



Basingstoke  
and Deane

## **TREASURY MANAGEMENT ANNUAL REPORT 2020/21**

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

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<b>Report to</b>	<b>Council</b>
<b>Ward(s):</b>	All
<b>Key Decision:</b>	No
<b>Appendix 1:</b>	<b>Treasury Management Investment Holdings</b>
<b>Papers relied on:</b>	<b>None</b>

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### **Recommendation to Council**

It is recommended that Council notes the Treasury Management Annual Report 2020/21.

### **Background, corporate objectives and priorities**

This report shows the activity within the council's treasury management 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**

<b>Term</b>	<b>Definition</b>
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 consisting 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

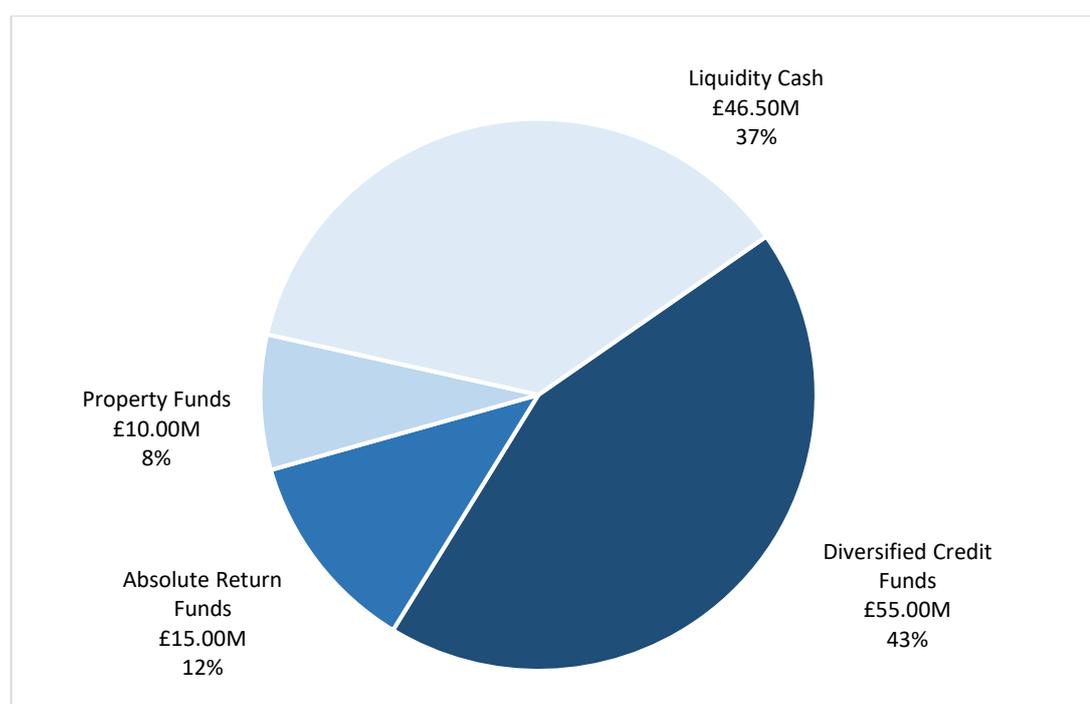
1.1 The key points to note on the forecast performance for this year are as follows:

- Treasury management investment income was £2.08M compared to the budgeted income of £2.56M. A breakdown of the £0.48M reduction of income can be seen in Table 4 (section 10).
- Investment balances as at 31 March 2021 were £126.50M. Average investment balances for the year were £129.00M.
- The overall return for the year was 1.63% compared with the budget estimate of 1.98%.

## 2 Treasury Management Holdings

2.1 The treasury management investment holdings as at 31 March 2021 are summarised in Chart 1:

**Chart 1 – Treasury Management Investment Allocation (£126.50M)**



2.2 The chart shows a portfolio with a mix of long-term strategic investments and highly liquid cash funds. Approximately 63% of the investment portfolio is in long-term, externally managed pooled funds which generate most of the council's treasury management income. The remaining 37% 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 March 2020 showing the names of the counterparties, credit ratings (where applicable) and the amounts invested can be seen in Appendix 1.

