Treasury Management activity and treasury and prudential indicators 2021-22

1. Introduction

1.1 The treasury management service is an important part of the overall financial management of the council. Whilst the prudential indicators consider the affordability and impact of capital expenditure decisions, the treasury service covers the effective funding of these decisions.

1.2 Strict regulations, such as statutory requirements and the CIPFA treasury management code of practice (the TM Code) govern the council's treasury activities, and the Prudential Code and MHCLG Investment Guidance non-treasury investments.

1.3 The Council holds a substantial amount of Investment property (non-treasury investment) and has a large capital programme which directly impacts on the treasury management decisions the Council may make.

2. Treasury management activity

2.1 The council has an integrated capital and investment strategy and manages its cash as a whole in accordance with its approved strategy. Therefore, overall borrowing may arise because of all the financial transactions of the council (for example, borrowing for cash flow purposes) and not just those arising from capital expenditure reflected in the Capital Financing Requirement (CFR).

Investments

2.2 The then Ministry of Housing, Communities and Local Government (MHCLG) Investment Guidance requires local authorities to focus on security and liquidity rather than yield.

2.3 CIPFA published a revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes on 20 December 2021. These define treasury management investments as

> "*investments that arise from the organisation's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business*".

2.4 Both the CIPFA Code and government guidance requires local authorities to invest funds prudently, and to have regard to the security and liquidity of investments before seeking the highest rate of return, or yield. The main objective, therefore, 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 unsuitable low investment income.

2.5 Ultra-low short-dated cash rates, which were a feature since March 2020 when Bank Rate was cut to 0.1%, prevailed for much of the 12-month reporting period which resulted in the return on sterling low volatility net asset value (LVNAV) Money Market Funds being close to zero even after some managers have temporarily waived or lowered their fees. However, higher returns on cash instruments followed the increases in Bank Rate in December, February and March.

2.6 Similarly, deposit rates with the Debt Management Account Deposit Facility (DMADF) initially remained very low with rates ranging from 0% to 0.1% but following the hikes to policy rates increased to between 0.55% and 0.85% depending on the deposit maturity.

2.7 Security of capital remains our main objective when placing investments. We maintained this during the year by following our investment policy, as approved in our treasury management strategy 2021-22, which defined "high credit quality" counterparties as those having a long-term credit rating of A- or higher.

2.8 Investments during the year included:

- investments in AAA rated constant net asset money market funds
- call accounts and deposits with banks and building societies systemically important to each country's banking system. We do have some investments with overseas banks, but in sterling
- other local authorities
- corporate bonds
- non-rated building societies
- covered bonds
- pooled funds without a credit rating, but only those subject to an external assessment

2.9 We divided our investments into three types

- short-term (less than one-year) internally managed cash investments
- long-term internally managed investments
- externally managed funds

2.10 Cash balances consisted of working cash balances, capital receipts, and council reserves.

2.11 The table below shows our investment portfolio, at 31 March 2022, compared to 31 March 2021. **Appendix 4** contains a detail schedule of investments outstanding at the end of the year.

Investment details	Balance at 31-03-21 £m	Weighted Avg Return for Year	Balance at 31-03-22 £m	Weighted Avg Return for Year
Internally Managed Investments				
Fixed Investments < 1 year to cover cash flow	57.50	0.89%	41.00	0.46%
Corporate bonds	2.00	0.17%	4.00	0.13%
Long term bonds	16.10	0.00%	15.00	0.29%
Notice Accounts	3.00	0.39%	3.00	0.40%
Call Accounts	0.33	0.07%	0.00	0.01%
Money Market Funds	39.22	0.13%	31.90	0.07%
Revolving credit facility	0.00	1.47%		
Long term investments > 1 year	18.50	1.21%	37.40	0.40%
Externally Managed Funds				
Funding circle	0.50	6.51%	0.21	10.90%
Cash plus	0.00	0.00%	5.00	0.00%
CCLA	6.49	4.81%	7.67	4.41%
Fundamentum	5.00	0.00%	2.07	1.65%
RLAM	2.33	2.19%	2.25	4.79%
M&G	3.53	4.45%	0.00	3.25%
Schroders	0.70	7.04%	0.77	7.31%
UBS	2.20	3.95%	2.11	4.71%
City Financial	1.97	0.85%	0.00	0.00%
Total Investments	**159.37**	**1.05%**	**152.38**	**0.65%**

2.12 Our level of investments decreased during 2021-22, and we achieved a lower return than last year. Interest rates have started to increase to try and alleviate the impact of Inflation in the Economy. The portfolio will have lower rates until investments mature and can be reinvested at the higher rates. FRN Bonds in the main have a quarterly reset date and will increase sooner than maturity date.

