council are highly creditworthy banks, building societies or local authorities.
Debt Management Agency Deposit Facility (DMADF)	An investment facility run by part of the HM Treasury taking deposits at fixed rates for up to 6 months.
Diversified Credit Funds	Externally managed pooled investment schemes investing in wide ranging mix of credit instruments including Gilts, Corporate Bonds, Investment Grade Credit, Asset Backed Securities, Senior Mortgages, Leveraged Loans and High Yield Bonds.
Absolute Return Bond Funds	These are pooled investment schemes which invest in a wide range of credit asset classes. Although similar to Diversified Credit Funds, they typically have lower levels of volatility and risk with a correspondingly lower level of return. They also provide better protection than traditional bond funds against rising interest rates or widening credit spreads.
Property Funds	These are pooled investment schemes which invest in a wide variety of commercial property such as offices, industrial buildings and warehouses. Funds distribute regular income payments to investors and provide exposure to the underlying value of the property assets within the fund. They are less liquid than funds made up of financial instruments.
Money Market Funds / Short-Term Cash Funds	Externally managed pooled investment schemes investing in short-term cash instruments. These are extremely low volatility, low return funds mostly used for cash liquidity management.
Fixed Deposits	These are loans to banks, building societies or other local authorities which are for a fixed period and at a fixed rate of interest.
Treasury Bills	Tradable debt securities issued by the UK Government with a short-term maturity (1, 3 or 6 months) issued at a discount. The income from these is in the form of a capital gain upon maturity.
Call Accounts	Deposit accounts with banks and building societies that provide same day access to invested balances. Interest paid is usually linked to the level of the official base rate.
Supranational Bonds	These are very similar in nature to gilts except that they are issued by supranational bodies supported by more than one national government.

1 Executive Summary

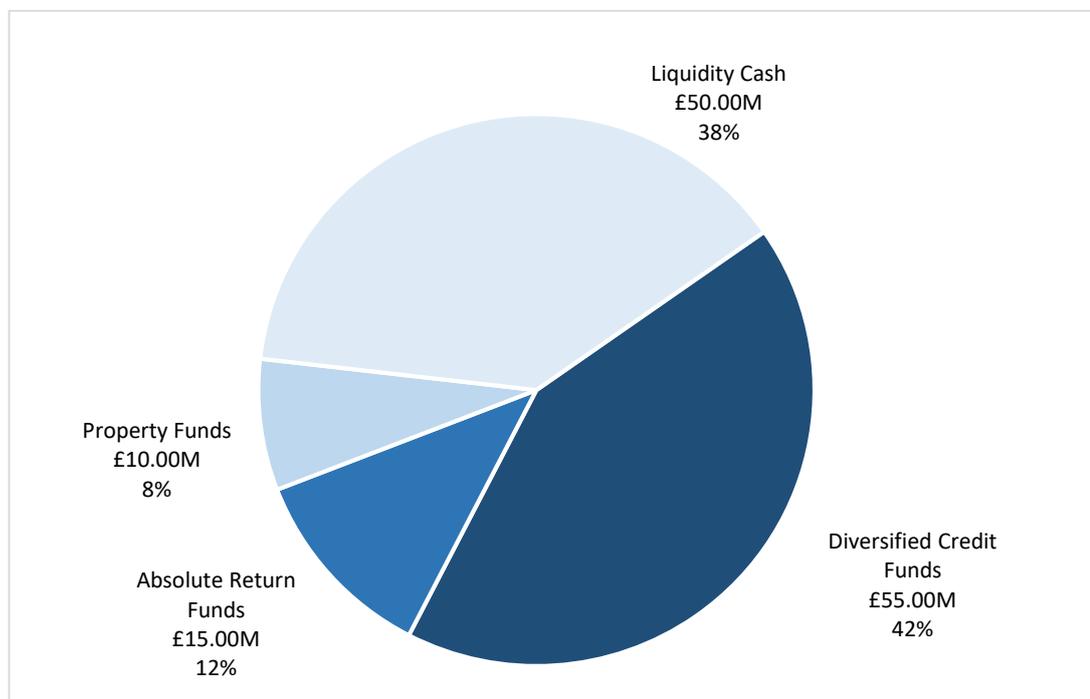
1.1 The key points to note on the forecast performance for this year are as follows:

