SURREY
COUNTY COUNCIL

Audit & Governance Committee
13 June 2022

2021/22 TREASURY MANAGEMENT OUTTURN REPORT

Purpose of the report:

This report summarises the Council's treasury management activities during 2021/22, as required, to ensure compliance with the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Authority to approve a treasury management annual report after the end of each financial year.

Recommendations:

It is recommended that the committee note the content of the Treasury Management Outturn Report for 2021/22 and compliance with all Prudential Indicators.

Background:

1. The Authority has 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 Authority to approve Treasury Management half-year and annual outturn reports. This is the annual outturn report for 2021/22.

2. The Authority's Treasury Management Strategy Statement and Prudential Indicators for 2021/22 were approved at Audit & Governance Committee on 29 January 2021. The investment and borrowing of cash 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 Authority's Treasury management Strategy.

3. An economic commentary provided by our expert Treasury Management Advisors, Arlingclose is included in Annex 1 (produced in March 2022)

Treasury Management Annual Report 2021/22

Overview

4. On 31 March 2022, the Authority had net borrowing of £566m arising from its revenue and capital income and expenditure, a decrease of £104m since 31 March 2021. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), which represents the amount of capital expenditure that is not funded from capital receipts, government grants, third party contributions or revenue.

5. Net borrowing has decreased due to the combination of an increase in working capital and useable reserves and a small reduction in the CFR. The CFR reduction was due to the minimum revenue provision being higher than new capital expenditure funded by borrowing. This is set out in table 1, below:

Table 1: Balance Sheet Summary

	31/03/21 Balance £m	2021/22 Movement £m	31/03/22 Balance £m
General Fund CFR	1,341	(6)	1,335
Less PFI Liabilities	(95)	4	(91)
Gross Borrowing Requirement	**1,246**	**(2)**	**1,244**
Less usable reserves and working capital	(586)	(92)	(678)
Net Borrowing Requirement	**660**	**(94)**	**566**

Note: Columns do not sum due to rounding

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6. The Treasury Management Strategy for 2021/22, approved by Audit & Governance Committee in January 2021, continued the policy of internal borrowing wherever possible. This maintains borrowing below its underlying level by using available reserves and working capital to reduce the need for external borrowing. This minimises interest rate risks and keeps interest costs low.

7. The Council also manages cash on behalf of Surrey Police and Crime Commissioner, the balance of which was £25.7m as at 31 March 2022. The Council accounts for this as short-term borrowing. The treasury management position as at 31 March 2022 and the year-on-year change is show in table 2 below.

Table 2: Treasury Management Summary

	31/03/21 Balance £m	2021/22 Movement £m	31/03/22 Balance £m
Long-term borrowing	434*	47	481*
Short-term borrowing	273	(73)	200
Surrey Police	12	14	26
Total borrowing	**719**	**(12)**	**707**
Money Market Funds	(59)	(82)	(141)
Net borrowing	**660**	**(94)**	**566**

*Total long term borrowing is £496m. This includes £1.7m of Local Enterprise Partnership (LEP) loans, £13m of Salix which are managed outside of the Treasury Management.

Borrowing Activity

8. At 31 March 2022, the Authority held £707m of borrowing, a decrease of £12m on the previous year. The sources of borrowing, interest rates and the year-on-year change is show in table 3 below.

Table 3: Borrowing Position

	31/03/21 Balance £m	2021/22 Net Movement £m	31/03/22 Balance £m	31/03/22 Rate %
Public Works Loan Board (PWLB)	424	47	471	3.67
Banks (fixed-term)	10	0	10	5.00
Local authorities (short-term)	273	(73)	200	0.14
Surrey Police & Crime Commissioner	12	14	26	0.75
Total borrowing	**719**	**(12)**	**707**	

9. The Authority's primary consideration when borrowing money is to balance low interest charges and cost certainty over the period, while allowing enough flexibility to renegotiate a portion of the debt portfolio based upon changing strategic needs. The Authority has explored the potential for early repayment of the £10m bank loan at 5% but the penalties of early repayment are prohibitively high. The average interest rate of PWLB loans has been falling over time and as existing loans mature, they are replaced with new loans at lower rates. 9

10. In keeping with these objectives, £50m of new long-term borrowing was undertaken in 2021/22 to maintain an appropriate balance of long and short term debt, undertaking long-term debt to provide cost certainty at a time when PWLB rates were attractive. Details of the new PWLB loans are detailed below.

Table 4: New Long-term Borrowing

Long Dated Loans borrowed	Amount £m	Rate %	Period (years)
PWLB EIP Loan (493192)	50	1.98%	20
Total new Borrowing	**50**	**1.98%**	**20**

Investment Activity

11. The Authority holds invested funds, representing income received in advance of expenditure, plus reserves and balances held which have not been utilised for internal borrowing.

12. Both the CIPFA Code and government 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 an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

13. In furtherance of these objectives and given the continuing risk and low returns from short-term unsecured bank investments, the Authority has kept its cash balances and investments low throughout 2021/22 and invested funds principally in Money Market Funds to ensure liquidity. During the year, the Authority's investment balance ranged between £3.9m and £170.9m. The Council's average daily level of cash investments was £59.6m during 2021/22, compared to an average of £57.1m during 2020/21. The Council invests temporary cash surplus exclusively through the use of money market funds (MMF).

14. The year-end investment position and the year-on-year change is show in table 5 below:

Table 5: Investment Position (Treasury Investments)

	31/03/21 Balance £m	2021/22 Net Movement £m	31/03/22 Balance £m	31/03/22 Rate* %
Money Market Funds	59	82	141	0.10
Total Investments	**59**	**82**	**141**	**0.10**

*weighted average rate earned in the year

15. The weighted average return on all investments the Council received in the year to 31 March 2022 was 0.10%. Ultra-low short-dated cash rates, which were a feature since March 2020 when Bank Rate was cut to 0.10%, 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. At 31 March, the 1-day return on the Authority's MMFs ranged between 0.47% and 0.55%.

