Mid Year Review 2021-22: Treasury Management and Annual Investment Strategy

Council	12 January 2022
Report Author	Chris Blundell, Director of Finance and Acting Section 151 Officer
Portfolio Holder	Councillor David Saunders, Cabinet Member for Finance
Status	For Decision
Classification	Unrestricted
Ward	Thanet Wide
Previously Considered by	Cabinet - 18 November 2021 Governance & Audit Committee - 1 December 2021

Executive Summary:

This report summarises treasury management activity and prudential/ treasury indicators for the first half of 2021-22.

The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as:

"The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the 2021-22 mid-year position for treasury activities.

Key reporting items to consider include:

- 2021-22 mid-year capital expenditure on long term assets was £5.1m (2020-21 mid-year: £5.4m), against a full-year budget of £31.0m.
- The council's gross debt, also called the borrowing position, at 30 September 2021 was £20.4m (30 September 2020: £24.7m).
- The council's underlying need to borrow to finance its capital expenditure, also called the Capital Financing Requirement (CFR), is estimated to be £54.6m at 31 March 2022 (31 March 2021: £56.7m).

- The council has held less gross debt than its CFR and accordingly has complied with the requirement not to exceed its authorised borrowing limit of £81m.
- As at 30 September 2021 the council's investment balance was £54.2m (30 September 2021: £42.3m).
- It is proposed that the 2021-22 Treasury Management Strategy Statement be amended as described in section 3 of this report.

Recommendation(s):

That council:

1. Makes comments on this report and annexes as appropriate;

2. Approves this report and annexes, including the prudential and treasury indicators that are shown and the proposed changes to the 2021-22 Treasury Management Strategy Statement.

Corporate Implications

Financial and Value for Money

The financial implications are highlighted in this report.

Legal

Section 151 of the 1972 Local Government Act requires a suitably qualified named officer to keep control of the council's finances. For this council, this is the Director of Finance, and this report is helping to carry out that function.

Corporate

Failure to undertake this process will impact on the council's compliance with the Treasury Management Code of Practice.

Equalities Act 2010 & Public Sector Equality Duty

There are no equity and equalities implications arising directly from this report, but the council needs to retain a strong focus and understanding on issues of diversity amongst the local community and ensure service delivery matches these.

It is important to be aware of the council's responsibility under the Public Sector Equality Duty (PSED) and show evidence that due consideration had been given to the equalities impact that may be brought upon communities by the decisions made by council.

CORPORATE PRIORITIES

This report relates to the following corporate priorities: -

- Growth

- Environment
- Communities.

1 Background

1.1 Treasury management

The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as:

> *"The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions;*
>
> *the effective control of the risks associated with those activities; and*
>
> *the pursuit of optimum performance consistent with those risks."*

The council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operation is to ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the treasury management service is the funding of the council's capital plans. These capital plans provide a guide to the borrowing need of the council, essentially the longer term cash flow planning to ensure the council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet council risk or cost objectives.

1.2 Capital Strategy

In December 2017, the Chartered Institute of Public Finance and Accountancy (CIPFA) issued revised Prudential and Treasury Management Codes. These require all local authorities to prepare a Capital Strategy which is to provide the following: -

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- an overview of how the associated risk is managed;
- the implications for future financial sustainability.

2 Introduction

2.1 This report has been written in accordance with the requirements of the CIPFA Code of Practice on Treasury Management (revised 2017).

2.2 The primary requirements of the Code are as follows:

a) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

b) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

c) Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy (for the year ahead), a Mid-year Review Report (this report) and an Annual Report (stewardship report), covering activities during the previous year.

d) Delegation by the council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

e) Delegation by the council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this council the delegated body is the Governance and Audit Committee.

2.3 This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first half of the 2021-22 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The council's capital expenditure (see also the Capital Strategy) and prudential indicators;
- A review of the council's investment portfolio for 2021-22;
- A review of the council's borrowing strategy for 2021-22;
- A review of any debt rescheduling undertaken during 2021-22;
- A review of compliance with Treasury and Prudential Limits for 2021-22.

3 Treasury Management Strategy Statement and Annual Investment Strategy Update

3.1 The Treasury Management Strategy Statement (TMSS) for 2021-22, which includes the Annual Investment Strategy, Capital Strategy and Non-Treasury Investment Report, was approved by the council on 11 February 2021.