- Treasury management investment income is forecast to be £2.06M compared to the budgeted income of £2.56M. A breakdown of the £0.50M reduction of income can be seen in Table 4 (section 10).
- This forecast assumes that Quarter 4 income from long-term investments in externally managed funds will be broadly in line with income received in Quarter 3. It also assumes that the Bank of England will maintain the official rate of interest at its present level of 0.10% and that the council will be able to avoid investing short-term cash at negative rates of interest.
- There is a risk that the amount of forecast income might not be achieved if income distributions from externally managed funds are below expectations or if the Bank of England reduces its official rate of interest into negative territory.
- Investment balances as at 31 December 2020 were £130.00M. Average investment balances for the year are expected to be £125.17M.
- The overall return for the year is forecast to be 1.68% compared with the budget estimate of 1.98%.

2 Treasury Management Holdings

2.1 The treasury management investment holdings as at 31 December 2020 are summarised in Chart 1:

Chart 1 – Treasury Management Investment Allocation (£130.00M)



2.2 The chart shows a portfolio with a mix of long-term strategic investments and highly liquid cash funds. Approximately 62% of the investment portfolio is in long-term, externally managed pooled funds which generate most of the council's treasury management income. The remaining 38% is being held as liquidity cash in response to the uncertainties around the council's cash flows as a result of the Covid-19 pandemic.

2.3 A full list of the council's treasury management investment holdings as at 31 December 2020 showing the names of the counterparties, credit ratings (where applicable) and the amounts invested can be seen in Appendix 1.

2.4 At the current time, there are no loans to other local authorities.

3 Treasury Management Activity

3.1 Table 1 below shows a summary of treasury management investment activity up to 31 December 2020.

Table 1 – Treasury Management Investment Activity

	Holding 31/03/20 £M	Investments Made £M	Investments Realised £M	Holding 31/12/20 £M
Government Gilts	12.34	0.00	(12.34)	0.00
Diversified Credit Funds	55.00	0.00	0.00	55.00
Absolute Return Bond Funds	15.00	0.00	0.00	15.00
Property Funds	10.00	0.00	0.00	10.00
Short Term Investments	30.00	0.00	(30.00)	0.00
Liquidity Cash	10.20	232.50	(192.70)	50.00
Total Investments	132.54	232.50	(235.04)	130.00

3.2 No short-term borrowing has been undertaken during the year as part of daily cash flow management.

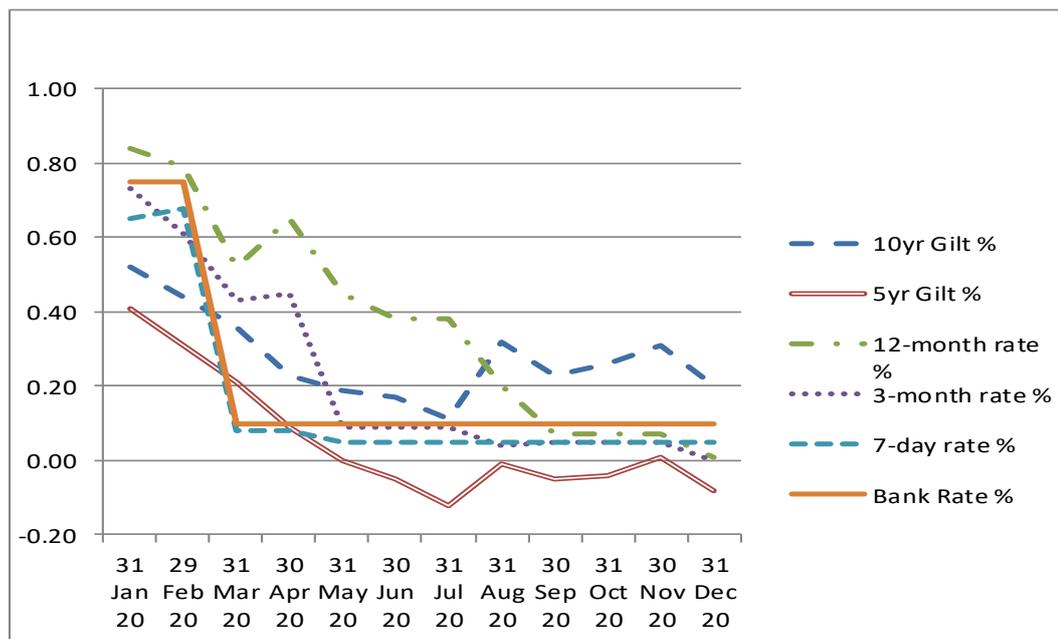
4 Financial Market Conditions

4.1 The Bank of England base rate is at an all-time low of 0.10% and Arlingclose Ltd. - the council's treasury management advisor - is forecasting that the base rate is likely to remain at this level, or lower, for a number of years. There has been discussion at the Bank of England about the potential for a negative base rate and this has already caused some market rates to fall below zero. Gilt yields are also at historic lows reflecting the outlook for interest rates as well as the demand for safe haven assets in a time of great uncertainty.