2.13 The Councils also holds £9.15 million equity investments in Guildford Holdings Ltd and £15.5 million in North Downs Housing Ltd.

2.14 We are earning an interest return of base rate plus 5% (5.75% at 31 March 2022) on the investment in North Downs Housing. This is higher than the return earned on treasury investments but reflects the additional risks to the Council of holding the investment.

Security of investments

2.15 Counterparty credit quality was assessed and monitored with reference to credit ratings; financial institutions analysis of funding structure and susceptibility to bail-in, credit default swap prices; financial statements; information on potential government support and reports in the quality financial press.

2.16 We also considered the use of secured investment products that provide collateral in the event that the counterparty cannot meet its obligations for repayment.

2.17 The minimum long-term counterparty credit rating for ‘high quality counterparties’ approved for 2021-22 was A-/A3 across all three main credit rating agencies (Fitch, S&P, and Moody’s).

2.18 The strategy set different limits for different counterparty credit ratings both in maximum duration and exposure in monetary terms.

2.19 We also can invest in non-rated institutions subject to due diligence.

Liquidity of investments

2.20 In keeping with the MHCLG's Guidance on Investments, the council maintained a sufficient level of liquidity using money market funds, call accounts, the maturity profile of fixed investments and short-term borrowing from other local authorities.

2.21 We use PSlive as our daily cash flow forecasting software to determine the maximum period for which funds may prudently be committed.

Yield of investments

2.22 The council sought to optimise returns commensurate with its objective of security and liquidity. The Bank of England base rate has increased during the year:

- 16 Dec 2021 0.25%
- 3 Feb 2022 0.75%

2.23 We invested in longer-term covered bonds, which increased the return of the portfolio and the duration. Bonds can be sold in the secondary market should we need the liquidity.

2.24 The council's budgeted investment income for the year was £1.278 million and actual interest was £1.878 million, at a weighted average yield of 0.65%.

Externally managed funds

2.25 We estimate to have cash balances over the medium-term (our "core" cash as identified in the Councils liability benchmark), and as such we have continued investing in pooled (cash-plus, bond, equity, multi-asset and property) funds. These funds have allowed us to diversify into asset classes other than cash without the need to own and manage the underlying investments. These funds operate on a variable net asset value (VNAV) basis offer diversification of investment risk, coupled with the services of a professional fund manager; they also offer enhanced returns over the longer term but are more volatile in the short term. All of our pooled funds are in the respective funds distributing share class, which pay out the income generated. They have no defined maturity date, but are available for withdrawal, some with a notice period.

2.26 In the nine months to December improved market sentiment was reflected in equity, property and multi-asset fund valuations and, in turn, in the capital values of the Authority's property, equity and multi-asset income funds in the Authority's portfolio. The prospect of higher inflation and rising bond yields did however result in muted bond fund performance. In the January- March quarter the two dominant themes were tighter UK and US monetary policy and higher interest rates, and the military invasion of Ukraine by Russia in February, the latter triggering significant volatility and uncertainty in financial markets.

2.27 In light of Russia's invasion, Arlingclose contacted the fund managers of our MMF, cash plus and strategic funds and confirmed no direct exposure to Russian or Belarusian assets had been identified. Indirect exposures were immaterial. It should be noted that that any assets held by banks and financial institutions (e.g. from loans to companies with links to those countries) within MMFs and other pooled funds cannot be identified easily or with any certainty as that level of granular detail is unlikely to be available to the fund managers or Arlingclose in the short-term, if at all.

2.28 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.

2.29 Due to the predicted over spend in year on the revenue account, the Executive agreed to sell the M&G Fund which was holding a capital gain. The net gain was £1.398 million.

Borrowing and debt management

2.30 The council's debt portfolio is detailed in the table below. Our loan portfolio decreased by £2.2 million due to the repayment of the £45 million variable HRA loan, offset by an increase in temporary borrowing and £22 million of PWLB GF borrowing for the WUV project.