3.2 The 2021-22 TMSS referred to in section 3.1 above requires revision as the implementation date of International Financial Reporting Standard 16 (IFRS16) on lease accounting has been deferred again to April 2022. The proposed change is to amend the 2021-22 TMSS so that the 2021-22 Operational Boundary for other long term liabilities is reduced from £35m to £10m and the 2021-22 Authorised Limit for other long term liabilities is reduced from £45m to £15m.

4 The Council's Capital Position (Prudential Indicators)

4.1 This part of the report is structured to update:

- The council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

4.2 Prudential Indicator for Capital Expenditure

This table shows the revised budgets for capital expenditure and the changes since the capital programme was agreed at the Budget.

The revised budget includes net reprofiling of £14.682m (reflecting unspent budgets from 2020-21 that have been slipped into 2021-22) for General Fund, and a review of the HRA capital programme now that the in-house team has become established.

Capital Expenditure	2021-22 Original Budget £m	Current Position – Actual spend at 30-09-21 £m	2021-22 Revised Budget £m
General Fund	5.461	3.145	23.210
HRA	16.518	1.999	7.838
Total	**21.979**	**5.144**	**31.048**

General Fund 2021-22 budget: As at 30 September 2021 there had not yet been any spend on the following projects with budgets over £0.5m:

- Office Accommodation (£3m).
- Parkway Railway Station (£2m).
- Margate Town Deal (£1.66m).
- Ramsgate Future High Street Fund (£1.25m).
- Public Toilet Refurbishment (£0.75m).
- 51-57 High Street, Margate - Refurbishment (£0.75m).

HRA 2021-22 budget: As at 30 September 2021, actual spend for council dwelling major works/adaptations was £2.198m, against a 2021-22 budget of £5.936m, and purchase/replenishment schemes was negative £0.199m (i.e £0.199m less than total 2021-22 expenditure estimated to relate to work done in 2020-21), against a budget of £1.902m.

More detailed monitoring information on the capital programme at scheme level, including forecasts to the end of the financial year, is included in the regular Cabinet Budget Monitoring Reports.

4.3 Changes to the Financing of the Capital Programme

The table below takes the capital expenditure plans (as detailed in the previous table), and shows the expected financing arrangements of this capital expenditure.

The borrowing element of the table increases the underlying indebtedness of the council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2021-22 Original Budget £m Total	Current Position – Actual at 30-09-21 £m	2021-22 Revised Budget £m GF	2021-22 Revised Budget £m HRA	2021-22 Revised Budget £m Total
Total spend	**21.979**	**5.144**	**23.210**	**7.838**	**31.048**
Financed by:					
Capital receipts	2.089		5.515	0.625	6.140
Capital grants	3.642		11.372	0.343	11.715
Reserves	12.313		2.646	6.045	8.691
Revenue	0.300		0.073	0.300	0.373
Total financing	**18.344**		**19.606**	**7.313**	**26.919**
Borrowing need	**3.635**		**3.604**	**0.525**	**4.129**

The table above shows that the revisions to the 2021-22 capital programmes are largely being financed by grants, with only a modest increase in borrowing.

4.4 Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary

The council's underlying need to borrow to fund its capital expenditure is termed the Capital Financing Requirement (CFR). The CFR can be thought of as the outstanding debt that still needs to be repaid in relation to the capital assets (buildings, vehicles etc) that the council has purchased or invested in. It can also be helpful to compare it to the outstanding balance that is still payable on a loan or a mortgage, in this case we are considering how much of the council's debt still needs to be paid for.

The table below shows the CFR, and also shows the expected debt position over the period, which is termed the Operational Boundary.

Prudential Indicator – Capital Financing Requirement

We are on target to achieve the forecast Capital Financing Requirement.

Prudential Indicator – the Operational Boundary for external debt

	2021-22 Original Estimate £m	Current Position – Actual at 30-09-21 £m	2021-22 Revised Estimate £m
Prudential Indicator – Capital Financing Requirement			
CFR –General Fund	48.249		26.039
CFR – HRA	32.216		28.511
Total CFR	80.465		54.550
Net movement in CFR	**23.780**		**(2.135)**
	2021-22 Original Indicator £m	**Current Position – Actual at 30-09-21 £m**	**2021-22 Revised Indicator £m**
Prudential Indicator - the Operational Boundary for External Debt			
Borrowing	76.000	20.385	76.000
Other long term liabilities*	35.000	1.339	10.000
Total debt	**111.000**	**21.724**	**86.000**

** Any 'on balance sheet' PFI schemes and finance leases etc (including the leisure centre deferred credit).*

The original CFR estimate and original Operational Boundary indicator both include an allowance for the recognition of leases under International Financial Reporting Standard 16 (IFRS 16). This allowance has been removed from both the revised CFR estimate and revised Operational Boundary indicator, as the IFRS 16 implementation date has been deferred again to April 2022.