4.2 The market's assessment of credit risk has improved markedly since April as a recovery from the pandemic-induced lows of March has been priced in. Central banks' actions of injecting liquidity into the system by buying corporate debt and also Government fiscal stimulus have been instrumental in restoring confidence to credit markets, as has the development of an effective vaccine. However, there remains some caution due to a recent surge in the number of virus cases with new strains being identified and also questions about how much more effective central bank action can be and how much more government support can be provided without significant implications for public finances.

4.3 Chart 2 shows the movement in interest rates over the 12 months prior to the reporting date.

Chart 2 – Interest Rates % over the last 12 months



5 Treasury Management Performance

5.1 A summary of the performance of treasury management investments is shown in Table 2 below:

Table 2 – Investment Performance Summary

	Original Estimate 2020/21	Annualised Return 30/09/2020	Forecast for Year 2020/21
Government Gilts	3.40%	2.72%	2.72%
Diversified Credit Funds	2.57%	2.35%	2.34%
Absolute Return Bond Funds	1.50%	1.52%	1.50%
Property Funds	3.55%	3.97%	3.89%
Short-Term Investments	0.88%	0.91%	0.91%
Liquidity Cash	0.75%	0.05%	0.04%
Average Overall Return	1.98%	1.73%	1.68%

5.2 The overall return on investments is forecast to be 1.68% compared to the original estimate of 1.98%.

5.3 The forecast return for the year for government gilts has been adjusted from the estimate to more accurately reflect the yields of the gilts actually held by the council and the expectation that no new gilt investments will be made during the year.

5.4 The return shown from diversified credit funds is from dividends paid which are variable and, although not directly linked, can be affected by market interest rates. These funds are expected to return 2.34% of income compared to the estimate of 2.57%.

5.5 The return shown from absolute return bond funds is also variable and from

dividends paid rather than from any increases in capital value. These funds are forecast to return 1.50% of income, in line with the estimate.

- 5.6 Dividend payments from property funds are affected less directly by market interest rates than are the council's other external fund investments. This fund is expected to return 3.89% income compared to the initial estimate of 3.55%.
- 5.7 The council's external funds provide returns primarily through income distributions and also have the potential for capital growth through changes in the value of the units when sold. Combining these two elements gives the total return for the fund.
- 5.8 The performance of externally managed funds is subject to a half-yearly report and analysis by the council's investment advisors. The most recent report was presented to members of the Audit and Accounts Committee on 25 January 2021.
- 5.9 Short-term investments are managed in-house and are forecast to achieve 0.91% this year compared to the estimate of 0.88%. Loans to other local authorities are usually a large proportion of these investments but there have been no new loans made during 2020/21 as the council has looked to retain cash due to COVID-19 related uncertainties.
- 5.10 Liquidity cash is managed primarily to ensure that cash is always available to meet the council's day to day spending and this is forecast to return 0.04% compared to the estimate of 0.75%. Many short-term cash rates have turned negative during the year and although the council has avoided investing at negative rates it has been difficult to generate any return on cash balances.