### 3 Treasury Management Activity

- 3.1 Table 1 below shows a summary of treasury management investment activity for the year.

**Table 1 – Treasury Management Investment Activity**

	<b>Holding 31/03/20 £M</b>	<b>Investments Made £M</b>	<b>Investments Realised £M</b>	<b>Holding 31/03/21 £M</b>
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	302.50	(266.20)	46.50
<b>Total Investments</b>	<b>132.54</b>	<b>302.50</b>	<b>(308.54)</b>	<b>126.50</b>

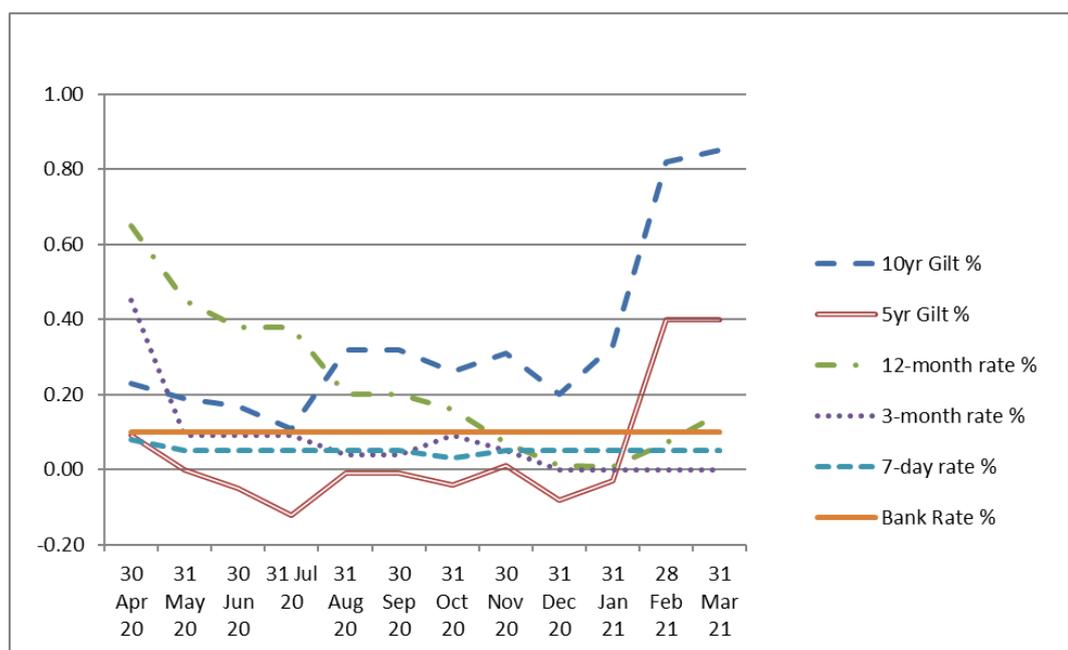
- 3.2 No short-term borrowing has been undertaken during the year as part of daily cash flow management.

### 4 Financial Market Conditions

- 4.1 The two main factors affecting the council's investments are the level of interest rates and the credit risk environment. Changes to interest rates have a direct impact on the council's short term investments in particular and changes in credit risk have a sizeable impact on the council's long term strategic investments.
- 4.2 The Bank of England base rate is at an all-time low of 0.10% throughout the year and Arlingclose Ltd. - the council's treasury management advisor - is forecasting that the base rate could remain at this level for a number of years. There was discussion at the Bank of England about the potential for a negative base rate and this caused some market rates to fall below zero. Gilt yields were also at historic lows for much of the year reflecting the outlook for interest rates as well as the demand for safe haven assets in a time of great uncertainty but these staged a recovery to higher levels in 2021 with optimism of an end to the pandemic.
- 4.3 The market's assessment of credit risk 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 Government fiscal stimulus were both instrumental in restoring confidence to credit markets, as was the rapid development of effective vaccines. However, some caution remains as new strains of the virus continue to be identified and there are 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.

