

# SWANAGE TOWN COUNCIL



## Annual Treasury Report 2020/21

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### **1. Background**

The Council's Treasury Management Strategy for 2020/21 is underpinned by having due regard to the Chartered Institute of Public Finance and Accountancy's Guidance for Smaller Public Organisations on the Application of the CIPFA Code of Practice for Treasury Management *in the Public Services: Code of Practice (2014 Edition) and Cross-Sectoral Guidance Notes 2017 Edition* (the CIPFA Code) and the Ministry for Housing, Communities and Local Government (MHCLG) *Guidance on Local Authority Investments*, updated February 2018. The Code recommends that members approve a treasury management annual report after the end of each financial year. This report fulfils the Authority's obligation to have regard to the CIPFA Code and any other appropriate guidance.

The Authority's Treasury Management Strategy for 2020/21 was approved by full Council on 20/03/2020 which can be accessed on <https://www.swanage.gov.uk/Publications-Finance.aspx>

The Authority has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

### **2. External Context**

**Economic background:** The coronavirus pandemic dominated 2020/21, leading to almost the entire planet being in some form of lockdown during the year. The start of the financial year saw many central banks cutting interest rates as lockdowns caused economic activity to grind to a halt. The Bank of England cut Bank Rate to 0.1% and the UK government provided a range of fiscal stimulus measures, the size of which has not been seen in peacetime.

Some good news came in December 2020 as two COVID-19 vaccines were given approval by the UK Medicines and Healthcare products Regulatory Agency (MHRA). The UK vaccine rollout started in earnest; over 31 million people had received their first dose by 31<sup>st</sup> March.

A Brexit trade deal was agreed with only days to spare before the 11pm 31<sup>st</sup> December 2020 deadline having been agreed with the European Union on Christmas Eve.

The Bank of England (BoE) held Bank Rate at 0.1% throughout the year but extended its Quantitative Easing programme by £150 billion to £895 billion at its November 2020 meeting. In its March 2021 interest rate announcement, the BoE noted that while GDP would remain low in the near-term due to COVID-19 lockdown restrictions, the easing of these measures means growth is expected to recover strongly later in the year. Inflation is forecast to increase in the near-term and while the economic outlook has improved there are downside risks to the forecast, including from unemployment which is still predicted to rise when the furlough scheme is eventually withdrawn.

Government initiatives supported the economy and the Chancellor announced in the 2021 Budget a further extension to the furlough (Coronavirus Job Retention) scheme until September 2021. Access to support grants was also widened, enabling more self-employed people to be eligible for



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government help. Since March 2020, the government schemes have helped protect more than 11 million jobs.

Despite the furlough scheme, unemployment still rose. Labour market data showed that in the three months to January 2021 the unemployment rate was 5.0%, in contrast to 3.9% recorded for the same period 12 months ago. Wages rose 4.8% for total pay in nominal terms (4.2% for regular pay) and was up 3.9% in real terms (3.4% for regular pay). Unemployment is still expected to increase once the various government job support schemes come to an end.

Inflation has remained low over the 12-month period. Latest figures showed the annual headline rate of UK Consumer Price Inflation (CPI) fell to 0.4% year/year in February, below expectations (0.8%) and still well below the Bank of England's 2% target. The ONS' preferred measure of CPIH which includes owner-occupied housing was 0.7% year/year (1.0% expected).

After contracting sharply in Q2 (Apr-Jun) 2020 by 19.8% q/q, growth in Q3 and Q4 bounced back by 15.5% and 1.3% respectively. The easing of some lockdown measures in the last quarter of the calendar year enabled construction output to continue, albeit at a much slower pace than the 41.7% rise in the prior quarter.

After collapsing at an annualised rate of 31.4% in Q2, the US economy rebounded by 33.4% in Q3 and then a further 4.1% in Q4. The US recovery has been fuelled by three major pandemic relief stimulus packages totalling over \$5 trillion. The Federal Reserve cut its main interest rate to between 0% and 0.25% in March 2020 in response to the pandemic and it has remained at the same level since. Joe Biden became the 46<sup>th</sup> US president after defeating Donald Trump.

The European Central Bank maintained its base rate at 0% and deposit rate at -0.5% but in December 2020 increased the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.

**Financial markets:** Monetary and fiscal stimulus helped provide support for equity markets which rose over the period, with the Dow Jones beating its pre-crisis peak on the back of outperformance by a small number of technology stocks. The FTSE indices performed reasonably well during the period April to November, before being buoyed in December by both the vaccine approval and Brexit deal, which helped give a boost to both the more internationally focused FTSE 100 and the more UK-focused FTSE 250, however they remain lower than their pre-pandemic levels.