6 Unrealised Valuation Gains and Losses

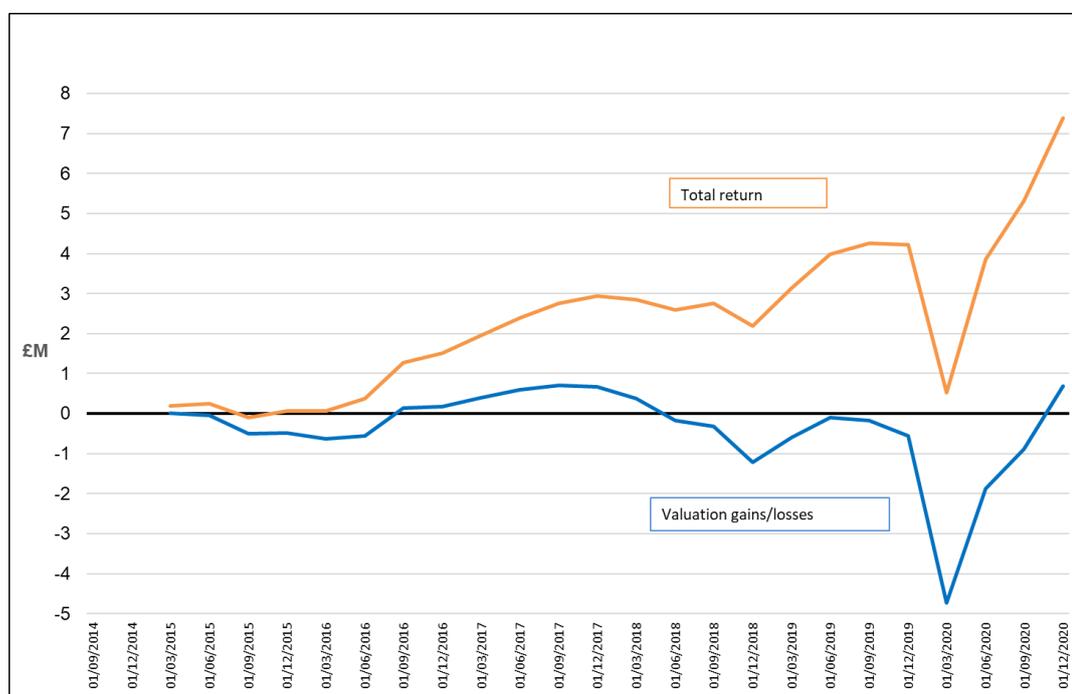
- 6.1 Valuation gains and losses on the council's externally managed funds are accounted for separately from the income distributions. Although they are recognised in the income and expenditure account there is a statutory requirement to reverse their impact until such time as the investments are realised by disinvesting.
- 6.2 COVID-19-related market turmoil in March 2020 caused the total valuation for the council's external fund holdings to fall approximately 6% below purchase price. The council maintained its investment holdings as stability returned to the markets and as of 31 December 2020 the total valuation of the same funds was almost 1% above purchase price.
- 6.3 Table 3 shows a significant recovery in fund valuations since the start of the year.

Table 3 – External Fund Valuations – Change since 31 March 2020

Fund	Initial Investment Amount £	Valuation at 31 March 2020 £	Valuation at 31 Dec 2020 £	Valuation Change 2020/21 £
M&G Alpha Opportunities	10,000,000	9,490,683	10,726,087	1,235,404
M&G Total Return Credit Investment	10,000,000	9,821,629	10,956,199	1,134,571
BlackRock Fixed Income Global Opportunities	20,000,000	17,994,954	19,983,007	1,988,053
Royal London Short Dated Credit Fund	15,000,000	14,576,770	15,224,327	647,557
Aegon Absolute Return Bond Fund	15,000,000	14,366,987	15,023,813	656,826
CCLA Local Authorities Property Fund	10,000,000	9,022,311	8,771,303	(251,007)
Total	80,000,000	75,273,334	80,684,736	5,411,402

6.4 The historical movement in the unrealised valuation gains and losses for the council's external funds can be seen in Chart 3 which shows significant movements above and below the initial capital invested over the period of investment up to 31 December 2020. However, the total net return, which includes the income distributions, is noticeably positive.

Chart 3 – Accumulated Unrealised Gains/Losses and Total Return of External Funds since Investment (£M)



7 Treasury Management Investment Portfolio Benchmarking

7.1 The council takes part in a quarterly investment benchmarking service provided by its treasury management advisors, Arlingclose Ltd. This shows

the council's relative returns and the amount of risk being taken compared with Arlingclose's other clients.