4.4 Chart 2 shows the movement in interest rates during the year.

**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**

	<b>Original Estimate 2020/21</b>	<b>Annual Return 2020/21</b>
Government Gilts	3.40%	2.73%
Diversified Credit Funds	2.57%	2.33%
Absolute Return Bond Funds	1.50%	1.45%
Property Funds	3.55%	3.91%
Short-Term Investments	0.88%	0.90%
Liquidity Cash	0.75%	0.03%
<b>Average Overall Return</b>	<b>1.98%</b>	<b>1.63%</b>

5.2 The overall return on investments was 1.63% compared to the original estimate of 1.98%. The original estimate for 2020/21 was set in the autumn of 2019 prior to knowledge of the COVID-19 pandemic and the significant impact that it would have on financial markets during 2020/21.

5.3 The council's government gilts performed in accordance with their contractual terms and all income and repayments of principal were received by the council as expected. These returned 2.73% for the year. The difference in performance when compared to the original estimate was due to an estimation technique that did not precisely reflect the individual yields and final maturity dates of the gilts 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 returned 2.33% of income compared to the estimate of 2.57%.
- 5.5 The return from absolute return bond funds is also variable and from dividends paid rather than from any increases in capital value. These funds returned 1.45% of income compared to the estimate of 1.50%.
- 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 returned 3.91% 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 achieved 0.90% this year compared to the estimate of 0.88%. Loans to other local authorities are usually a large proportion of these investments but there were no new loans made during 2020/21 as the council retained 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 returned 0.03% compared to the estimate of 0.75%. Many short-term cash rates turned negative during the year and although the council avoided investing at negative rates of interest it was 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 at 31 March 2021 the total valuation of the same funds was almost 1% above purchase price.

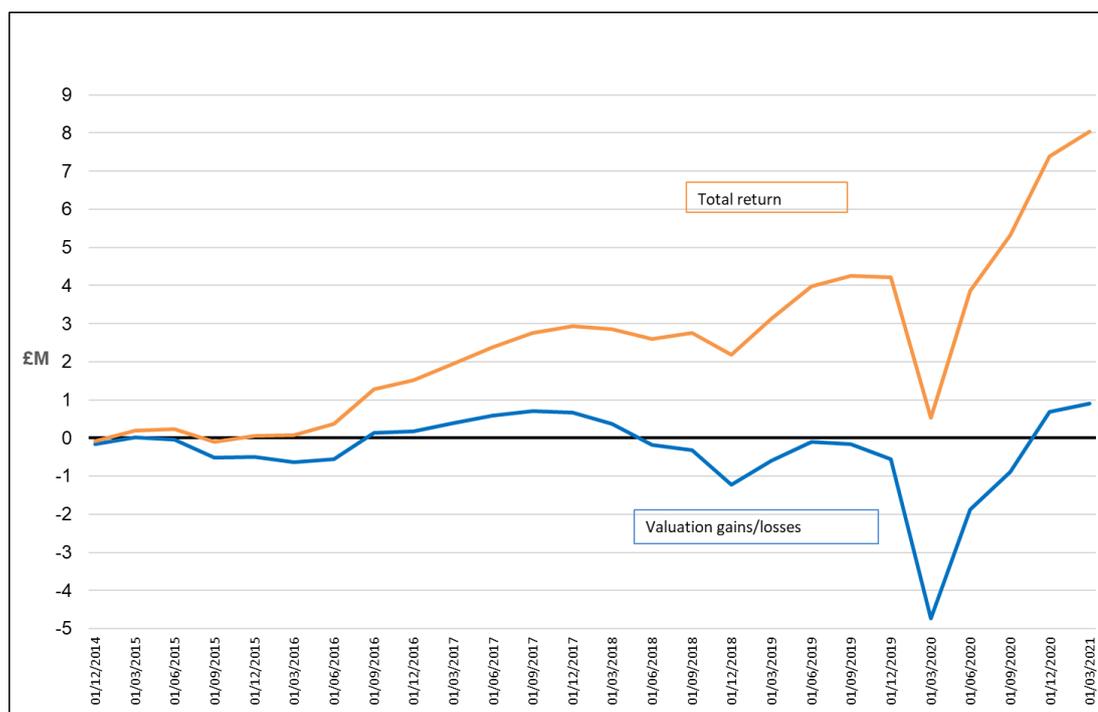
6.3 Table 3 shows a significant recovery in fund valuations during the year.

