DF/21/11
Corporate Infrastructure & Regulatory Services Scrutiny Committee
18 November 2021

Treasury Management – Mid Year Stewardship Report 2021-22

Report of the Director of Finance (Designate)

Please note that the following recommendations are subject to consideration and determination by the Committee before taking effect.

Recommendation: That the Committee consider whether it wishes to draw to the attention of the Cabinet any observations on the Treasury Management Mid Year Stewardship Report.

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1. Introduction

1.1 The County Council has adopted the CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management in the Public Services. A revised Code of Practice was published by CIPFA in December 2017 and a revised Policy Statement and Treasury Management Practices (TMPs) were agreed by Council in February 2018. The Treasury Management and Investment Strategy for 2021/22 was agreed by Council in February 2021 and forms part of the published budget book.

1.2 The purpose of this report is to inform members of any key matters arising from the Council's Treasury and Debt Management activities during the first seven months of the 2021/22 financial year. It is intended to enable members to ensure that agreed policy is being implemented. This report, together with any comments offered by this committee, will be considered by Cabinet on 8th December.

2. Borrowing Strategy 2021-22 to 2023-24

2.1 The overall aims of the Council's borrowing strategy are to achieve:

- Borrowing at the lowest rates possible in the most appropriate periods;
- The minimum borrowing costs and expenses;
- A reduction in the average interest rate of the debt portfolio.

2.2. The Medium Term Financial Strategy assumes that, over the three year period, no new long-term borrowing will be required, although this will be kept under review. The majority of the capital programme is funded by capital grants or use of capital receipts. Some use is made of internal borrowing from the Council's cash resources, and prudent management of the capital programme aims to ensure that there is no requirement to take on additional
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external borrowing. If short-term borrowing is required to aid cashflow, this will be targeted at an average rate of 0.1%.

2.3 Active treasury management and the maintenance of levels of liquidity have ensured that no short term borrowing has been required for the financial year to date. Cash positions are monitored daily and modelled over a monthly horizon to ensure that anticipated liquidity levels are forecast accurately.

2.4 In accordance with the Medium Term Financial Strategy no long term external borrowing has been undertaken this financial year. Instead, all borrowing required to fund capital expenditure has been funded by internal cash balances.

2.5 At 31st October 2021 the level of long term debt remains unchanged at £507.85m as detailed in the table below.

Analysis of Long Term Debt

	Actual 31.03.21 £'m	Interest Rate %	Actual 31.10.21 £'m	Interest Rate %
Fixed Rate Debt				
PWLB	436.35	4.99	436.35	4.99
Money Market	71.50	5.83	71.50	5.83
Variable Debt				
PWLB	0.00		0.00	
Money Market	0.00		0.00	
Total External Borrowing	**507.85**	**5.11**	**507.85**	**5.11**

2.6 Every year the Council budgets for a Minimum Revenue Provision to set aside cash to then repay this external debt. At the same time, we are then borrowing that cash back, by way of internal borrowing from the Council's cash balances to finance the capital programme. The ability to internally borrow from the Council's cash has enabled the Council to fund its capital programme in recent years without taking out further external debt and incurring additional interest costs and other capital financing costs.

2.7 While cash balances remain relatively high, we can continue to internally borrow to meet our capital commitments and maintain a measured level of future capital investment. However, this may become more challenging if there continues to be growing pressure on both the Council's capital programme and revenue budget, and other calls on cash balances such as the deficit on Special Educational Needs.

2.8 No opportunities have arisen during this financial year to repay external debt without incurring substantial premium penalties, which would negate any benefit of repaying the debt. The PWLB sets premature repayment rates and, where the interest rate payable on a current loan is higher than the repayment rate, the PWLB policy imposes premium penalties for early repayment. With current low rates of interest these penalties would be of a significant cost. Therefore, it will only make financial sense to repay debt early if the PWLB changes its current policy, or if interest rates rise significantly and cancel out the repayment premiums. This is unlikely to happen in the short to medium term.

2.9 The earliest date on which any of the Council's external debt matures is 31 March 2027, when the Council is due to repay a PWLB loan of £33.8 million, with a further £5.8 million to be repaid later in 2027. While this may still seem a long time away, officers have begun to consider plans for the repayment of these loans. Given that the Council's capital programme is "over borrowed" from its internal cash, there will need to be careful management of future capital requirements to ensure that cash resources are available so that these loans can be repaid, otherwise there might be a future need to take out new external borrowing to re-finance the debt.

