TORBAY COUNCIL

Meeting: **Audit Committee** **Date:** **6th December 2021**
Council **9th December 2021**

Wards Affected: All Wards in Torbay

Report Title: Treasury Management Mid-Year Review 2021/22

Is the decision a key decision? No

When does the decision need to be implemented? Immediate

Cabinet Member Contact Details: Councillor Darren Cowell, Darren.Cowell@torbay.gov.uk

Supporting Officer Contact Details: Pete Truman, Principal Accountant, pete.truman@torbay.gov.uk

1. Purpose and Introduction

1.1 This report provides Members with a review of Treasury Management activities during the first part of 2021/22. The Treasury function aims to support the provision of all Council services through management of the Council's cash flow and debt & investment operations.

1.2 The key points in the Treasury Management review are as follows:

- No new borrowing planned in 2021/22
- Bank Rate expected to remain at 0.1% for 2021/22 (but with a risk of increase)
- Investment rates close to zero
- Internal cash resources applied to capital funding and loan repayments
- Cash flow influenced by MLUH and BEIS grant and funding changes

2. Proposed Decision

Audit Committee

2.1 that the Audit Committee provide any comments and/or recommendations on the Treasury Management decisions made during the first part of 2021/22

Council

2.2 that the Treasury Management decisions made during the first part of 2021/22 as detailed in this report be noted.

3. Reason for Decision

3.1 The preparation of a mid-year review on the performance of the treasury management function forms part of the minimum formal reporting arrangements required by the CIPFA Code of Practice for Treasury Management.

Supporting Information

4. Position

4.1 In February 2019 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Council to approve treasury management semi-annual and annual reports.

4.2 The original Treasury Management Strategy for 2021/22 was approved by Council on 11th February 2021. The successful identification, monitoring and control of risk remains central to the Council's treasury management strategy.

4.3 The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing. The Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 11th February 2021.

4.4 Treasury management decisions and strategies have been made in consultation with the Council's advisors, Arlingclose Ltd.

5. Economic Commentary

5.1 The significant economic events impacting the Treasury Management strategy during the year were:

- MPC has maintained Bank Rate at 0.1% because of the continued impact of the Covid-19 pandemic on the economy.
- The potential use of negative interest rates has eased on the back of rising inflationary pressures
- Market interest rates remain at little more than zero although the market has begun to price in increases.

5.2 A full economic commentary by Arlingclose Ltd is provided at Appendix 1 to this report.

5.3 The probability of an increase in the bank base rate has increased in recent months. However, at its November meeting the Bank of England chose to hold the rate but did signal that in the "coming months" rates would rise.

6 Local Context

6.1 On 31st March 2021, the Council had net borrowing of £314m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.21 Actual £m
Total CFR	**419.5**
Less: Other debt liabilities (PFI only)	(16.8)
Loans CFR	**402.7**
External borrowing	391.5
Internal borrowing	11.2
Less: Usable reserves	(57.7)
Less: Working capital	(30.4)
Net Borrowing	**314.6**

6.2 Lower official interest rates have reduced the cost of short-term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing. The Council pursued its strategy of keeping borrowing and investments below their underlying levels, i.e. internal borrowing, in order to reduce risk.

6.3 The treasury management position on 30th September 2021 and the change over the six months is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.21 Balance £m	**Movement £m**	**30.9.21 Balance £m**	**30.9.21 Rate %**
Long-term borrowing	391.5	(0.2)	391.3	2.99
Short-term borrowing	0	0	0	0
Total borrowing	391.5	(0.2)	391.3	2.99
Long-term investments	5.0	0	5.0	4.30
Short-term investments	71.4	25.8	97.2	0.09
Cash and cash equivalents	0.8	9.7	10.5	0.01
Total investments	**77.2**	**12.6**	**112.7**	**0.27**

7. Borrowing Update

7.1 The Council's preferred lender is the Public Works Loan Board (PWLB). Local authorities can borrow from the PWLB provided they can confirm they are not planning to purchase 'investment assets primarily for yield' in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 Officer. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing.

7.2 Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

7.3 Competitive market alternatives may be available for authorities with or without access to the PWLB. However, the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders. Further changes to the CIPFA Prudential Code expected in December 2021 are likely to prohibit borrowing for the primary purpose of commercial return even where the source of borrowing is not the PWLB.