4.5 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, borrowing will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2021-22 and next two financial years. This allows some flexibility for limited early borrowing for future years. The council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

	2021-22 Original Estimate £m	Current Position – Actual at 30-09-21 £m	2021-22 Revised Estimate £m
Gross borrowing	46.448	20.385	34.455
Plus other long term liabilities*	21.223	1.339	1.169
Total gross borrowing	**67.671**	**21.724**	**35.624**

CFR (year end position)	80.465		54.550

The Section 151 Officer reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised Limit for external debt	2021-22 Original Indicator £m	Current Position – Actual at 30-09-21 £m	2021-22 Revised Indicator £m
Borrowing	81.000	20.385	81.000
Other long term liabilities*	45.000	1.339	15.000
Total	**126.000**	**21.724**	**96.000**

** Any 'on balance sheet' PFI schemes and finance leases etc (including the leisure centre deferred credit).*

The original CFR and Other Long Term Liabilities estimates and original Authorised Limit indicator all include an allowance for the recognition of leases under International Financial Reporting Standard 16 (IFRS 16). This allowance has been removed from the revised CFR and Other Long Term Liabilities estimates and revised Authorised Limit indicator, as the IFRS 16 implementation date has been deferred again to April 2022.

5 Annual Investment Strategy 2021-22

5.1 The Treasury Management Strategy Statement (TMSS) for 2021-22, which includes the Annual Investment Strategy, was approved by council on 11 February 2021. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

5.2 The council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the council's risk appetite. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit rated financial institutions.

5.3 As shown by the interest rate forecasts in annex 1, it is now impossible to earn the level of interest rates commonly seen in previous decades as all short-term money market investment rates have only risen weakly since Bank Rate was cut to 0.10% in March 2020 until the Monetary Policy Committee (MPC) meeting on 24th September 2021 when 6 and 12 month rates rose in anticipation of Bank Rate going up in 2022. Given this environment and that Bank Rate may only rise marginally, or not at all, before mid-2023, investment returns are expected to remain low.

5.4 **Creditworthiness**

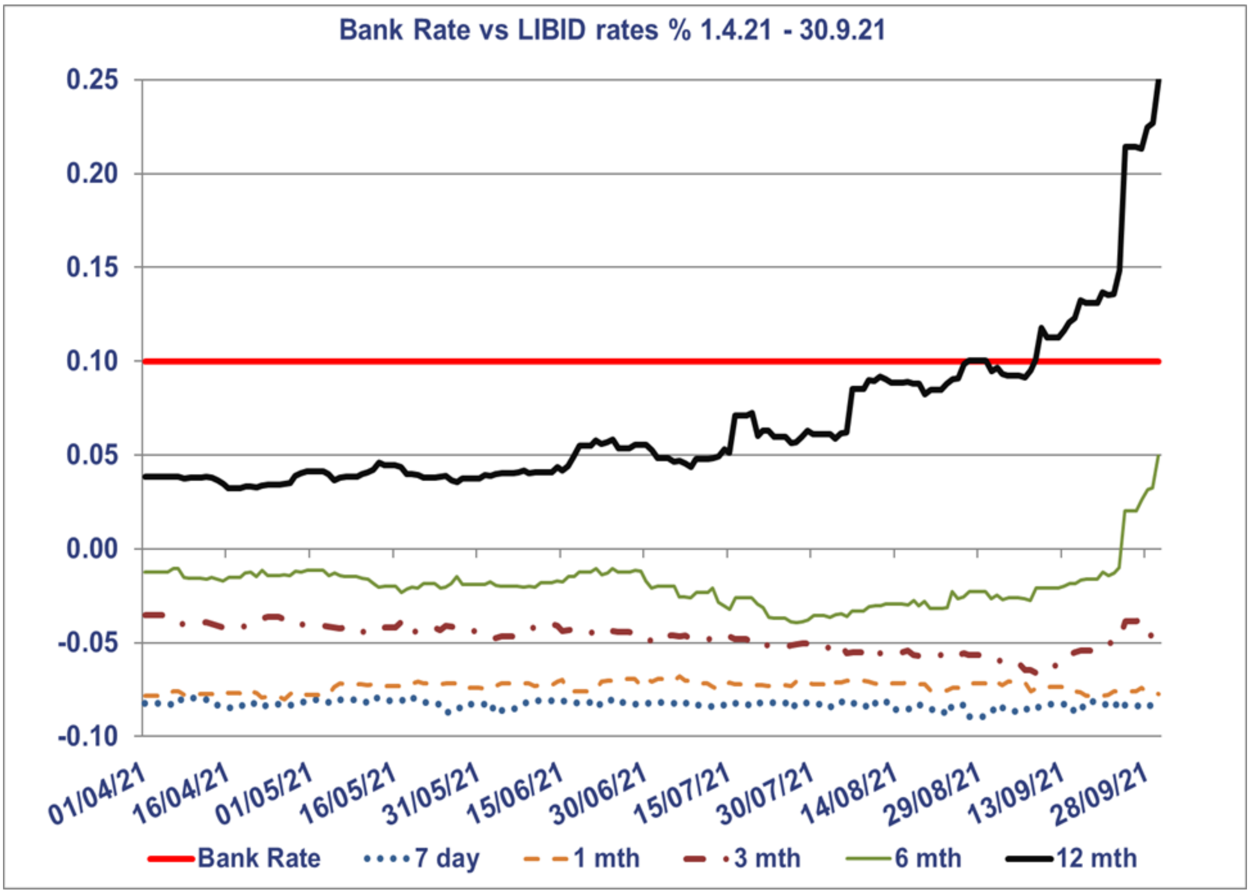
Significant levels of downgrades to Short and Long Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, as economies are beginning to reopen, there have been some instances of previous lowering of Outlooks being reversed.