Ultra-low interest rates prevailed throughout most of the period, with yields generally falling between April and December 2020. From early in 2021 the improved economic outlook due to the new various stimulus packages (particularly in the US), together with the approval and successful rollout of vaccines, caused government bonds to sell off sharply on the back of expected higher inflation and increased uncertainty, pushing yields higher more quickly than had been anticipated. The 5-year UK benchmark gilt yield began the financial year at 0.18% before declining to -0.03% at the end of 2020 and then rising strongly to 0.39% by the end of the financial year. Over the same



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period the 10-year gilt yield fell from 0.31% to 0.19% before rising to 0.84%. The 20-year declined slightly from 0.70% to 0.68% before increasing to 1.36%.

1-month, 3-month and 12-month SONIA bid rates averaged 0.01%, 0.10% and 0.23% respectively over the financial year.

The yield on 2-year US treasuries was 0.16% at the end of the period, up from 0.12% at the beginning of January but down from 0.21% at the start of the financial year. For 10-year treasuries the end of period yield was 1.75%, up from both the beginning of 2021 (0.91%) and the start of the financial year (0.58%).

German bund yields continue to remain negative across most maturities.

**Credit review:** After spiking in March 2020, credit default swap spreads declined over the remaining period of the year to broadly pre-pandemic levels. The gap in spreads between UK ringfenced and non-ringfenced entities remained, albeit Santander UK is still an outlier compared to the other ringfenced/retail banks. At the end of the period Santander UK was trading the highest at 57bps and Standard Chartered the lowest at 32bps. The other ringfenced banks were trading around 33 and 34bps while Nationwide Building Society was 43bps.

Credit rating actions to the period ending September 2020 have been covered in previous outturn reports. Subsequent credit developments include Moody's downgrading the UK sovereign rating to Aa3 with a stable outlook which then impacted a number of other UK institutions, banks and local government. In the last quarter of the financial year S&P upgraded Clydesdale Bank to A- and revised Barclay's outlook to stable (from negative) while Moody's downgraded HSBC's Baseline Credit Assessment to baa3 whilst affirming the long-term rating at A1.

The vaccine approval and subsequent rollout programme are both credit positive for the financial services sector in general, but there remains much uncertainty around the extent of the losses banks and building societies will suffer due to the economic slowdown which has resulted due to pandemic-related lockdowns and restrictions. The institutions and durations on the Authority's counterparty list recommended by treasury management advisors Arlingclose remain under constant review, but at the end of the period no changes had been made to the names on the list or the recommended maximum duration of 35 days.

### **3. Local Context**

At 31<sup>st</sup> March 2020 the Authority held investments valued at £6.27m, with usable reserves and working capital being the underlying resources available for investment. At 31<sup>st</sup> March 2021, the Authority held investments valued at £6.23m. These year-end values include unrealised gains from the Council's strategic investments, being £0.39m in 2020 and £0.51m in 2021.

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### 4. Borrowing Strategy and Debt Management

The Authority is debt free. The 2020/21 capital expenditure plans and treasury strategy did not imply a need to borrow over the 3-year forecast period. Usable reserves are forecast to fall to £2.65m by March 2024, as capital receipts and earmarked reserves are used to finance the Council's extensive capital programme.

### 5. Treasury Investment Activity

The Authority holds significant invested funds, representing balances and reserves held. During the year the Authority's investment balances remained relatively stable. The investment position is shown in table 1 below.

Table 1: Treasury Investment Position

Investment Portfolio	31.03.20 Balance £	Net Movement £	31.03.21 Balance £	31.03.21 Income Return %
Banks and building societies (unsecured)	179,245	333,728	512,973	
Money Market Funds	750,000	0	750,000	
UK Govt - DMO	950,000	(500,000)	450,000	
<b>Total Internal Investments</b>	<b>1,879,245</b>	<b>(166,272)</b>	<b>1,712,973</b>	<b>0.01%</b>
*Investments in Pooled Funds:				
Property	3,067,341	(21,808)	3,045,533	
Multi-Asset	878,416	87,284	965,700	
Bonds	445,157	58,017	503,174	
<b>Total External Funds</b>	<b>4,390,914</b>	<b>123,493</b>	<b>4,514,407</b>	<b>4.17%</b>
<b>TOTAL INVESTMENTS</b>	<b>6,270,159</b>	<b>(42,779)</b>	<b>6,227,380</b>	<b>3.03%</b>

\*Funds stated at Fair Value-Issued by Arlingclose

Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

Continued downward pressure on short-dated cash rate brought net returns on sterling low volatility net asset value money market funds (LVNAV MMFs) close to zero even after some managers have temporarily lowered their fees. At this stage net negative returns are not the central case of most MMF managers over the short-term, and fee waivers should maintain positive net yields, but the possibility cannot be ruled out.

Deposit rates with the Debt Management Account Deposit Facility (DMADF) have continued to fall and are now largely around zero.

The net return on Money Market Funds net of fees, which had fallen after Bank Rate was cut to 0.1% in March, are now at or very close to zero; fund management companies have temporarily lowered

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or waived fees to avoid negative net returns. Investment risk has been diversified as much as possible given the Council's overall balances.

The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in table 2 below, which only includes the Council's short-term investments.

