SURREY
COUNTY COUNCIL

Audit & Governance Committee
28 November 2022

TREASURY MANAGEMENT MID YEAR REPORT 2022/23

Purpose of the report:

This report summarises the Council's treasury management activity during the first half of 2022/23, as required to ensure compliance with CIPFA's Code of Practice for Treasury Management.

Recommendations:

The Audit & Governance Committee is asked to note the content of the Treasury Management Mid-Year Report for 2022/23.

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 2022/23 was approved at the Audit and Governance Committee meeting on 24 January 2022. 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 external context for Treasury Management activity and Annex 2 provides their economic outlook for the remainder of 2022/23.

4. The ongoing conflict in Ukraine has continued to put pressure on global inflation and the economic outlook for UK and world growth remains

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weak. The UK political situation towards the end of the period following the 'fiscal event' increased uncertainty further.

5. The economic backdrop during the April to September period continued to be characterised by high oil, gas and commodity prices, ongoing high inflation and its impact on consumers' cost of living, no imminent end in sight to the Russia-Ukraine hostilities and its associated impact on the supply chain, and China's zero-Covid policy.

6. Central Bank rhetoric and action remained robust. The Bank of England, Federal Reserve and the European Central Bank all pushed up interest rates over the period and committed to fighting inflation, even when the consequences were, in all likelihood, recessions in those regions.

7. UK inflation remained extremely high. Annual headline CPI hit 10.1% in July, the highest rate for 40 years, before falling modestly to 9.9% in August. RPI registered 12.3% in both July and August. The energy regulator, Ofgem, increased the energy price cap by 54% in April, while a further increase in the cap from October, which would have seen households with average energy consumption pay over £3,500 per annum, was dampened by the UK government stepping in to provide around £150 billion of support to limit bills to £2,500 annually until 2024.

8. The Bank of England increased the official Bank Rate to 2.25% over the period. From 0.75% in March, the Monetary Policy Committee (MPC) pushed through rises of 0.25% in each of the following two MPC meetings, before hiking by 0.50% in August and again in September. August's rise was voted by a majority of 8-1, with one MPC member preferring a more modest rise of 0.25%. The September vote was 5-4, with five votes for an 0.5% increase, three for an 0.75% increase and one for an 0.25% increase. The Committee noted that domestic inflationary pressures are expected to remain strong and so given ongoing strong rhetoric around tackling inflation further Bank Rate rises should be expected.

Mid-Year Treasury Management Report 2022/23

Overview

9. Table 1 shows that the Authority held a net borrowing position of £566m on 31 March 2022 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). Useable reserves and working capital are the underlying resources available for use in the short term to reduce the gross borrowing requirement.

10. The Treasury Management Strategy for 2022/23, approved by Audit and Governance Committee in January 2022, 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 2022 is summarised in Table 1 below. 12

Table 1: Balance Sheet Summary

	31/03/22 Actual £m
General fund CFR	1,335
Less: Other long-term liabilities	(91)
Gross Borrowing Requirement	**1,244**
Less: useable reserves and working capital	(678)
Net Borrowing Requirement	**566**

11. The Council also manages cash on behalf of Surrey Police and Crime Commissioner, the balance of which was £29m as at 30 September 2022. The Council accounts for this as short-term borrowing. The treasury management position as at 30 September 2022 and the change over the six months is summarised in Table 2.

Table 2: Treasury Management Summary

	31/03/22 Balance £m	Movement £m	30/09/22 Balance £m
Long-term borrowing*	481	(12)	469
Short-term borrowing	200	(117)	83
Surrey Police	26	3	29
Total Borrowing	**707**	**(126)**	**581**
Money Market Funds	(141)	57	(84)
Net Borrowing	**566**	**(69)**	**497**

*Total Long-Term Borrowing is £496m, which includes £1.7m of Local Enterprise Partnership (LEP) loans and £13m of Salix which are managed outside of the Treasury Management Strategy.

Borrowing Strategy

12. At 30 September 2022 the Authority held £581m of loans (a decrease of £126m since 31 March 2021).

13. The reduction in short-term borrowing of £117m is due to higher cash balances at 30 September compared to 31 March 2022.

14. Outstanding loans on 30 September 2022 are summarised in Table 3 below.

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Table 3: Borrowing position

	31/03/22 Balance £m	Net change £m	30/09/22 Balance £m	30/09/22 Weighted average rate %	30/09/22 Weighted average maturity (years)
Public Works Loan Board	471	(12)	459	3.60	29 years
Banks (fixed-term)	10	-	10	5.00	31 years
Local Authorities (short-term)	200	(117)	83	1.04	< 1 year
Surrey Police & Crime Commissioner	26	3	29	1.08	0 days
Total Borrowing	**707**	**(126)**	**581**		

15. The Authority's main objective when borrowing has been to strike a balance between securing low interest rates and 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 the level of funds available for internal borrowing reduces, or financial forecasts indicate that external borrowing rates may increase.

16. The Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. The Council actively manages the borrowing position, especially in time of interest rate fluctuations, to ensure we are managing risks. £50m of new long-term borrowing was undertaken in March 22 which helped 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.

17. No new long-term borrowing was undertaken in the first half of 2022/23; internal borrowing was maximised, and short-term borrowing was utilised to manage cash flow. Monthly discussions are undertaken with Arlingclose, immediately after the Bank of England's Monetary Policy Committee meetings, to review interest rate forecasts, assess the cost of carry and review the need to undertake further borrowing in advance for future years' planned expenditure.