5.5 **Credit Default Swap (CDS) prices**

Although CDS prices (these are market indicators of credit risk) for banks (including those from the UK) spiked at the outset of the pandemic in 2020, they have subsequently returned to near pre-pandemic levels. However, sentiment can easily shift, so it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances.

5.6 Investment rates during half year ended 30th September 2021

The levels shown below use the traditional market method for calculating LIBID rates – i.e., LIBOR – 0.125%. Given the ultra-low LIBOR levels this year, this produces negative rates across some periods.



	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
High	0.10	-0.08	-0.07	-0.04	0.05	0.25
High Date	01/04/2021	09/04/2021	06/07/2021	01/04/2021	30/09/2021	30/09/2021
Low	0.10	-0.09	-0.08	-0.07	-0.04	0.03
Low Date	01/04/2021	27/08/2021	26/04/2021	08/09/2021	27/07/2021	16/04/2021
Average	0.10	-0.08	-0.07	-0.05	-0.02	0.07
Spread	0.00	0.01	0.01	0.03	0.09	0.22

5.7 The council held £54.151m of investments as at 30 September 2021, with maturities all under one year (£31.325m at 31 March 2021). The investment portfolio yield for the first six months of the year is 0.07% against a benchmark (average 7-day LIBID rate) of negative 0.08%. The constituent investments are:

Sector	Country	Total £m
Banks	UK	4.894
Money Market Funds	UK	49.257
Total		**54.151**

5.8 The Section 151 Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2021-22.

5.9 The council's budgeted investment return for 2021-22 is £0.017m (£0.009m half-year) and performance for the first half of the financial year is above budget at £0.017m. The revised estimate for 2021-22 is £0.030m.

5.10 Investment Risk Benchmarking

Investment risk benchmarks were set in the 2021-22 Treasury Management Strategy Statement (TMSS) for security, liquidity and yield. The mid-year position against these benchmarks is given below.

5.10.1 Security

The council's maximum security risk benchmark for the current portfolio, when compared to historic default tables, is:

- 0.05% historic risk of default when compared to the whole portfolio (excluding unrated investments).

The security benchmark for each individual year is (excluding unrated investments):

	1 year	2 years	3 years	4 years	5 years
Maximum	**0.05%**	**0.05%**	**0.05%**	**0.05%**	**0.05%**

Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

The Section 151 Officer can report that the investment portfolio was maintained within this overall benchmark for the first half of this financial year.

5.10.2 Liquidity

In respect of this area the council seeks to maintain:

- Liquid short term deposits of at least £10m available with a week's notice.
- Weighted Average Life benchmark is expected to be 0.5 years, with a maximum of 1.0 year.

The Section 151 Officer can report that liquidity arrangements were adequate for the first half of this financial year.

This authority does not currently place investments for more than 370 days due to the credit, security and counterparty risks of placing such investments.