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Financial Implications

16. The outturn for interest paid, interest received and the minimum revenue provision are outlined in table 6 below.

Table 6: Revenue Implications of Treasury Management Activity

	Budget £m	Outturn £m	Variance £m
Interest Paid	17.9	16.8	(1.1)
Interest Received	(0.03)	(0.02)	(0.01)
MRP	18.8	20.7	0.9

17. The amount of the Authority's revenue budget required to be set aside for the future repayment of external borrowing is known as the Minimum Revenue Provision (MRP). This amount is calculated by reference to the Council's balance sheet as at the end of the previous financial year. The overspend relates to a change in MRP policy ins respect of funding provided to subsidiaries. This is due to providing for recent fluctuations in fair value of investment properties held by the subsidiary, by reviewing the repayment profile of the loan to determine whether principal repayment is required over the asset's life to ensure prudent provision is made to repay the Capital Financing Requirement over the asset's life. This was the first year in which the change to the MRP policy has been applied.

The underspend in interest payable reflects the persistent low interest rates on short term debt and a reduced average debt balance.

Compliance Report

18. All treasury management activities undertaken during 2021/22 complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits, the authorised limit and operational boundary for external debt, is demonstrated in tables 7 & 8 below.

Table 7: Debt Limits

	2021/22 Maximum actual position £m	31/03/22 Actual £m	2021/22 Operational Boundary £m	2021/22 Authorised Limit £m	Complied
Total			1,435	1,935	
Less: Other long term liabilities (PFI)			(137)	(137)	
Underlying Borrowing	740	707	1,298	1,798	✓

19. 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 at any point in 2021/22.

Table 8: Investment Limits

	2021/22 Maximum actual position £m	31/03/22 Actual £m	2021/22 Limit £m	Complied
UK Central Government	0	0	Unlimited	✓
Money Market Funds	171	141	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

20. The Authority measures and manages its exposure to treasury management risks using the following indicators.

Security: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard is therefore given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis. No investments will be made with an organisation if there are substantive doubts about its credit quality. In addition, if insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills or with other Local Authorities.

Liquidity: The Council manages its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments. The Council maintains a bank overdraft of £100,000, utilises overnight access Money Market Funds and accesses short term borrowing to meet cash flow requirements. The Local Authority market provides readily available funds.

Interest Rate Exposures:

The Council had £200m of short-term borrowing at 31 March 2022, with an additional £153m expected to be required to finance the 2022/23 capital programme, which would result in total of £353m by March 2023. Short term borrowing is subject to variable interest rates linked to the Bank of England (BoE) base rate, meaning it is subject to interest rate risk if the base rate increases. The Council's Treasury Management advisor Arlingclose has forecast an increase in interest rates to 1.25% in the short term, this is an additional increase of 0.5% compared to when the budget was set for interest and would result in a potential increase of £1.1m in interest costs by March 2023, assuming an even profile of borrowing to fund capital expenditure in 2022/23 and factoring in the Q1 BoE rate decision has already passed with a 0.25% increase in rates to 0.1% in May 2022. The Council has set aside £2.1m in reserves to mitigate variable interest rate exposure which more than covers this interest exposure scenario. In addition, the Council continually monitors the capital programme throughout the year and will borrow to address requirements driven by the cash flow forecast, including updates on the level of capital expenditure being incurred against the programme budget.

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 fixed rate borrowing were:

Table 9: Maturity Structure of Borrowing

	31/03/22 Actual	**Upper Limit**	**Lower Limit**	**Complied**
Under 12 months	37%	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	67%	100%	25%	✓

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 interest rate changes.

Table 10: Sums invested for more than one year

	2021/22 Maximum actual position £m	**31/03/22 Actual £m**	**2021/22 Limit £m**	**Complied**
Sums invested for longer than one year	0	0	40	✓

Other Non-Treasury Holdings and Activity

21. Although not classed as treasury management activities, the CIPFA Code requires the Authority to report on investments for policy reasons outside of normal treasury management. This includes service investments for operational and/or regeneration as well as commercial investments which are made mainly for financial reasons.

22. The Authority holds the following non-treasury investments:
    - £122m of directly owned investment property
    - £234m of loans to Halsey Garton Property Ltd
    - £93m of equity investments in Halsey Garton Property Ltd

- £7.2m of loans to Halsey Garton Residential Ltd
- £4m of equity investments in Halsey Garton Residential Ltd
- £2m of loans to other subsidiaries

23. Such loans and investments have been approved in accordance with the Council's agreed processes. A register of such investments is maintained and performance information is reported to the Strategic Investment Board or the Shareholder and Investment Panel, in accordance with their Terms of Reference.

24. These non-treasury investments generated £6.2 of investment income for the Authority after taking account of direct costs and interest payable.

Implications:

Financial

25. The financial implications of this report are discussed in paragraph 53-55 and were included in the outturn report to Cabinet on 31 May 2022.

Equalities and Diversity Implications 9

26. There are no direct equities implications of this report

Risk Management Implications

27. The risk management arrangements in relation to treasury management are discussed in paragraph 22.

Next steps:

i. The treasury team will continue to monitor the UK and overseas banking sector and will continue to update this Committee as appropriate

ii. In line with the requirements the CIPFA Code, this Committee will receive a half yearly report on the Council's treasury management activities in December 2022 and a full year report for 2022/23 in July 2023.

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Sources/background papers:

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

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