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

Fund	Initial Investment Amount £M	Valuation at 31 March 2020 £M	Valuation at 31 March 2021 £M	Valuation Change 2020/21 £M
M&G Alpha Opportunities	10.00	9.49	10.85	1.36
M&G Total Return Credit Investment	10.00	9.82	11.07	1.25
BlackRock Fixed Income Global Opportunities	20.00	17.99	19.86	1.87
Royal London Short Dated Credit Fund	15.00	14.58	15.07	0.49
Aegon Absolute Return Bond Fund	15.00	14.37	15.08	0.71
CCLA Local Authorities Property Fund	10.0	9.02	8.96	(0.06)
<b>Total</b>	<b>80.00</b>	<b>75.27</b>	<b>80.89</b>	<b>5.62</b>

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 March 2021. However, the total net return, which includes the income distributions, is noticeably positive.

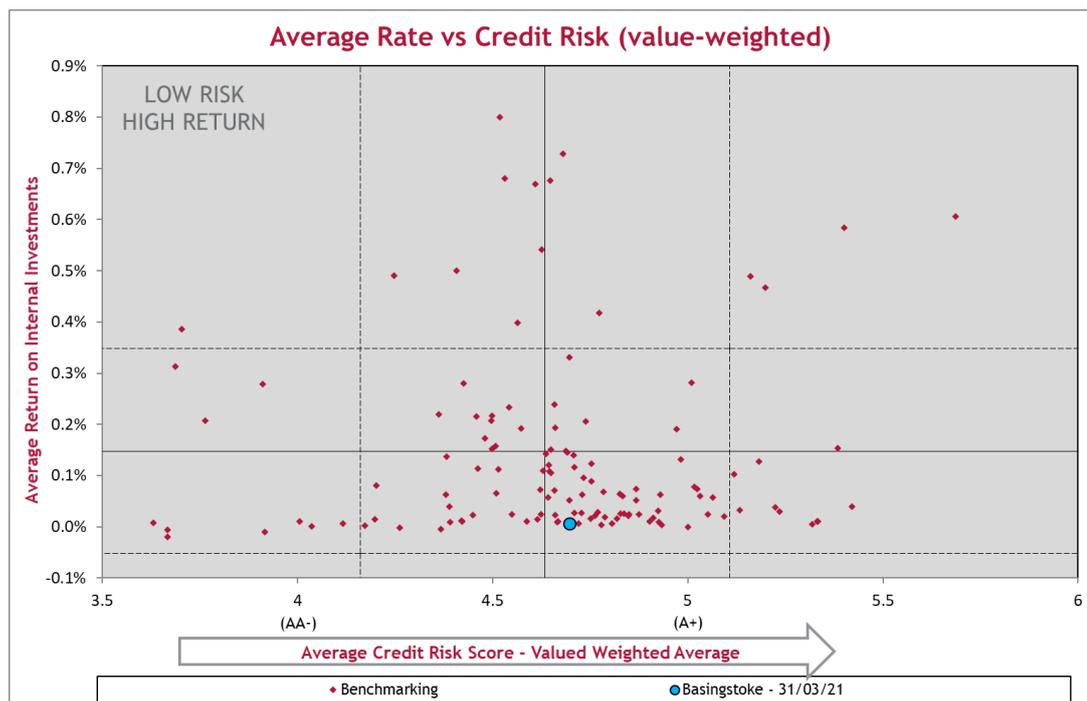
**Chart 3 – Accumulated Unrealised Gains/Losses and Total Return of External Funds since Investment (£M)**