5.10.3 Yield

Local measures of yield benchmarks are:

- Investments – Internal returns above the 7 day LIBID rate

The Section 151 Officer can report that the yield on deposits for the first half of the financial year is 0.07% against a benchmark (average 7-day LIBID rate) of negative 0.08%

5.11 Investment Counterparty criteria

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

6 Borrowing

6.1 The council's capital financing requirement (CFR) revised estimate for 2021-22 is £54.550m. The CFR denotes the council's underlying need to borrow for capital purposes. If the CFR is positive the council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The council has borrowings of £20.385m (table 4.5) and has utilised an estimated £34.165m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

6.2 No new external borrowing was undertaken from the PWLB during the first half of this financial year.

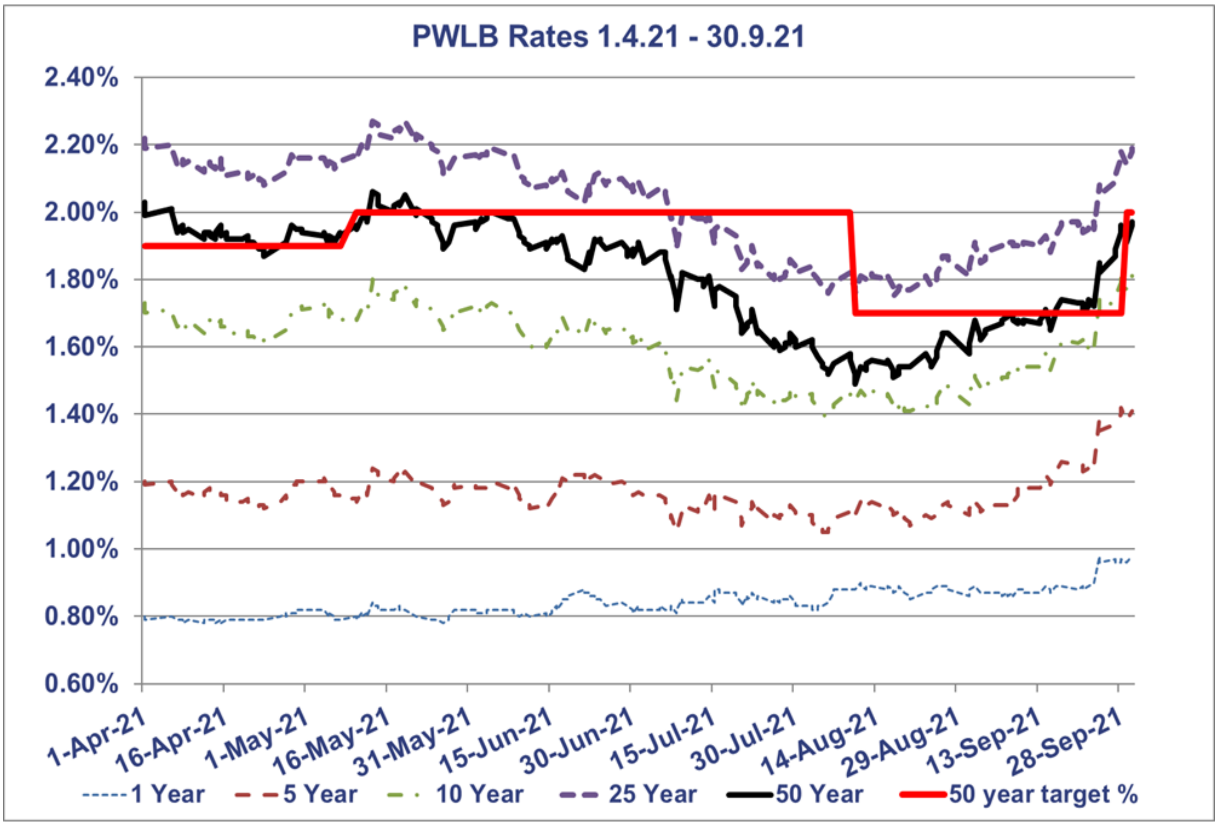
6.3 The council repaid £4.009m of maturing debt during the first half of this financial year using investment balances, as below:

Lender	Principal £'000	Interest Rate	Repayment Date
Salix	4	0.00%	01-04-21
PWLB	43	3.08%	23-04-21
PWLB	50	2.48%	27-05-21
PWLB	72	1.28%	20-06-21
PWLB	3,840	3.31%	15-09-21
Total	**4,009**		

6.4 Borrowing may be undertaken during the second half of this financial year and options will be reviewed in due course in line with market conditions. The capital programme is being kept under regular review due to the effects of coronavirus and shortages of materials and labour. The council's borrowing strategy will therefore also be regularly reviewed and then revised, if necessary, in order to achieve optimum value and risk exposure in the long-term.