Table 2: Investment Benchmarking-Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return
31.03.2020	3.94	AA-	49%	34	0.31%
31.03.2021	4.42	AA-	74%	13	0.01%
Similar LAs	4.62	A+	47%	67	0.10%
All LAs	4.63	A+	63%	14	0.15%

### Externally Managed Pooled Funds

£4.51m of the Authority's investments are held in externally managed strategic pooled funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. In terms of measuring the performance of these funds, the current value is used.

For the 2020/21 financial year these funds generated an income return of £0.18m (4.17%) which is used to support services in year, and £0.12m (2.72%) of capital growth during the year, with a total return of 6.89%.

The Authority is invested in bond, multi-asset and property funds. During the initial phase of the pandemic in March 2020, the sharp falls seen in corporate bond and equity markets had a negative impact on the value of the Council's pooled fund holdings and was reflected in the 31<sup>st</sup> March 2020 fund valuations with every fund registering negative capital returns over a 12-month period. Since March 2020 there has been improvement in market sentiment which is reflected in an increase in capital values of these strategic bond and multi-asset income funds in the Authority's portfolio. The recovery in UK equities has lagged those of US and European markets.

Similar to many other property funds, dealing (i.e. buying or selling units) in the CCLA Local Authorities' Property Fund was suspended by the fund in March 2020 and lifted in September. There was also a change to redemption terms for the CCLA Local Authorities Property Fund; from September 2020 investors are required to give at least 90 calendar days' notice for redemptions. The capital value of the property fund is shown in table 3, below.

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Table 3: Strategic Investment Returns – 12 months to 31<sup>st</sup> March 2021

<b>Fund Name</b>	<b>Book Value £m</b>	<b>Current Value £</b>	<b>Capital Growth £</b>	<b>Dividends Earned £</b>	<b>Capital Return %</b>	<b>Income Return %</b>	<b>Total Return %</b>
CCLA-LAMIT Property Fund	2.50	3,045,533	(21,808)	133,050	(0.71)	4.34	3.63
M & G Strategic Corporate Bond Fund	0.50	503,174	54,031	14,372	12.03	3.20	15.23
Ninety-One Diversified Income Fund	1.00	965,700	87,284	36,061	9.94	4.11	14.04
<b>Total</b>	<b>4.00</b>	<b>4,514,407</b>	<b>119,507</b>	<b>183,482</b>	<b>2.72</b>	<b>4.17</b>	<b>6.89</b>

Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's medium- to long-term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rates.

Following the cut in Bank rate from 0.75% to 0.10% in March 2020, the Authority had expected to receive significantly lower income from its cash and short-dated money market investments, including money market funds in 2020/21, as rates on cash investments are close to zero percent. Income from most of the Authority's externally managed funds are also lower than in 2019/20 and earlier years. Whilst the arrival and approval of vaccines against COVID-19 and the removal of Brexit uncertainty that had weighed on UK equities were encouraging developments, dividend and income distribution was dependent on company earnings in a very challenging and uncertain trading environment as well as enforced cuts or deferral required by regulatory authorities. As a guide, comparing 2020/21 to 2019/20, the Council received £11.6K less by way of income distribution on its portfolio.

Due to accounting practices, these funds are currently stated at cost price in the Council's Annual Return, £4m in total, and as such these funds have an overall unrealised gain of £0.51m at 31<sup>st</sup> March 2021. However, one fund (Ninety-One) is showing an unrealised loss. Unrealised capital losses, or gains, will not have an impact on the General Fund until such a time as the Council redeems all or part of the units held in the funds.

### Treasury Performance

The budget for investment income in 2020/21 was £185,000, based on an average investment portfolio with a fair value of £5.3million at an interest rate of 3.5%. The actual income derived from investments was £184,898 with average investment balances of £6.2m, at an average interest rate of 3%.

### Non-Treasury Investments

The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the





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definition of investments is further broadened to also include all such assets held partially for financial return.

The Council did not invest in non-treasury investments during the year.

### **6. Compliance & Treasury Management Indicators**

This report provides members with a summary report of the treasury management activity during 2020/21, having due regard to both the CIPFA Code of Practice and MHCLG Guidance. A prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

The Authority measures and manages its exposures to treasury management risks using the following indicators.

**Security:** The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

<b>Credit Risk Indicator</b>	<b>31.3.21 Actual</b>	<b>2020/21 Target</b>	<b>Complied?</b>
Portfolio average credit rating	AA-	A	Yes

**Liquidity:** The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

<b>Liquidity Risk Indicator</b>	<b>31.3.21 Actual</b>	<b>2020/21 Target</b>	<b>Complied?</b>
Total cash available within 3 months	£1.88m	£1m	Yes

**Principal Sums Invested for Periods Longer than a year:** The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

<b>Price Risk Indicator</b>	<b>2020/21</b>	<b>2021/22</b>	<b>2022/23</b>
Limit on principal invested beyond year end	£4.5m	£4m	£2.3m
Complied?	Yes	Yes	Yes

The Authority can confirm that during 2020/21 it complied with its **Treasury Management Policy Statement** and **Treasury Management Practices**.