2.31 The schedule of borrowing is shown in the table below

Interest calc	Lender	Loan type	Principal £'000	Initial loan period (yrs)	Period remaining years	Maturity date	Rate
Long-term							
Fixed	PWLB	Maturity	10,000	12	2.0	28/03/2024	2.70%
Fixed	PWLB	Maturity	10,000	13	3.0	28/03/2025	2.82%
Fixed	PWLB	Maturity	10,000	14	4.0	28/03/2026	2.92%
Fixed	PWLB	Maturity	10,000	15	5.0	28/03/2027	3.01%
Fixed	PWLB	Maturity	25,000	17	7.0	28/03/2029	3.15%
Fixed	PWLB	Maturity	25,000	20	10.0	28/03/2032	3.30%
Fixed	PWLB	Maturity	25,000	25	15.0	28/03/2037	3.44%
Fixed	PWLB	Maturity	15,000	29	19.0	28/03/2041	3.49%
Fixed	PWLB	Maturity	17,435	30	20.0	28/03/2042	3.50%
Fixed	PWLB	Maturity	10,800	50	50.0	09/03/2072	1.82%
Fixed	PWLB	Maturity	5,000	10	10.0	29/03/2032	2.26%
Fixed	PWLB	Maturity	7,000	11	11.0	31/03/2033	2.06%
Short-term							
Fixed	Wokingham BC	Maturity	10,000	0.75	0.1	19/04/2022	0.08%
Fixed	Hampshire CC	Maturity	5,000	1.00	0.1	03/05/2022	0.09%
Fixed	Oxfordshire CC	Maturity	10,000	0.87	0.1	13/05/2022	0.10%
Fixed	Durham CC	Maturity	10,000	1.00	0.1	20/05/2022	0.12%
Fixed	Chesire West & Chester Council	Maturity	10,000	0.22	0.2	30/05/2022	0.55%
Fixed	West of England Combined Authority	Maturity	1,500	1.00	0.2	07/06/2022	0.15%
Fixed	Local Government Assocoation	Maturity	10,000	1.00	0.2	07/06/2022	0.10%
Fixed	North of Tyne Authority	Maturity	8,000	1.00	0.3	01/07/2022	0.17%
Fixed	Nottingham office of PCC	Maturity	10,000	1.00	0.3	04/07/2022	0.15%
Fixed	NORTH NORTHAMPTONSHIRE COUN	Maturity	5,000	0.50	0.4	25/08/2022	0.70%
Fixed	Brighton & Hove CC	Maturity	10,000	1.00	0.4	26/08/2022	0.12%
Fixed	West Mids CA	Maturity	4,000	0.50	0.5	28/09/2022	0.85%
Fixed	Crawley BC	Maturity	5,000	1.00	0.6	01/11/2022	0.10%
Fixed	Oxfordshire CC	Maturity	5,000	0.76	0.7	05/12/2022	0.80%
Fixed	Portsmouth CC	Maturity	10,000	1.00	0.7	19/12/2022	0.20%
Fixed	NOTTINGHAM CITY COUNCIL	Maturity	10,000	1.00	0.9	27/02/2023	0.20%
Fixed	TAMESIDE MET BC	Maturity	5,000	1.00	1.0	13/03/2023	0.80%
Fixed	SHEFFIELD CITY COUNCIL	Maturity	10,000	1.00	1.0	14/03/2023	0.80%
Total			**308,735**				

2.32 Our primary 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 our long-term plans change being a secondary objective.

2.33 We also have short-term loans outstanding at the end of the year which we took out for cash flow purposes, from other local authorities. Temporary and short-dated loans borrowed during the year from other local authorities remained affordable and attractive.

2.34 Affordability and the "cost of carry" remained important influences on our long-term borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would be invested at rates of interest significantly lower than the cost of borrowing. As short-term interest rates have remained low, lower than long-term rates, the council determined it was more cost effective in the short-term to use internal resources and borrow short-term to medium-term instead.

2.35 The Councils borrowing position is monitored regularly as to whether it is more beneficial to externalise borrowing now or whether to continue internal borrowing based on predicted future borrowing costs (which are likely to be higher). Arlingclose assist us with this 'cost of carry' and break-even analysis.

2.36 Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management. Misuse of PWLB borrowing could result in the PWLB requesting that Council unwinds problematic transactions, suspending access to the PWLB and repayment of loans with penalties.

2.37 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

3. Treasury and prudential indicators

3.1 The Local Government Act 2003 requires local authorities to have regard to the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury decisions are taken in accordance with good professional practice. To demonstrate the Council has fulfilled these objectives, the Prudential Code sets various indicators that must be set and monitored each year.

3.2 The CFO confirms that we have complied with our prudential indicators for 2021-22, which were approved in February 2021 as part of the treasury management strategy statement. The CFO also confirms that we have complied with our treasury management policy statement and treasury management practices during 2021-22.

