

AUDIT COMMITTEE – 7 DECEMBER 2021

PART I - DELEGATED

TREASURY MANAGEMENT MID-YEAR REPORT 2021/22 (DoF)

1 Summary

- 1.1 This report gives details of the 2021/22 mid-year review of the Treasury Management function.

2 Details

- 2.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as: “the management of the local authority’s 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”.
- 2.2 The Council’s 2021/22 Treasury Management Policy as approved by Council on 23 February 2021 has the primary objectives of safeguarding the repayment of the principal and interest of its investments on time, and then ensuring adequate liquidity, with the investment return being the final objective.
- 2.3 This report updates the Committee with the progress on whether the Council is meeting the Treasury Management Policy for the first six months of 2021/22.
- 2.4 The Council has appointed treasury advisors to assist with our treasury management, Link Asset Services. The advisors have provided the following forecast:

Interest rate forecasts

| Month & Year | Bank Rate % |
|----------------|-------------|
| December 2021 | 0.25 |
| March 2022 | 0.25 |
| June 2022 | 0.50 |
| September 2022 | 0.50 |
| December 2022 | 0.50 |
| March 2023 | 0.75 |
| June 2023 | 0.75 |

2.5 The Council’s Capital Position (Prudential Indicators)

- 2.6 The Council’s capital expenditure plans are one of the key drivers of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members’ overview and confirm capital expenditure plans.
- 2.7 The capital expenditure plans are by capital receipts, grants and contributions, capital reserves or borrowing.

2.8 Capital Financing Requirement (CFR), External Debt and Operational Boundary

- **CFR** measures the Council's underlying need to borrow for capital purposes, representing the Council's total outstanding indebtedness.

External Debt (borrowing) may not exceed the CFR except in the short-term.

- **The Operational Boundary** is a limit on the level of external debt set by the Council. This is set based on the most likely prudent (ie not worst-case scenario) estimate of total external debt, in line with statutory guidance. External debt may exceed the Operational Boundary, but may not exceed the Authorised Limit for external debt, which is set at a higher level and provides further headroom for unusual cash movements or refinancing.

2.9 The CFR and Operational Boundary estimates are shown below:

| Prudential Indicator | 2021/22 Original Estimate | 2021/22 Mid-Year Projection | 2021/22 Revised Estimate |
|--|---------------------------------|-----------------------------------|--------------------------------|
| Capital Financing Requirement | £25.5m | £19.2m | £19.2m |
| External Debt / the Operational Boundary | | | |
| Borrowing | £26m | £6.7m | £6.7m |

2.10 The borrowing balance of £6.7m represents long-term loans applied to Capital Expenditure. It is net of a £1.3m loan to Watford Community Homes which the Council has borrowed to finance. Gross Debt is £8m. There is no change forecast for the CFR to the end of the year as no borrowing funded Capital Expenditure is projected to be incurred this financial year.

Limits to Borrowing Activity

The first key control over the treasury activity is a Performance Indicator (PI) to ensure that over the medium term, net borrowing (borrowings less investments) 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.

2.11 The Authorised Limit

This PI, which is required to be set and revised by Members, controls the overall level of borrowing and represents the limit beyond which borrowing is prohibited. 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 | Current Borrowing Position | 2021/22 Revised Indicator |
|------------------------------------|----------------------------|----------------------------|---------------------------|
| Borrowing | £29m | £6.7m | £18m |

2.12 Investment Portfolio 2020/21

2.13 In accordance with the CIPFA Treasury Management Code of Practice (the “TM Code”), it is the Council’s priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council’s risk appetite. The interest rate environment has created a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the Bank of England Bank Rate.

2.14 In response to the COVID-19 pandemic, the Bank reduced base rate to 0.10% in March 2020 in order to support the UK economy. Interest rates have remained at this level since. It now appears that the worst effects of the pandemic on the economy has passed although the environment remains volatile.

2.15 Returns on deposits with the UK Government’s Debt Management Office (DMO) were 0.01% for the 6 months to 30 September 2021. Interest rates are expected to rise in the final two quarters of 2021/22 as a result of inflationary pressures being felt in the wider economy. This may lead to an increase in the base rate by the Bank of England. However given this risk environment, investment returns are likely to remain relatively low.