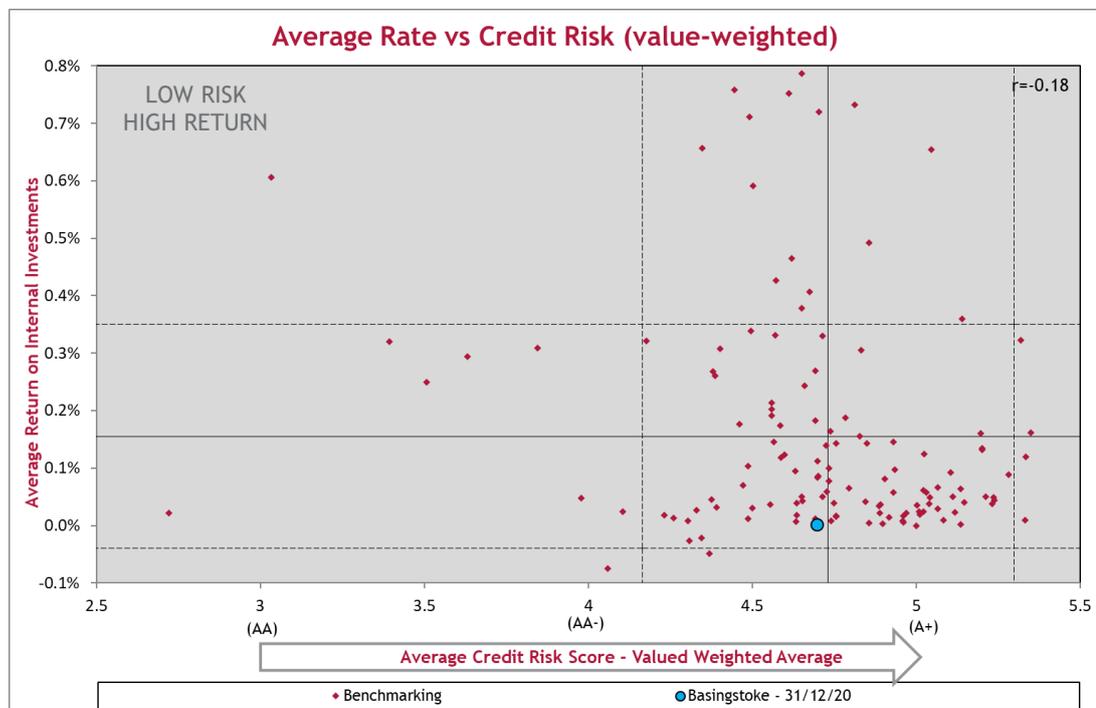
7.2 Although the council's total interest and investment income has reduced over recent years, the benchmarking results demonstrate that the council's returns still compare well against those of other local authorities. These returns are being achieved whilst taking less indicated risk than most other authorities.

7.3 Chart 4 shows the benchmarking for the council's internally managed investments.

7.4 It should be noted that Chart 4 is a snapshot of the average running yield on internally managed treasury investments, including cash held for liquidity, and shows the council's running yield at 0.00%. This differs from the reported annual performance due to returns from investments that are held and mature throughout the course of the year.

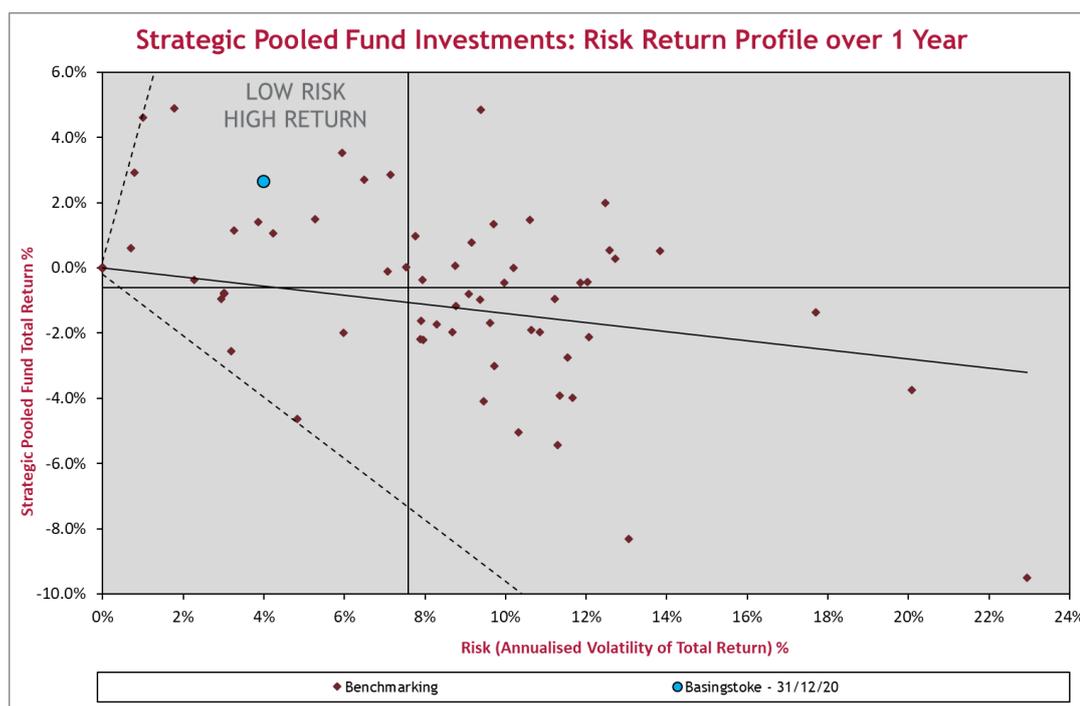
7.5 The council's internal investments have moved away from the usual position in the top left quarter of Chart 4 as gilts have matured and the emphasis has been placed on cash availability rather than returns in this uncertain environment. Whilst we are unable to tell what investments other participants are holding, it is likely that many of the higher yields are from longer dated investments which therefore do not offer the liquidity that this council has recently chosen to prioritise. Fortunately, the council's internally managed investments make up the smaller proportion (38%) of the overall portfolio.