3. Investment Strategy 2021-22

3.1 The County Council continues to adopt a very prudent approach to counterparties to whom the County Council is willing to lend. As a result, only a small number of selected UK banks and building societies, money market funds and Non-Eurozone overseas banks in highly rated countries are being used, subject to strict criteria and the prudent management of deposits with them. In addition, the CCLA (Churches, Charities and Local Authorities) Property Fund is being used. The lending policy is kept under constant review with reference to strict criteria for inclusion in the counterparty list.

3.2 The 2021/22 Treasury Management Strategy also included provision for the use of multi-asset income funds or short dated bond funds. Use of such funds would be subject to the approval of the Cabinet Member for Resources Management.

3.3 The overall aim of the Council's investment strategy is to:

- Limit the risk to the loss of capital;
- Ensure that funds are always available to meet cash flow requirements;
- Maximise investment returns, consistent with the first two aims;
- Review new investment instruments as they come to the Local Authority market, and to assess whether they could be a useful part of our investment process.

3.4 The target rate for interest on deposits with banks, building societies and money market funds is 0.3%. The target rate for the CCLA Property Fund is 3.8%.

3.5 The following table shows the County Council's fixed and variable rate investments as at the start of the financial year and as at 31st October 2021:

Schedule of Investments

	Maturing in:	Actual 31.03.21 £'m	Interest Rate %	Actual 31.10.21 £'m	Interest Rate %
Bank, Building Society & MMF Deposits					
Fixed Rates					
Term Deposits	< 365 days	80.00	0.86	157.50	0.17
	365 days & >	18.00	1.13	26.00	0.90
Variable Rate					
Call Accounts		20.46	0.03	28.62	0.03
Notice Accounts		70.00	0.16	50.00	0.19
Money Market Funds (MMF's)		0.00	0.00	0.00	0.00
Property Fund		10.00	4.21	10.00	4.14
All Investments		**198.46**	**0.72**	**272.12**	**0.37**

3.6 Following the outbreak of the Covid pandemic the Bank of England reduced its base rate firstly to 0.25% and then to 0.1% during March 2020. As a result, the target for investment income from banks, building societies and local authorities was reduced to 0.3% for 2021/22. The average rate achieved for the year to date (not including the CCLA Property Fund) is 0.28%. The return achieved for the £10 million investment in the CCLA Property Fund remains at just over 4%.

3.7 The total level of cash remains high. Generally, cash does increase during the early part of the year as grants are received in advance of spend, with a gradual reduction during the Autumn and Winter. It is anticipated that the cash balance at the 31st March 2022 will be lower than the balance at the beginning of the financial year, but that will depend on the level of slippage on the capital programme and the level of carry-forwards at year end.

3.8 Revenue lending up to 31st October, including the use of term deposits, call accounts, money market funds and the CCLA property fund, has earned interest of £583,000 against a full year budget of £800,000. It is forecast that the investment income for the full financial year will exceed budget by around £150,000.

3.9 This position results from the higher than anticipated levels of cash being invested. The level of carry-forwards and additions to revenue reserves from the 2020/21 outturn position has contributed to the high levels of cash, along with the additional funding provided by Government for Covid related issues. It is anticipated that Covid related expenditure will reduce the levels of cash by year end.

4. Minimum Revenue Provision

4.1 Each year the Council has a statutory obligation to charge to the revenue account an annual amount of Minimum Revenue Provision (MRP), which is a charge to make provision for the repayment of the authority's external debt and internal borrowing. The charge is based on the historic borrowing required to fund the Council's capital programme.

4.2 The current policy, following a review in 2018/19 is to charge MRP in equal instalments over the life of the asset benefiting from the capital spend, based on the annuity method. The budgeted MRP for 2021/22 is £12.996 million.

5. Prudential Indicators

5.1 Linked to its Treasury Management Strategy, the County Council is required to monitor its overall level of debt in line with the CIPFA Code of Practice. Part of the code requires consideration of a set of Prudential Indicators in order to allow the Council to form a judgement about the affordable, prudent and sustainable level of debt.