## 7 Treasury Management Investment Portfolio Benchmarking

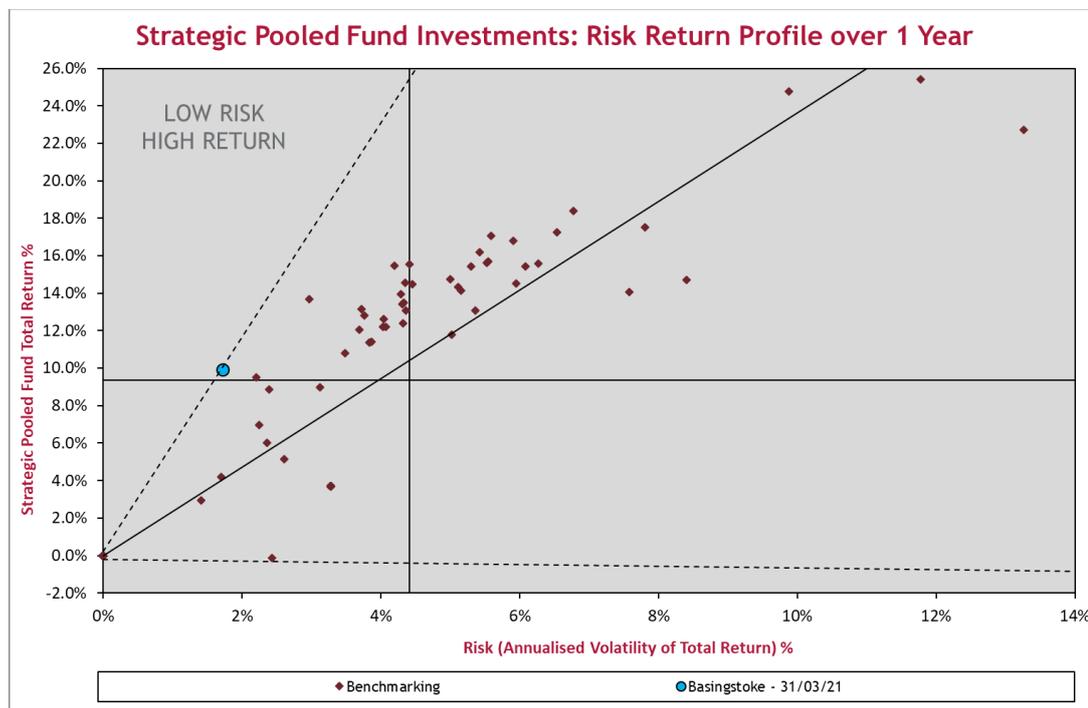
- 7.1 The council takes part in a quarterly investment benchmarking service provided by its treasury management advisors, Arlingclose Ltd. This shows the council's relative returns and the amount of risk being taken compared with Arlingclose's other clients.
- 7.2 Although the council's total interest 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 0.01%. 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 (37%) of its overall portfolio.

**Chart 4 – Internal Investments Benchmarking at 31 March 2021**



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

**Chart 5 – External Fund Investments Benchmarking at 31 March 2021**



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 9.92% and above the average of 9.34%. 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 revised limits have been approved by Council 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 March 2021)

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 2021/22 and future years which was reported to Council in February 2021.