7.4 The Council is not planning to purchase any investment assets primarily for yield within the next three years and so is able to fully access the PWLB

Revised PWLB Guidance

7.5 HM Treasury published further guidance on PWLB borrowing in August 2021 providing additional detail and clarifications predominantly around the definition of an 'investment asset primarily for yield'. The principal aspects of the new guidance are:

- Capital plans should be submitted by local authorities via an online (DELTA) return. These open for the new financial year on 1st March and remain open all year. Returns must be updated if there is a change of more than 10%.
- An asset held primarily to generate yield that serves no direct policy purpose should not be categorised as service delivery.
- Further detail on how local authorities purchasing investment assets primarily for yield can access the PWLB for the purposes of refinancing existing loans or externalising internal borrowing.
- Additional detail on the sanctions which can be imposed for inappropriate use of the PWLB loan. These can include a request to cancel projects, restrictions to accessing the PLWB and requests for information on further plans.

Changes to PWLB Terms and Conditions from 8th September 2021

7.6 The settlement time for a PWLB loan has been extended from two workings days (T+2) to five working days (T+5). In a move to protect the PWLB against negative interest rates, the minimum interest rate for PWLB loans has also been set at 0.01% and the interest charged on late repayments will be the higher of Bank of England Base Rate or 0.1%.

8. Borrowing Strategy during the period

8.1 At 30th September 2021 the Council held £391.3m of loans, (a decrease of £0.3m) as part of its strategy for funding previous years' capital programmes. Outstanding loans on 30th September 2021 are summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.21 Balance £m	Net Movement £m	30.9.21 Balance £m	30.9.21 Weighted Average Rate %	30.9.21 Weighted Average Maturity (years)
Public Works Loan Board	381.5	(0.2)	381.3	2.951	28
Banks (LOBO)	5.0	0	5.0	4.395	57
Banks (fixed-term)	5.0	0	5.0	4.700	53
Total borrowing	**391.5**	**(0.2)**	**391.3**	**2.992**	**28**

8.2 The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

8.3 In keeping with these objectives, no new borrowing has been undertaken, while a £2m existing loan will likely be allowed to mature without replacement in December 2021. This strategy has enabled the Council to reduce net borrowing costs and reduce overall treasury risk.

8.4 Going forward - with short-term interest rates remaining much lower than long-term rates and temporary investments earning virtually zero, the most cost-effective strategy in the near term will be to use internal resources or short-term loans instead of long-term borrowing.

8.5 There is, however, some concern on the effect of market conditions (discussed in section 17 below). While these are expected to be short term the CFO may elect to vary the strategy and take some long-term borrowing earlier than anticipated to balance risks.

8.6 The Council will continue to review its options for borrowing such as via the Municipal Bonds Agency and/or the UK Infrastructure Bank

9 Treasury Investment Activity

9.1 The Council has continued to receive central government funding to support small and medium businesses during the coronavirus pandemic through grant schemes. Over £20M was received in April 2021, temporarily invested in short-dated, liquid instruments such as call accounts and Money Market Funds. £17m was disbursed by the end of September.

9.2 The balance along with significant levels of other residual Covid-19 related grants still held on 30th September 2021 will be recalled by central government in the coming months.

9.3 The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.21 Balance £m	Net Movement £m	30.9.21 Balance £m	30.9.21 Income Return %	30.9.21 Weighted Average Maturity days
Banks & Building Societies	22.8	15.7	38.5	0.06	26
Government	26.0	16.0	42.0	0.01	19
Local Authorities	5.0	0	5.0	1.00	49
Money Market Funds	14.4	3.8	18.2	0.2	1
Other Pooled Funds:					
- Short-dated bond funds	4.0	0	4.0	0.20	-
- Property fund	4.7	0.2	4.9	4.46	-
Total Investments	**76.9**	**35.7**	**112.6**	**0.27**	**20**

9.4 Both the CIPFA Code and government guidance require the Council 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 Council'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. In these uncertain economic times, the Council will keep an emphasis on the security of its investments.

9.5 Ultra-low short-dated cash rates, which have been a feature since March 2020 when Bank Rate was cut to 0.1%, have resulted in the return on sterling low volatility net asset value money market funds (LVNAV MMFs) being at or close to zero even after some managers have temporarily waived or lowered their fees. At this stage net negative returns are not the central case of most MMF managers over the short-term, and fee cuts or waivers should result in MMF net yields having a floor of zero, but the possibility cannot be ruled out.