2.16 The nature of the Council’s cash flows gives rise to very short-term cash surpluses which cannot be accommodated within the £10m counterparty limit applicable to Lloyds Bank. This exposes the Council to the achieving a negative return on deposits with the DMO. Officers will seek to minimise deposits at negative rates, but this is may be unavoidable at times during the second half of the year.

2.17 During 2020/21 the Council identified an amount of core cash available for longer-term investment. The cash was invested in a Money Market Fund managed by Royal London Asset Management. This is an ‘accumulating’ fund, which means it does not pay regular interest. Instead, returns generated by the fund are reinvested, increasing the value of the investment. A total of £2.35m was invested in November 2020, and a gain of £3.6k had been recorded by 30 September 2021.

2.18 The Council held £19.0m of other Treasury Investments as at 30 September 2021:

| Institution | Principal (£) |
|-------------------------------|---------------|
| Lloyds Bank – Current Account | 7,999,408.91 |
| UK Debt Management Office | 6,000,000.00 |

| | |
|-----------------------------|----------------------|
| Nationwide Building Society | 5,000,000.00 |
| Total | 18,999,408.91 |

2.19 The approved limits within the Annual Investment Strategy were not breached during the first six months of 2021/22.

2.20 **Security**

2.21 The Council uses benchmarks as simple guides to maximum risk, and these may be breached from time to time, depending on movements in interest rates and counterparty criteria. Any breach of the benchmarks will be reported, with supporting reasons, in this report.

2.22 In line with the Treasury Management Policy, the Council has managed to invest with those institutions who offered the best rate and the investment portfolio is above the overall benchmark during the year to date.

2.23 Members are invited to note that the definition of the security of an investment is defined as receiving contractually agreed amounts at the contractually agreed date. When a negative return is applicable on an investment the amount repaid on maturity will be lower than originally invested but not less than contractually agreed. This represents the prioritisation of security and liquidity management over investment yield, in line with the principals of the TM Code.

2.24 **Liquidity**

2.25 The Council set liquidity facilities/benchmarks to maintain:

- Authorised bank overdraft of £nil.
- Liquid short term deposits of at least £1m available with a week's notice.

2.26 The liquidity arrangements were adequate during the year to date. The loan to Thrive is excluded in this liquidity calculation.

2.27 **Yield**

2.28 The budget for interest earned on investments for 2021/22 is £90,000; interest received and accrued up to the end of September was £15,825. It is expected that the budget will not be achieved due to the low interest rate environment.

2.29 Short-term investments returns are benchmarked against SONIA, the Sterling Overnight Index Average. This is a measure of market rates for actual returns on overnight cash deposits.

2.30 The average yield return of 0.01% was lower than the benchmark for the year to date of 0.05%, and reflects the return on the investment of short term, highly liquid, cash required to meet working capital requirements

2.31 The Council keeps all investments short term. There are no sums within the portfolio invested for greater than 364 days. Given the unusual risk environment, and the need to ensure cash is available for prompt payment of suppliers, investments have been limited to short-term deposits with the UK Debt Management Office in order to remain within the approved bank counterparty limit.

2.32 The current investment counterparty criteria selection approved in the Treasury Management Policy is being met.

2.33 **Credit Ratings**

2.34 Credit rating information is supplied by our treasury consultants, Link Asset Services, on all counterparties that comply with the Council's criteria. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. There have been no changes to the Council's approved counter party list as a result of changes to credit ratings during the year.

3 Financial Implications

3.1 As contained in the body of the report.

4 Legal Implications

4.1 There is no requirement to make any amendments to the Treasury Management Strategy at this stage.

5 Equal, Staffing, Environmental, Community Safety, Public Health, Customer Services Centre, Communications & Website, Risk Management and Health & Safety Implications

5.1 None specific.

6 Recommendation

6.1 That the Committee notes the contents of the 2021/22 mid-year review of the Treasury Management function.

Report prepared by: Hannah Doney, Head of Finance

Data Quality

Data sources:

KPI monitoring information to SSOB

Link reports

Data checked by:

Bernard Ofori-Atta, Interim Finance Manager

Data rating: Tick

| | | |
|---|------------|---|
| 1 | Poor | |
| 2 | Sufficient | |
| 3 | High | x |

Background Papers

None

APPENDICES / ATTACHMENTS

None