SURREY
COUNTY COUNCIL

Audit & Governance Committee
29 November 2021

TREASURY MANAGEMENT MID YEAR REPORT 2021/22

Purpose of the report:

This report summarises the Council's treasury management activity during the first half of 2021/22, as required to ensure compliance with CIPFA's Code of Practice for Treasury Management

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Recommendations:

The Audit & Governance Committee is asked to note the content of the Treasury Management Mid-Year Report for 2021/22

Introduction:

1. The Authority has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in Public Services: Code of Practice (the CIPFA Code) which requires the authority to produce treasury management mid-year and annual reports.

2. The Authority's Treasury Management Strategy Statement for 2021/22 was approved at the Audit and Governance Committee meeting on 29 January 2021. The investing and borrowing of cash potentially exposes the Council to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's Treasury Management Strategy.

External Context

3. Annex 1 contains commentary from Arlingclose, our Treasury Management advisors, on the economic backdrop for 2021/22. The economic recovery from the Covid-19 pandemic continued to dominate the first half of the year. The impact on Treasury Management activities is relatively limited as it has resulted in very low interest rates which

support our strategy of minimising cash balances and meeting our borrowing requirement with short-term debt.

4. The Bank of England (BoE) held Bank Rate at 0.1% throughout the period and maintained its Quantitative Easing programme at £895 billion, unchanged since the November 2020 meeting. In its September 2021 policy announcement, the BoE noted it now expected the UK economy to grow at a slower pace than was predicted in August, as the pace of the global recovery had shown signs of slowing and there were concerns inflationary pressures may be more persistent. Within the announcement, Bank expectations for GDP growth for the third (calendar) quarter were revised down to 2.1% (from 2.9%), in part reflecting tighter supply conditions. The path of CPI inflation is now expected to rise slightly above 4% in the last three months of 2021, due to higher energy prices and core goods inflation. While the Monetary Policy Committee meeting ended with rates unchanged, future rises now appear more likely.

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5. The revenue budget for interest costs over the five-year medium term financial strategy is set in the knowledge that current rates are at a historic low and that some increases are to be expected, including a contingency to deal with that eventuality. Officers discuss the best balance of short-term variable debt as against long-term fixed rate debt on a regular basis with Arlingclose and decisions are taken with the risk of interest rate rises in mind.

Mid-Year Treasury Management Report 2021/22

Overview

6. Table 1 shows that the Authority held a net borrowing position of £660m on 31 March 2021 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 useable reserves and working capital are the underlying resources available for investment.

7. The Treasury Management Strategy for 2021/22, approved by Audit and Governance Committee in January 2021, continued the policy of internal borrowing. This maintains borrowing below its underlying level by utilising available cash balances on a temporary basis (i.e. working capital and useable reserves) which are not required in the short to medium term. This approach reduces market and credit risk for the investment portfolio and reduces borrowing costs. The Balance sheet position at 31 March 2021 is summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31/03/21 Actual £m
General fund CFR	1,344
Less: Other long-term liabilities	(186)
Gross Borrowing Requirement	**1,158**
Less: useable reserves and working capital	(498)
Net Borrowing Requirement	**660**

8. The Council also manages cash on behalf of Surrey Police and Crime Commissioner, the balance of which was £29.6m as at 30 September 2021. The Council accounts for this as short-term borrowing. The treasury management position as at 30 September 2021 and the change over the six months is summarised in Table 2.

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Table 2: Treasury Management Summary

	31/03/21 Balance £m	Movement £m	30/09/21 Balance £m
Long-term borrowing*	434	(2)	432
Short-term borrowing	273	(123)	150
Surrey Police	12	18	30
Total Borrowing	**719**	**(107)**	**612**
Money Market Funds	(59)	48	(11)
Net Borrowing	**660**	**(59)**	**601**

*Total Long-Term Borrowing is £444m, which includes £4.3m of Local Enterprise Partnership (LEP) loans and £6.1m of Salix which are managed outside of the Treasury Management Strategy.