Chart 4 – Internal Investments Benchmarking at 31 December 2020



7.6 Chart 5 shows the benchmarking for the council's externally managed fund investments.

Chart 5 – External Fund Investments Benchmarking at 31 December 2020



7.7 The council’s externally managed fund investments are to the left in Chart 5 which indicates a relatively low level of risk being taken; however, the returns are recorded at 2.67% and above the average of minus 0.61%. It should be noted that the quoted returns are a combination of income and unrealised capital gains/losses over one year. Accounting rules require the council to reverse the effect of unrealised gains/losses and therefore the income return is the only component that has actually had a net effect on the council’s interest and investment income for the year.

8 Compliance with Strategy Limits for 2020/21

8.1 As part of the strategy for 2020/21, approved by Council on 27 February 2020, limits were set for different types of treasury management investment.

8.2 In August 2020 the Executive Director of Corporate Services, under delegated powers, increased the limits for Money Market Funds from £25M to £50M to cope with increased levels of liquid investments during the pandemic. The limits are proposed to remain as part of the Treasury Management Strategy for 2021/22.

8.3 All investments have remained within approved limits during 2020/21.

9 Events Since the Reporting Date, 31 December 2020

9.1 There are no events to report.

10 Financial Implications

10.1 All of the activities and returns detailed in this report culminate in a financial impact on the council’s interest and investment income. A breakdown of the

income for 2020/21 is shown in Table 4.

- 10.2 The continuation of a low interest rate environment will have on-going financial implications in future years. These implications have been recognised in the council's Medium Term Financial Strategy update and were further reviewed as part of budget setting for 2020/21 and future years which was reported to Council in February 2020.

Table 4 – Treasury Management Income 2020/21

	Estimate 2020/21 £M	Actual 30/12/20 £M	Forecast 2020/21 £M	Variance 2020/21 £M *
Interest and Investment Income				
Net Interest from Gilts	0.20	0.13	0.13	(0.07)
Distributions from Diversified Credit Funds	1.41	0.97	1.29	(0.12)
Valuation of Diversified Credit Funds	0.00	5.00	5.00	5.00
Distributions from Absolute Return Bond Funds	0.23	0.17	0.22	(0.01)
Valuation of Absolute Return Bond Funds	0.00	0.66	0.66	0.66
Distributions from Property Funds	0.36	0.30	0.39	0.03
Valuation of Property Funds	0.00	(0.25)	(0.25)	(0.25)
Interest from Short Term Investments	0.27	0.06	0.06	(0.21)
Interest from Liquidity Cash	0.09	0.01	0.01	(0.08)
Sub Total	2.56	7.05	7.51	4.95
Miscellaneous Interest Received	0.02	0.00	0.02	(0.00)
Statutory Reversal of Valuation of Funds	0.00	(5.41)	(5.41)	(5.41)
Total Interest and Investment Income	2.58	1.64	2.12	(0.46)
Interest Paid	(0.02)	(0.03)	(0.06)	(0.04)
Total Net Income for Treasury Management	2.56	1.61	2.06	(0.50)
*() denotes an adverse variance				

11 Risk Management

- 11.1 The significant risks relating to treasury management are recorded on the council's Corporate Risk Register with details of how these risks are mitigated.
- 11.2 In addition, the Treasury Management Strategy sets Risk Indicators that act as a benchmark for the comparison of risk exposure.
- 11.3 Treasury Management Risk Indicators from the approved strategy and the latest comparisons are set out in Table 5.