9.6 Deposit rates with the Debt Management Account Deposit Facility (DMADF) are also largely around zero.

9.7 In light of the adopted strategy of internal borrowing and with cash balances inflated by grants payable/(repayable) to third parties, the Council kept more cash available at very short notice than is normal. Liquid cash was diversified over several counterparties and Money Market Funds to manage both credit and liquidity risks. The result of this policy is reflected in the total return of 0.27%.

9.8 **Externally Managed Pooled Funds**: £5m of the Council's investments are held in the CCLA Local Authorities Property Fund where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. The fund has generated an average income return to date of £105k (4.46%), which is used to support services in year. There was a capital gain of £328k on the year opening fund value at the end of Q2 which counteract losses in 2020/21 from the pandemic.

9.9 Because the Council's externally managed fund has no defined maturity date, but is available for withdrawal after a notice period, its performance and continued suitability in meeting the Council's investment objectives is 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.

10 Non-Treasury Investments

10.1 The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in the Investment Guidance issued by the Ministry of Housing, Communities and Local Government (MHCLG) in which the definition of investments is further broadened to also include all such assets held partially for financial return.

10.2 A full list of the Council's non-treasury investments is provided at Appendix 2 to this report

11 Impact of Treasury Performance on the Revenue Budget

11.1 The net revenue budget for treasury management is projected to be underspent after the suspension of new borrowing and use of internal resources.to fund capital expenditure in the near term.

Table 5: Revenue Budget Performance

As at end September 2021	Current Budget 2021/22	Projected Outturn 2021/22	Variation
	£M	£M	£M
Investment Income	(0.3)	(0.3)	0.0
Interest Paid on Borrowing	11.8	11.7	(0.1)
Net Position (Interest)	**11.5**	**11.4**	**(0.1)**
Minimum Revenue Provision	7.6	7.5	(0.1)
Net Position (Other)	**7.6**	**7.5**	**(0.1)**
Net Position Overall	**19.1**	**18.9**	**(0.2)**

12 Compliance

12.1 The Chief Finance Officer reports that all treasury management activities undertaken during the quarter complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

12.2 Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 6 below.

Table 6: Debt Limits

	Maximum in period	**30.9.21 Actual**	**2021/22 Operational Boundary**	**2021/22 Authorised Limit**	**Complied?**
Borrowing	£391.5m	£391.3m	£590m	£700m	Yes
PFI and Finance Leases	£16.8m	£16.8m	£20m	£20m	Yes
Total debt	**£408.3m**	**£408.1m**	**£610m**	**£720m**	**Yes**

12.3 Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure. Total debt did not exceed the operational boundary during the period.

12.4 The Head of Finance confirms that the approved limits set in accordance with the Annual Investment Strategy and varied temporarily by him under delegated powers were not breached during the period of this report. Detail in table 7 below

Table 7: Investment Limits

	Maximum in period	**30.9.21 Actual**	**2021/22 Limit (Highest in period)**	**Complied?** Yes/No
Any single organisation, except the UK Government	£15M	£10M	£15M	Yes
Any group of organisations under the same ownership	£17M	£17M	£18M	Yes
Money Market Funds	£15	£9m	£15M	Yes

13 Treasury Management Indicators

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

13.2 **Security:** The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment rating (AAA=1, AA+=2,…..A=6 etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	30.9.21 Actual	2021/22 Target	Complied?
Portfolio average credit score	4.5	6	Yes

13.3 **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 one-month period, without additional borrowing.

	30.9.21 Actual	2021/22 Target	Complied?
Total cash available within 1 month	£64M	£15m	Yes

13.4 **Interest Rate Exposures**: This indicator is set to control the Authority's exposure to interest rate risk. The limits set in the original strategy recognised the majority of current borrowing as fixed (no effect of a 1% change) and the potential for investment rates to turn negative. During the year no new borrowing has been undertaken (maintaining no exposure to variable rates) and inflationary pressures have all but removed the threat of negative rates on investments.