18. The Authority regularly reviews changes in interest rate expectations to inform the outlook for its borrowing strategy and borrowing decisions. CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the Authority.

Investment Activity

19. The Authority holds invested funds, representing income received in advance for expenditure plus balances and reserves held. During the first half of 2022/23 the Authority's average daily level of investments was £138m compared to £58m for the first 6 months of 2021/22.

20. 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 2022/23. All investments have been made through overnight money market funds.

21. The weighted average return on all investments the council received in the quarter to 30 September 2022 is 1.48%. This compares to the average Bank of England (BoE) base rate of 1.61% for the same period.

Table 4: Investment Benchmarking

	BoE base rate (average)	**Weighted return on Investments**
2022/23 Quarter 2	1.61%	1.48%
2022/23 Quarter 1	0.95%	0.77%
2021/22 Total	0.19%	0.10%
2020/21 Total	0.10%	0.14%

22. 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, in line with these codes of practice, 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.

Other Investment Activity

23. The definition of investments in CIPFA's revised 2021 Treasury Management Code covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) or for commercial purposes (made primarily for financial return).

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The Authority holds the following non-treasury investments:

- £131m of directly owned investment property
- £234m of loans to Halsey Garton Property Ltd
- £6m of loans to Halsey Garton Residential Ltd
- £93m of equity investments in Halsey Garton Property Ltd
- £4m of equity investments in Halsey Garton Residential Ltd
- £2m of loans to other subsidiaries

24. It is projected that these non-treasury investments will generate £6.8m net investment income for the Authority in 2022/23 after taking account direct costs, notional interest and Minimum Revenue Provision (MRP). This is a reduction of non-treasury investment income from last year, primarily due to £1.2m of additional MRP in 2022/23 due to the adoption of a more prudent policy regarding loans to subsidiaries (refer para 25 below) a £1.1m benefit in 2020/21 from the reversal of a bad debt provision and the loss of £0.5m of income due to the disposal of Ramsay House.

25. The Council updated its MRP Policy for 2022/23 to ensure it's prudence, in anticipation of proposed Government changes to capital finance regulations and in response to observations made by the Council's external auditors. The policy statement was reported as part of the Capital Investment and Treasury Management Strategy for 2022/23 which was approved by Council in February 2022. Where loans are made to other bodies for their capital expenditure – which includes some non-treasury investments – the Council now charges MRP as it would for any other asset. The Government is currently consulting on the final nature of changes to these regulations, which are yet to be implemented in full.

Treasury Performance

26. 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 2022/23. Current cash balances are higher than forecast and have been for the majority of the first half of the year (due to upfront receipt of grant funding and the long-term borrowing entered into in March 2022). This has meant that short-term borrowing has been lower than budgeted, mitigating the impact of higher than anticipated interest rates. Interest receivable is in excess of the budget due in part to the higher cash levels, but also by the higher interest rates achieved on the Money Market Funds.

Table 5: Revenue implications of treasury management activity

	Budget £m	**Full Year Forecast £m**	**Variance £m**
Interest Payable	17.9	17.9	0.0
Interest Receivable	(0.03)	(0.003)	(0.3)

Treasury Advisors

27. The Authority's current contract for treasury advisory services is with Arlingclose and runs for a four-year period which commenced on 1st January 2022. Arlingclose provide the Council with specific advice on investments, debt and capital finance matters.

Compliance Report

28. All treasury management activities undertaken during the first half of 2022/23 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.

Table 6: Debt Limits

	01/04/22 to 30/09/22 Maximum £m	**30/09/22 Actual £m**	**2022/23 Operational Boundary £m**	**2022/23 Authorised Limit £m**	**Complied?**
Total			1,394	1.894	
Less: Other long-term liabilities			(87)	(87)	
Underlying Borrowing	**712**	**581**	**1,307**	**1,807**	✓

29. 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 2022/23.

Table 7: Investment Limits

	01/04/21 – 30/09/22 Maximum £m	**30/09/22 Actual £m**	**2022/23 Limit £m**	**Complied?**
UK Central Government	0	0	Unlimited	✓
Money Market Funds	239	84	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	✓

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Treasury management Indicators

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

31. **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

	30/09/22 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	20%	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	80%	100%	25%	✓

32. 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.

33. **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

	30/09/22 Actual £m	2022/23 Limit £m	Complied?
Principal invested for more than one year	0	40	✓

Other Implications

Financial and value for money implications

34. 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

35. There are no direct implications of this report.

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Risk Management Implications

36. 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.

37. The Council engages regularly with its treasury advisors to assess the risk environment and actively manage our portfolio of borrowing, including the balance of short and long term debt. In addition, the Council holds an interest rate risk reserve to protect again unanticipated fluctuations in interest rates.

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 2022/23 will be bought to the Committee after financial year end.

c. Corporate Finance will prepare the annual Treasury Management Strategy for 2023/24, which will be presented to this committee in January 2023 for approval.

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Sources/background papers:

- Capital Budget, Prudential Indicators and Treasury Management Strategy 2022/23.
- CIPFA Code of Practice for Treasury Management (2021 Edition)
- CIPFA Prudential Code for Capital Finance in Local Authorities (2021 Edition)

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