Table 5 – Treasury Management Risk Indicators for 2020/21

	Strategy Indicator	Actual as at 31/12/20
Credit Risk Indicator – Portfolio average credit rating	A-	A+
Liquidity Risk Indicator – Total cash available within 3 months	£100.00M	£121.92M
Interest Risk Indicator – Annual revenue impact of a 1% change in interest rates	£0.50M	£1.30M
Price/Market Risk Indicator – Annual revenue impact of a 1% change in value of investments (without Statutory adjustments)	£1.00M	£0.81M

- 11.4 The Credit Risk Indicator shows the average overall credit rating for the council's treasury management investment portfolio calculated by assigning each investment a credit score. This indicator excludes the council's property fund investment which has no financial instruments and therefore cannot be assigned a credit rating. A wide divergence from the strategy indicator might indicate that there may be scope for the council to take on more risk in the portfolio in order to increase returns or that there could be too much risk in the portfolio.
- 11.5 The council has a higher level of liquidity in the portfolio compared to the indicator which may indicate a need to reduce liquidity which could lead to increased returns from suitable new investments. Due to the resurgence of COVID-19 and with further lockdown measures in place additional cash has been kept available to meet any unexpected demand on the council's cash flow.
- 11.6 This higher than usual level of liquidity has also led to a greater exposure to interest rate changes as shown in the Interest Rate Risk Indicator. This indicator shows the effect that a 1% change in returns would have on investment income. The council currently has no investments at fixed rates of interest.
- 11.7 The Price/Market Risk indicator shows the effect of a 1% change in the value of the council's investments that have a quoted market price. Statutory accounting requirements prevent unrealised changes in value from affecting the council's investment income. Although these statutory adjustments are not recognised in the indicator, it provides a measure of how much of the council's investment portfolio is affected by market prices and the potential revenue impact from the movement in those prices.

12 Other Corporate Implications

- 12.1 There are no Legal, Human Resources, Equalities or Climate Change implications.

13 Consultation and Communication

- 13.1 There is no requirement for consultation.

Date: 29 March 2021
Decision taken by: Audit and Accounts Committee

Lead officer	Executive Director of Corporate Services (Section 151 Officer) – Sue Cuerden
Report author	Senior Accounting Technician – Mark Jewers
Version	Final
Dated	18 February 2021
Status	Open
Confidentiality	It is considered that this report and appendices do not contain exempt information under the meaning of Schedule 12A of the Local Government Act 1972, as amended, and therefore can be made public.

Appendix 1

Treasury Management Investment Holdings as at 31 December 2020

Type of Investment	Income Yield (%)	Start Date	Maturity Date	Cost Amount (£)
Diversified Credit Funds (Not Rated)				
M&G Alpha Opportunities Fund	2.70	01/12/2014	74 days notice	10,000,000
M&G Total Return Credit Investment Fund	2.31	26/11/2014	3 days notice	10,000,000
BlackRock Fixed Income Global Opportunities Fund	2.27	22/10/2015	3 days notice	10,000,000
BlackRock Fixed Income Global Opportunities Fund	2.27	10/01/2017	3 days notice	10,000,000
Royal London Investment Grade Short Dated Credit Fund	2.13	03/12/2019	3 days notice	15,000,000
Total				55,000,000
Absolute Return Bond Funds (Not Rated)				
Aegon Absolute Return Bond Fund *	1.38	12/02/2018	3 days notice	15,000,000
Total				15,000,000
Property Funds (Not Rated)				
CCLA Local Authorities Property Fund	4.64	31/12/2019	3 mths notice	10,000,000
Total				10,000,000
Liquidity Cash (Rated AAAM, S&P)				
Goldman Sachs Liquid Reserves	0.00	31/12/2020	On Call	9,500,000
Blackrock Sterling Liquidity	0.00	31/12/2020	On Call	10,000,000
Morgan Stanley Sterling Liquidity	0.00	31/12/2020	On Call	9,000,000
Aviva Sterling Liquidity	0.01	31/12/2020	On Call	9,500,000
Deutsche Managed Sterling	0.00	31/12/2020	On Call	9,000,000
Invesco Short Term Liquidity Portfolio	0.01	31/12/2020	On Call	3,000,000
Total				50,000,000
Grand Total				130,000,000