6.5 The graph and table below show the movement in PWLB borrowing rates for the first six months of the year to 30 September 2021.

6.6 PWLB borrowing rates during half year ended 30th September 2021



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.78%	1.05%	1.39%	1.75%	1.49%
Date	08/04/2021	08/07/2021	05/08/2021	17/08/2021	10/08/2021
High	0.98%	1.42%	1.81%	2.27%	2.06%
Date	24/09/2021	28/09/2021	28/09/2021	13/05/2021	13/05/2021
Average	0.84%	1.16%	1.60%	2.02%	1.81%
Spread	0.20%	0.37%	0.42%	0.52%	0.57%

6.7 Gilt yields and PWLB rates were on a falling trend between May and August. However, they rose sharply towards the end of September.

6.8 Link's 50 year PWLB target certainty rate for new long-term borrowing started 2021-22 at 1.90%, rose to 2.00% in May, fell to 1.70% in August and returned to 2.00% at the end of September after the MPC meeting of 23rd September.

6.9 The current PWLB rates are set as margins over gilt yields as follows: -

- **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
- **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

6.10 Debt rescheduling opportunities have been very limited in the current economic climate and following the various increases in the margins added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year. The council is currently under-borrowed to address investment counterparty risk and the differential between borrowing and investment interest rates. This position is carefully monitored.

6.11 The council's budgeted debt interest payable for 2021-22 is £1.368m (£0.684m half-year) and performance for the first half of the financial year is below budget at £0.466m, reflecting the use of internal borrowing (see section 6.1). The revised estimate for 2021-22 is £1.056m.

7 Treasury Management Indicators

7.1 Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	2021-22 Original Indicator	2021-22 Revised Indicator
GF	11.7%	9.4%
HRA	6.2%	5.0%

7.2 Maturity Structures of Borrowing

These gross limits are set to reduce the council's exposure to large fixed rate sums falling due for refinancing.

	2021-22 Original Upper Limit	Current Position – Actual at 30-09-21	2021-22 Revised Upper Limit
Maturity structure of fixed rate borrowing			
Under 12 months	50%	24%	50%
1 year to under 2 years	50%	2%	50%
2 years to under 5 years	50%	13%	50%
5 years to under 10 years	50%	12%	50%
10 years to under 20 years	50%	35%	50%

20 years to under 30 years	50%	9%	50%
30 years to under 40 years	50%	0%	50%
40 years to under 50 years	50%	5%	50%
50 years and above	50%	0%	50%

The current position shows the actual percentage of fixed rate debt the authority has within each maturity span. None of the upper limits have been breached.

8 Options

8.1 The recommended option (to ensure regulatory compliance as set out in section 1 of this report) is that council:

- Makes comments on this report and annexes as appropriate.
- Approves this report and annexes (including the prudential and treasury indicators that are shown and the proposed changes to the 2021-22 Treasury Management Strategy Statement).

8.2 Alternatively, council may decide not to do this and advise the reason(s) why.

9. Disclaimer

9.1 This report (including annexes) is a technical document focussing on public sector investments and borrowings and, as such, readers should not use the information contained within the report to inform personal investment or borrowing decisions. Neither Thanet District Council nor any of its officers or employees makes any representation or warranty, express or implied, as to the accuracy or completeness of the information contained herein (such information being subject to change without notice) and shall not be in any way responsible or liable for the contents hereof and no reliance should be placed on the accuracy, fairness or completeness of the information contained in this document. Any opinions, forecasts or estimates herein constitute a judgement and there can be no assurance that they will be consistent with future results or events. No person accepts any liability whatsoever for any loss howsoever arising from any use of this document or its contents or otherwise in connection therewith.

Contact Officer: Chris Blundell, Director of Finance & Acting Section 151 Officer
Reporting to: Madeline Homer, Chief Executive

Annex List

Annex 1: Economic Update, Interest Rate Forecast and Debt Maturity
Annex 2: Guidance on the Treasury Management Strategy Statement and Annual Investment Strategy – Mid Year Review Report 2020-21

Corporate Consultation Undertaken

Finance: N/A
Legal: Estelle Culligan, Deputy Monitoring Officer