**Table 4 – Treasury Management Income 2020/21**

	<b>Estimate 2020/21 £M</b>	<b>Actual 2020/21 £M</b>	<b>Variance 2020/21 £M *</b>
<b>Interest and Investment Income</b>			
Net Interest from Gilts	0.20	0.13	(0.07)
Distributions from Diversified Credit Funds	1.41	1.28	(0.13)
Valuation of Diversified Credit Funds	0.00	4.98	4.98
Distributions from Absolute Return Bond Funds	0.23	0.22	(0.01)
Valuation of Absolute Return Bond Funds	0.00	0.70	0.70
Distributions from Property Funds	0.36	0.39	0.03
Valuation of Property Funds	0.00	(0.06)	(0.06)
Interest from Short Term Investments	0.27	0.06	(0.21)
Interest from Liquidity Cash	0.09	0.01	(0.08)
<b>Sub Total</b>	<b>2.56</b>	<b>7.71</b>	<b>5.15</b>
Miscellaneous Interest Received	0.02	0.04	0.02
Statutory Reversal of Valuation of Funds	0.00	(5.62)	(5.62)
<b>Total Interest and Investment Income</b>	<b>2.58</b>	<b>2.13</b>	<b>(0.45)</b>
Interest Paid	(0.02)	(0.05)	(0.03)
<b>Total Net Income for Treasury Management</b>	<b>2.56</b>	<b>2.08</b>	<b>(0.48)</b>
<b>*( ) denotes an adverse variance</b>			

## 11 Legal Implications

- 11.1 There are no legal implications relating to this report or the activity being reported on.

## 12 Equalities

- 12.1 There are no specific equalities implications.

### **13 Consultation and communication**

13.1 There are no implications.

### **14 Climate change**

14.1 There are no specific implications arising.

### **15 HR implications**

15.1 There are no staffing or HR implications in relation to the content of this report.

### **16 Risk Management**

16.1 A risk assessment has been completed in accordance with the council's risk management process and has identified no significant (Red or Amber) residual risks that cannot be fully minimised by existing or planned controls or additional procedures.

16.2 In addition, the Treasury Management Strategy sets Risk Indicators that act as a benchmark for the comparison of risk exposure.

16.3 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**

	<b>Strategy Indicator</b>	<b>Actual as at 31/03/21</b>
Credit Risk Indicator – Portfolio average credit rating	A-	A+
Liquidity Risk Indicator – Total cash available within 3 months	£100.00M	£118.44M
Interest Risk Indicator – Annual revenue impact of a 1% change in interest rates	£0.50M	£1.27M
Price/Market Risk Indicator – Annual revenue impact of a 1% change in value of investments (without Statutory adjustments)	£1.00M	£0.81M

16.4 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.

16.5 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. During the year the council's strategy was to maintain higher than usual cash balances in order to meet any unexpected demand on the council's cash flow as a result of the

COVID-10 pandemic.

- 16.6 This higher than usual level of liquidity 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. At 31 March 2021 the council currently had no investments at fixed rates of interest.
- 16.7 The Price/Market Risk indicator shows the effect of a 1% change in the value of the council's investments which 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.

## 17 Prudential Indicators

- 17.1 Under the prudential capital finance system the council determines, at a local level, its capital expenditure and borrowing provided that it can demonstrate that its plans are affordable, prudent and sustainable. Under the Prudential Code of Practice there is a statutory requirement to set, monitor and report Prudential Indicators and limits.
- 17.2 The Prudential Indicator limits and the compliance with those limits are set out in Table 6.

**Table 6 – Prudential Indicators for 2020/21**

	<b>Prudential Indicator 2020/21</b>	<b>Actual as at 31/03/21</b>
Actual Capital Expenditure	£39.76M	£32.39M
Actual Capital Financing Requirement	£2.20M	£2.20M
Authorised Limit for External Debt	£50.00M	£2.27M
Operational Boundary for External Debt	£25.00M	£2.27M
Actual Proportion of Financing Costs to Net Revenue Stream	-21%	-8%

- 17.3 The Executive Director of Corporate Services as the Section 151 Officer is required under the Prudential Code to report to Council the 2020/21 actuals for the following non-treasury management prudential indicators.
- Actual capital expenditure for 2020/2021 was £32,391,278.
  - Actual capital financing requirement as at 31/03/21 was £2,200,000.
  - Actual external debt as at 31/03/21 was £2,265,435.
  - Actual proportion of financing costs to net revenue stream was -8%.
- 17.4 The capital financing requirement is the council's underlying need to borrow to finance capital expenditure that has not been financed by its own resources. As most of the council's capital expenditure has been financed by the use of capital receipts and contributions or by revenue reserves the capital financing requirement is £2,200,000. The council's Minimum Revenue Provision (MRP) requirement (i.e. the council's need to set aside amounts to repay borrowing) for 2020/21 is nil.