5.2 The purpose of the indicators is to demonstrate that:

- Capital expenditure plans are affordable;
- All external borrowing and other long term liabilities are within prudent and sustainable levels;
- Treasury management decisions are taken in accordance with professional good practice.

5.3. Three Prudential Indicators control the overall level of borrowing. They are:

- The Authorised Limit - this represents the limit beyond which any additional borrowing is prohibited until the limit is revised by the County Council. Revision may occur during the year if there are substantial and unforeseen changes in circumstances, for example, a significant delay in achieving forecast capital receipts. In normal circumstances this limit will not require revision until the estimate for 2022/23 is revised as part of the 2022/23 budget process.
- The Operational Boundary – this indicator is based on the probable external debt and other long term liabilities during the year. Variations in cash flow may lead to occasional, short term breaches of the Operational Boundary that are acceptable.
- The Underlying Borrowing Requirement to Gross Debt - the Council also needs to ensure that its gross debt does not, except in the short term, exceed the total of the Capital Financing Requirement.

5.4 During the Budget process, the following Borrowing Limits were set for 2021/22:

- Maximum borrowing during the period (Authorised Limit) - £766.193 million.
- Expected maximum borrowing during the year (Operational Boundary) - £741.193 million.
- Maximum amount of fixed interest exposure (as a percentage of total) - 100%
- Maximum amount of variable interest exposure (as a percentage of total) - 30%

5.5 Members are asked to note that for 2021/22 to date, the Council has remained within its set Borrowing Limits and has complied with the interest rate exposure limits.

6. Prospects for 2022/23

6.1 There was significant expectation that the Bank of England Monetary Policy Committee would increase interest rates at their meeting on 4th November. While this did not happen, there is still an expectation that rates will increase in the next few months. Emerging supply constraints on economic output, plus an increase in inflation expectations have prompted the change in outlook. Our Treasury Advisors, Link, forecast an increase in the base rate from 0.1% to 0.25% by June next year, with other economists predicting an earlier increase. As a result, we have seen the rates offered by banks and building societies increase over the last few weeks.

6.2 This provides the possibility of a small improvement in the return that can be achieved from investing the Council's cash balances. Should bond yields begin to rise there may also be benefit in initiating an investment in short-dated bond funds. However, in setting the target for next year, it would be wise to be prudent. Therefore, the target return for 2022/23 is likely to be similar to the target for 2021/22, with perhaps a small uplift.

6.3 There is also likely to be significant pressure on the Council's finances going forward. Significant expenditure has been committed to support the response to the pandemic, while the Council also faces a growing deficit on the provision for Special Educational Needs (SEND). While at the end of October 2021 the cash balances remain high, this has been partly due to the front-loading of Government grants related to the pandemic, and as this continues to be spent, and the SEND deficit grows, it is likely that the cash balances will reduce significantly before the financial year end.

6.4 In planning the Treasury Management Strategy for 2022/23, the target rate for lending to banks and building societies is likely to remain close to the 2021/22 target of 0.3%, with perhaps a small increase. This may allow a small increase in the budgeted income for 2022/23 over the current year. These assumptions will be reviewed before the 2021/22 Strategy is presented in January.

6.5 During the Autumn, CIPFA has been consulting on a revised Prudential Code and a revised Treasury Management Code. As a result, it will be necessary to review the Council's Treasury Management Practices in line with the new code. This will include the introduction of new prudential indicators which will need to be included within the Treasury Management Strategy. The main aim of the revised codes appears to be to ensure that borrowing is properly controlled and to reduce the amount of borrowing undertaken by local authorities to fund commercial investment to achieve a return rather than to meet service priorities. This should be less of a concern to Devon County Council, as our policy has not been to borrow to fund long term investments.

7. Summary

7.1. No long term borrowing has been undertaken to date in 2021/22. The expectation is that no new borrowing will be required during the remainder of the 2021/22 financial Year.

7.2 No short term borrowing has been undertaken to date in 2021/22.

7.3 The investment income achieved as at the end of October stands at around £580,000 compared to the budget target for the year of £800,000.

7.4 Looking ahead, there may be a small increase in the rates available for treasury investments in 2022/23, but rates will remain very low. The Council will need to manage its capital programme carefully to ensure it remains affordable within the policy of not taking out further external debt.

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Electoral Divisions: All

Local Government Act 1972:
List of Background Papers: Nil
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