Balance sheet and treasury position prudential indicator

3.3 The capital financing requirement (CFR) measures the council's underlying need to borrow for a capital purpose. Over the medium-term, borrowing must be only for a capital purpose, although in the short-term, we can borrow for cash flow purposes, which does not affect the CFR.

3.4 The council's CFR for 2021-22 is shown in the following table

Capital Financing Requirement	2021-22 Approved Estimate £000	2021-22 Revised Estimate £000	2021-22 Actual £000
HRA			
Opening balance (01 Apr 21)	217,024	199,204	199,204
Movement in year: Unfinanced cap exp	10,000	7,820	0
Closing balance (31 Mar 22)	227,024	207,024	199,204
General Fund			
Opening balance (01 Apr 21)	122,374	128,643	133,942
Movement in year: Unfinanced cap exp	84,269	29,667	24,656
Movement in year: MRP	(1,535)	(1,419)	(1,380)
Closing balance (31 Mar 22)	205,108	156,891	157,218
Total			
Opening balance (01 Apr 21)	339,398	327,847	333,146
Movement in year: Unfinanced cap exp	94,269	37,487	24,656
Movement in year: MRP	(1,535)	(1,419)	(1,380)
Closing balance (31 Mar 22)	432,132	363,915	356,422
Balances and Reserves	(176,489)	(155,204)	(185,016)
Cumulative net borrowing requirement / (investments)	**255,643**	**208,711**	**171,406**

3.5 The GF unfinanced capital expenditure mainly relates to WUV, transport schemes and loan / equity to North Downs housing. This is lower than budgeted because of the slippage in the capital programme – we projected some slippage during the year, which is shown by the revised estimate (as in the strategy report presented to Council in February 2021), and is reflected in the 2022/23 MRP budget.

3.6 We budgeted an underlying need to borrow of £83.5 million for 2021-22, and our actual underlying need to borrow was £24.6 million because of slippage in the capital programme and also a higher amount of capital receipts/grants than anticipated.

Gross debt and the CFR

3.7 We monitor the CFR to gross debt continuously to ensure that, over the medium term, borrowing is only for a capital purpose and does not exceed the CFR. This is a key indicator of prudence. We will report any deviations to the CFO for investigation and appropriate action. The following table shows the council is in a net internal borrowing position and gross debt does not exceed the CFR over the period.

Gross Debt and the CFR	2021-22 Actual £000
General Fund CFR	157,218
HRA CFR	199,204
Total CFR (at 31 March)	**356,422**
Gross External Borrowing	(308,735)
Net (external) / internal borrowing position	**47,687**

3.8 Actual debt levels are monitored against the operational boundary and authorised limit for external debt, detailed in paragraph 3.20 to 3.25.

3.9 We are showing as being internally borrowed up to £16 million in at the end of March 2021.

Capital expenditure prudential indicator

3.10 This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits, and, in particular, to consider the impact on council tax or housing rent levels for the HRA.

3.11 The following table shows capital expenditure in the year, compared to the original estimate approved by the Executive in January 2021.

Projects	Original Estimate (£'000)	Actual (£'000)	Variance (£'000)
Housing Revenue Account			
HRA Capital Programme	52,105	15,739	(36,366)
Total Housing	**52,105**	**15,739**	**(36,366)**
General Fund			
Vehicles purchase	566	1,152	586
Weir	0	418	418
Infrastructure	3,336	4,080	744
Strategic Property	25,000	458	(24,542)
Ash road bridge & Footbridge	19,976	3,598	(16,378)
NDH/GHL	2,799	4,296	1,497
Midleton redevelopment	3,700	3,991	291
WUV	28,347	18,035	(10,312)
Other General Fund Projects	9,066	3,749	(5,317)
Provisional schemes	55,508	0	(55,508)
Total General Fund	**148,298**	**39,777**	**(108,521)**
Total Capital Programme	**200,403**	**55,516**	**(144,887)**

3.12 The table shows that there was a lot of slippage in the capital programme. This was mainly over a few larger schemes including:

- provisional schemes were re-profiled during the year, and include:
  - various transport and infrastructure schemes
  - ash road bridge
  - WUV
  - Strategic Property

3.13 The following table shows the financing of capital expenditure in the year, compared with the original approved estimate.