- 17.5 External debt is made up of borrowing and other long term liabilities. The council has long term borrowing of £2,200,000 from the Local Enterprise Partnership in relation to a commercial office development at Basing View. Parish council deposits with this council were £65,435 and are deemed to be temporary borrowing.
- 17.6 The purpose of the proportion of financing costs to net revenue stream is to identify what percentage of net revenue costs relate to the financing of debt. As the council has investments which far exceed the amount of long term debt the percentage is usually expected to be negative and shows interest income as a proportion of the council's net revenue expenditure.
- 17.7 The Prudential Indicators were set as part of the council's Capital Strategy for 2020/21 and were approved by Council on 27th February 2020. The council is required by the Prudential Code of Practice to report annually on prudential indicators and limits relating to capital expenditure, affordability, external debt and investments.

## 18 Consultation and Communication

- 18.1 There is no requirement for consultation.
- 18.2 A draft of this report was presented to the Audit and Accounts Committee on 28<sup>th</sup> June 2021 for comments.

**Date: 15 July 2021**  
**Decision taken by: Council**

<b>Lead officer</b>	Sue Cuerden - Executive Director of Corporate Services (S151 Officer) <a href="mailto:sue.cuerden@basingstoke.gov.uk">sue.cuerden@basingstoke.gov.uk</a>
<b>Report author</b>	Mark Jewers – Senior Accounting Technician <a href="mailto:mark.jewers@basingstoke.gov.uk">mark.jewers@basingstoke.gov.uk</a>
<b>Version</b>	FINAL
<b>Dated</b>	29 June 2021
<b>Status</b>	Open
<b>Confidentiality</b>	It is considered that information contained within this report 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 March 2021

Type of Investment	Income Yield (%)	Start Date	Maturity Date	Cost Amount (£)
<b>Diversified Credit Funds (Not Rated)</b>				
M&G Alpha Opportunities Fund	2.47	01/12/2014	74 days notice	10,000,000
M&G Total Return Credit Investment Fund	2.03	26/11/2014	3 days notice	10,000,000
BlackRock Fixed Income Global Opportunities Fund	2.17	22/10/2015	3 days notice	10,000,000
BlackRock Fixed Income Global Opportunities Fund	2.17	10/01/2017	3 days notice	10,000,000
Royal London Investment Grade Short Dated Credit Fund	2.24	03/12/2019	3 days notice	15,000,000
<b>Total</b>				<b>55,000,000</b>
<b>Absolute Return Bond Funds (Not Rated)</b>				
Aegon Absolute Return Bond Fund *	1.24	12/02/2018	3 days notice	15,000,000
<b>Total</b>				<b>15,000,000</b>
<b>Property Funds (Not Rated)</b>				
CCLA Local Authorities Property Fund	3.69	31/12/2019	3 mths notice	10,000,000
<b>Total</b>				<b>10,000,000</b>
<b>Liquidity Cash (Rated AAAm, S&amp;P)</b>				
Goldman Sachs Liquid Reserves	0.00	31/03/2021	On Call	9,500,000
Blackrock Sterling Liquidity	0.00	31/03/2021	On Call	10,000,000
Morgan Stanley Sterling Liquidity	0.03	31/03/2021	On Call	2,500,000
Aviva Sterling Liquidity	0.01	31/03/2021	On Call	10,000,000
Deutsche Managed Sterling	0.00	31/03/2021	On Call	4,500,000
Invesco Short Term Liquidity Portfolio	0.01	31/03/2021	On Call	10,000,000
<b>Total</b>				<b>46,500,000</b>
<b>Grand Total</b>				<b>126,500,000</b>

\* Previously named Kames Absolute Return Bond Fund. Name change effective from 7 September 2020.