Borrowing Strategy

9. At 30 September 2021 the Authority held £612m of loans (a decrease of £107m since 31 March 2021).

10. The reduction in short-term borrowing of £123m is due primarily to a reduction of £48m of investment balances held in Money Market Funds; and receipt of £46m Schools Basic Need grant.

11. Outstanding loans on 30 September 2021 are summarised in Table 3 below.

Table 3: Borrowing position

	31/03/21 Balance £m	Net change £m	30/09/21 Balance £m	30/09/21 Weighted average rate %	30/09/21 Weighted average maturity (years)
Public Works Loan Board	424	(2)	422	3.86	28 years
Banks (fixed-term)	10	-	10	5.00	32 years
Local Authorities (short-term)	273	(123)	150	0.09	< 1 year
Surrey Police & Crime Commissioner	12	18	30	0.10	0 days
Total Borrowing	**719**	**(107)**	**612**		

12. The Authority's main objective when borrowing has been to strike a balance between securing low interest rates an achieving cost certainty over a period for which funds are required. This position provides short term savings with the flexibility to secure longer dated loans as and when
11 the level of funds available for internal borrowing reduces, or financial forecasts indicate that external borrowing rates may increase.

13. In order to best meet these objectives, no new long-term borrowing was undertaken in the first half of 2021/22; internal borrowing was maximised, and short-term borrowing was utilised to manage cash flow. This strategy enabled the authority to minimise net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

14. Discussions with Arlingclose did not indicate any immediate need to borrow in advance for future years' planned expenditure and therefore none was taken.

15. A cost of carry assessment is currently being re-visited to ascertain how the change in interest rate expectations over the last month impacts on the outlook for the Council's borrowing strategy and borrowing decisions.

Investment Activity

16. The Authority holds invested funds, representing income received in advance for expenditure plus balances and reserves held. During the first half of 2021/22 the Authority's average daily level of investments was £58m compared to £67m for the first 6 months of 2020/21.

17. The Council can place cash on deposit on the money market through brokers, directly with counterparties, through the use of call accounts, money market funds or direct deal facilities, or with the Debt Management Office (DMO). No new fixed term deposits have been agreed during the first half of 2022/22. All investments have been made through overnight money market funds.

18. The weighted average return on all investments the council received in the quarter to 30 September 2021 is 0.02%. This compares to the average Bank of England (BoE) base rate of 0.10% for the same period.

Table 4: Investment Benchmarking

	BoE base rate	Weighted return on Investments
2021/22 Quarter 2	0.10%	0.02%
2021/22 Quarter 1	0.10%	0.02%
2020/21 Total	0.10%	0.14%
2019/20 Total	0.72%	0.69%

19. Both the CIPFA Code and the government's Investment Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike and appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. In furtherance of these objectives, the Council's strategy of maximising internal borrowing has reduced the cash available for investment and reduced the scope of creating longer-term investment deposits.

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20. 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 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.

Other Investment Activity

21. The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return.

The Authority holds the following non-treasury investments:

- £122m of directly owned investment property
- £240m of loans to Halsey Garton Ltd
- £96m of equity investments in Halsey Garton Ltd
- £3m of loans to other subsidiaries

22. It is projected that these non-treasury investments will generate £10.8m net investment income for the Authority in 2021/22 after taking account of direct costs and Minimum Revenue Provision (MRP).

23. The Council has updated the MRP Policy to ensure it is prudent in light of recent fluctuations in fair value of investment properties held by the subsidiary. The repayment profile of the loan is periodically reviewed to determine whether principal repayment is required over the asset's life on top of the current MRP provision. This is to ensure prudent provision to repay the Capital Financing Requirement over the asset's life.

Treasury Performance

24. The authority measures the financial performance of its treasury management activities in terms of its impact on the revenue budget. Table 5 outlines the forecast for the interest payable and interest receivable budget for the full year of 2021/22. Currently both interest payable and interest receivable are forecast to budget as both depend on the level of capital expenditure for the remainder of the year and the extent to which this is funded through borrowing.