CAPITAL EXPENDITURE - SUMMARY	Original Estimate (£'000)	Actual (£'000)
General Fund Capital Expenditure		
- Main programme	146,323	38,096
- Reserve & s106 Capital Schemes	1,975	1,681
HRA Capital expenditure		
- Main programme	52,105	15,739
Total Capital Expenditure	**200,403**	**55,516**
CAPITAL EXPENDITURE - SUMMARY	**Original Estimate (£'000)**	**Actual (£'000)**
General Fund Capital Expenditure Financed by:		
- Borrowing/Use of Balances	(94,593)	(23,512)
- Capital Receipts	(95)	(969)
- Capital Grants/Contributions	(51,415)	(12,936)
- Capital Reserves/Revenue	(2,195)	(2,360)
HRA Capital Expenditure Financed by:		
- Capital Receipts	(18,419)	(3,731)
- Capital Reserves/Revenue	(33,686)	(11,978)
Financing - Totals	**(200,403)**	**(55,516)**

3.14 GF borrowing was less than budgeted because of slippage in the capital programme, and an increase in the opening of available capital resources which reduced the need for internal borrowing in the year.

Ratio of financing costs to the net revenue stream prudential indicator

3.15 This is an indicator of affordability and highlights the revenue impact of capital expenditure by identifying the proportion of the revenue budget required to meet the financing costs associated with capital spending. Financing costs include interest on borrowing, MRP, premium or discount on loans repaid early, investment income and depreciation where it is a real charge.

3.16 Depreciation is not a real charge to the GF but has been to the HRA since April 2012.

3.17 The ratio is based on costs net of investment income.

3.18 The net revenue stream for the GF is the total budget requirement and for the HRA is total income. Where the figure is negative, it is because there is a net investment position (more investments than debt). The total budget requirement for the GF used is the 2021-22 budget.

	2021-22 Original Estimate	2021-22 Actual
General Fund	8.07%	0.13%
HRA	31.03%	33.01%

3.19 The GF is lower than originally estimated because the long-term borrowing figure was lower than estimated as the budget assumed a large amount of external borrowing for the capital programme which was not required and was reported throughout the year as part of budget monitoring.

The authorised limit prudential indicator

3.20 The Local Government Act 2003 requires the council to set an affordable borrowing limit, irrespective of the indebted status. This is a statutory limit, which we cannot breach.

3.21 The limit is the maximum amount of external debt we can legally owe at any one time. It is expressed gross of investments and includes capital expenditure plans, the CFR and cash flow expenditure. It also provides headroom over and above for unexpected cash movements.

3.22 The limit was set at £531 million for the year and the highest level of debt was £331 million.

3.23 We measure the levels of debt on an ongoing basis during the year for compliance. The CFO confirms there were no breaches to the authorised limit in 2020-21.

The operational boundary prudential indicator

3.24 The operational boundary, based on the same estimates as the authorised limit, reflects the most likely, prudent but not worst-case scenario. It does not allow for additional headroom included in the authorised limit.

3.25 The limit was set at £477 million for the year and the highest level of debt was £331 million.

Maturity structure of borrowing treasury indicator

3.26 The aim of this indicator is to control our exposure to refinancing risk (large concentrations of debt needing refinancing at once).

	Loans Maturity (Liquidity Risk)	
31 March 2021		**31 March 2022**
£'000		**£'000**
	Short Term Borrowing	
163,500	Less than one year	134,136
	Long Term Borrowing	
45,000	Over 1 but not over 2 years	10,318
30,000	Over 2 but not over 5 years	32,227
35,000	Over 5 but not over 10 years	58,182
25,000	Over 10 but not over 15 years	25,636
40,000	Over 15 but not over 20 years	32,435
17,435	Over 45 years	10,800
355,935	**Total Borrowings**	**303,735**

3.27 The above table shows the amount of debt maturing in each period and its percentage of total fixed rate loans. That less than 12 months is mainly made up of short-term borrowing.

Actual external debt treasury indicator

3.28 This indicator comes directly from our balance sheet. It is the closing balance for actual gross borrowing (short and long term) plus other deferred liabilities. It is measured in a manner consistent for comparison with the authorised limit and operational boundary.

3.29 Actual external debt (as per 3.7) stood at £308 million.

Upper limit for total principal sums invested over 1 year

3.30 The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the council having to seek early repayment of the sums invested.

3.31 Our limit was set at £50 million we ended the year with exposure of £39 million.

3.32 As mentioned earlier in the report, many of our long-term investments are covered bonds, which can be sold on the secondary market. There could be a price differential if they were sold, but it is unlikely to be material.