13.5 **Maturity Structure of Borrowing:** This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	30.9.21 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	1%	0%	40%	Yes
12 months and within 24 months	1%	0%	40%	Yes
24 months and within 5 years	4%	0%	30%	Yes
5 years and within 10 years	9%	0%	40%	Yes
10 years and within 20 years	17%	0%	50%	Yes
20 years and within 30 years	8%	0%	60%	Yes
30 years and within 40 years	35%	0%	50%	Yes
40 years and above	25%	0%	50%	Yes

13.5 **Principal Sums Invested for Periods Longer than a year:** The purpose of this indicator is to control the Council'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:

	2021/22	2022/23	2023/24
Actual principal invested beyond year end	£5m	£5m	5m
Limit on principal invested beyond year end	£20m	£20m	£20m
Complied?	Yes	Yes	Yes

14 Revisions to CIPFA Codes

14.1 In February 2021 CIPFA launched two consultations on changes to its Prudential Code and Treasury Management Code of Practice. These followed the Public Accounts Committee's recommendation that the prudential framework should be further tightened following continued borrowing by some authorities for investment purposes. In June, CIPFA provided feedback from this consultation.

14.2 In September CIPFA issued the revised Codes and Guidance Notes in draft form and opened the latest consultation process on their proposed changes. The changes include:

- Clarification that (a) local authorities must not borrow to invest primarily for financial return (b) it is not prudent for authorities to make any investment or spending decision that will increase the Capital Financing Requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority.
- Categorising investments as those (a) for treasury management purposes, (b) for service purposes and (c) for commercial purposes.
- Defining acceptable reasons to borrow money: (i) financing capital expenditure primarily related to delivering a local authority's functions, (ii) temporary management of cash flow within the context of a balanced budget, (iii) securing affordability by removing exposure to future interest rate rises and (iv) refinancing current borrowing, including replacing internal borrowing.
- For service and commercial investments, in addition to assessments of affordability and prudence, an assessment of proportionality in respect of the authority's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services).
- Prudential Indicators
- New indicator for net income from commercial and service investments to the budgeted net revenue stream.
- Inclusion of the liability benchmark as a mandatory treasury management prudential indicator. CIPFA recommends this is presented as a chart of four balances – existing loan debt outstanding; loans CFR, net loans requirement, liability benchmark – over at least 10 years and ideally cover the authority's full debt maturity profile.
- Excluding investment income from the definition of financing costs.
- Incorporating ESG issues as a consideration within TMP 1 Risk Management.
- Additional focus on the knowledge and skills of officers and elected members involved in decision making

15 MHCLG Improvements to the Capital Finance Framework

15.1 MHCLG published a brief policy paper in July outlining the ways it feels that the current framework is failing and potential changes that could be made. The paper found that “while many authorities are compliant with the framework, there remain some authorities that continue to engage in practices that push the bounds of compliance and expose themselves to excessive risk”.

15.2 The actions announced include greater scrutiny of local authorities and particularly those engaged in commercial practices; an assessment of governance and training; a consideration of statutory caps on borrowing; further regulations around Minimum Revenue Provision (MRP) and ensuring that MHCLG regulations enforce guidance from CIPFA and the new PWLB lending arrangements.

15.3 A further consultation on these matters is expected soon.

16 Other

16.1 **IFRS 16**: The implementation of the new IFRS 16 Leases accounting standard is now expected to be from April 2022.

17 Outlook for the remainder of 2021/22 (Arlingclose Ltd – October 2021)

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Official Bank Rate													
Upside risk	0.00	0.15	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.10	0.10	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	0.00	0.15	0.15	0.15	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40

17.1 Bank Rate is expected to remain at 0.10% for the rest of the current year with a rise in Q2 2022. Arlingclose believe this is driven as much by the Bank of England’s desire to move from emergency levels as by fears of inflationary pressure. (At its meeting in November the Bank of England held the Bank Rate at 0.10% but advised will need to rise “over coming months” to meet target.)

17.2 Investors have priced in multiple rises in Bank Rate to 1% by 2024. While Arlingclose believes Bank Rate will rise, it is by a lesser extent than expected by markets.

17.3 The global economy continues to recover from the pandemic but has entered a more challenging phase. The resurgence of demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. This is particularly apparent in the UK due to the impact of Brexit.

17.4 Gilt yields have risen sharply as investors factor in higher interest rate and inflation expectations. From here, Arlingclose believe that gilt yields will be broadly steady, before falling as inflation decreases and market expectations align with their forecast.

17.5 The risk around the forecasts for Bank Rate is to upside over the next few months, shifting to the downside in the medium term. The risks around the gilt yield forecasts are initially broadly balanced, shifting to the downside later.

Appendices

Appendix 1: Economic commentary
Appendix 2: Non-Treasury Management Investments

Additional Information

[Treasury Management Strategy 2021/2022]