Table 5: Revenue implications of treasury management activity

	Budget £m	**Full Year Forecast £m**	**Variance £m**
Interest Payable	17.7	17.2	(0.5)
Interest Receivable	(0.003)	(0.003)	0.0

Revision to CIPFA Codes

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25. 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.

26. 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:

- a clarification that local authorities must not borrow in order to invest primarily for financial return;
- the requirement for Authorities to categorise investments for Treasury purposes, commercial purposes and for service delivery purposes;
- the introduction of Investment Management Practices (IMPs) by which local authorities will need to start monitoring their non-treasury investment portfolios;
- the requirement to for local authorities to assess the proportionality of non-treasury investments in the authorities overall financial capacity; and
- some revisions in the prudential indicators, including the inclusion of the liability benchmark to measure the need to borrow.

27. The revisions, if implemented as drafted, are not expected to have a significant impact on the authority's activities but will increase the reporting requirements of the authority in respect of non-treasury investments among other items.

Treasury Advisors

28. The Authority's current contract for treasury advisory services with Arlingclose expires on 31 December 2021. A tender process is underway to re-procure these services which is expected to be concluded in the first half of December.

29. The outcome of the procurement will be reported alongside the presentation of the Authority's Treasury Management strategy for 2022/23 in January 2022.

Compliance Report

30. All treasury management activities undertaken during the first half of 2021/22 comply fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits, the authorised borrowing limit and operational boundary for external debt, is demonstrated in tables 6 and 7 below.

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Table 6: Debt Limits

	01/04/21 to 30/09/21 Maximum £m	30/09/21 Actual £m	2021/22 Operational Boundary £m	2021/22 Authorised Limit £m	Complied?
Total Less: Other long-term liabilities			1,435 (137)	1,729 (116)	
Underlying Borrowing	**738**	**612**	**1,298**	**1,613**	✓

31. 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 considered a compliance failure. Total debt did not exceed the operational boundary in any period during the first half of 2021/22.

Table 7: Investment Limits

	01/04/21 – 30/09/21 Maximum £m	30/09/21 Actual £m	2021/22 Limit £m	Complied?
UK Central Government	0	0	Unlimited	✓
Money Market Funds	153	11	Unlimited	✓
Any group of pooled funds under the same management	0	0	25	✓
Any group of organisations under the same ownership	0	0	20	✓

Any single organisation, except the UK Central Government	0	0	20	✓
Unsecured Investments with Building Societies	0	0	10	✓

Treasury management Indicators

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

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

Table 8: Maturity Structure of Borrowing

	30/09/21 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	31%	60%	0%	✓
12 months and within 24 months	0%	50%	0%	✓
24 months and within 5 years	0%	50%	0%	✓
5 years and within 10 years	0%	75%	0%	✓
10 years and above	69%	100%	25%	✓

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34. Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

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

Table 9: Principal invested for more than one year

	30/09/21 Actual £m	2021/22 Limit £m	Complied?
Principal invested for more than one year	0	40	✓

Other Implications

Financial and value for money implications

36. The direct financial implications of this report are highlighted in table 5 and form part of the monthly budget monitoring report to Cabinet.

Equalities and Diversity Implications

37. There are no direct implications of this report.

Risk Management Implications

38. The noteworthy risks posed by Treasury management are outlined in the body of the report and are monitored through the Authority's compliance with the approved Prudential and Treasury Management Indicators.

Next steps:

a. The Treasury Team will continue to monitor the UK and overseas economy and banking sector and will continue to update this Committee as appropriate.

b. In line with the requirements of CIPFA's Code of Practice for Treasury Management, a full-year report for 2021/22 will be bought to the Committee after financial year end.

c. Corporate Finance will prepare the annual Treasury Management Strategy for 2022/23, which will be presented to this committee in January 2022 for approval.

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Sources/background papers:

- Capital Budget, Prudential Indicators and Treasury Management Strategy 2021/22.
- CIPFA Code of Practice for Treasury Management
- CIPFA Prudential Code

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