DECISION-MAKER:	GOVERNANCE COMMITTEE			
SUBJECT:	REVIEW OF PRUDENTIAL LIMITS AND TREASURY MANAGEMENT MIDYEAR 2021/22			
DATE OF DECISION:	16 NOVEMBER 2021			
REPORT OF:	**EXECUTIVE DIRECTOR FINANCE & COMMERCIALISATION (S151 Officer)**			
CONTACT DETAILS				
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STATEMENT OF CONFIDENTIALITY

NOT APPLICABLE

BRIEF SUMMARY

The purpose of this report is to inform Governance Committee of the Treasury Management activities and performance for 2021/22 to date against the approved Prudential Indicators for External Debt and Treasury Management.

This report:

a) is prepared in accordance with the revised CIPFA Treasury Management Code and the revised Prudential Code;
b) presents details of capital financing, borrowing, debt rescheduling and investment transactions;
c) reports on the risk implications of treasury decisions and transactions;
d) gives details of the midyear position on treasury management transactions in 2021/22; and
e) confirms compliance with treasury limits and Prudential Indicators.

RECOMMENDATIONS:

It is recommended that Governance committee:

	(i)	Notes the Treasury Management (TM) activities for 2021/22 and performance against Prudential Indicators.
	(ii)	Notes that the continued proactive approach to TM has led to reductions in borrowing costs and safeguarded investment income during the year.
	(iii)	Continues to delegate authority to the S151 Officer to make any future changes which benefit the authority and to report back at the next Treasury update.

REASONS FOR REPORT RECOMMENDATIONS

1.	The Treasury Management Code requires public sector authorities to determine an annual TM Strategy and formally report on their treasury activities and arrangements to Governance Committee mid-year and after the

	year-end. These reports enable those tasked with implementing policies and undertaking transactions to demonstrate they have properly fulfilled their responsibilities and enable those with ultimate responsibility/governance of the TM function to scrutinise and assess its effectiveness and compliance with policies and objectives.	
ALTERNATIVE OPTIONS CONSIDERED AND REJECTED		
2.	No alternative options are relevant to this report.	
DETAIL (Including consultation carried out)		
CONSULTATION		
3.	Not applicable.	
BACKGROUND		
4.	The Local Government Act 2003 introduced a system for borrowing based largely on self-regulation by local authorities themselves. The basic principle of the new system is that local authorities will be free to borrow as long as their capital spending plans are affordable, prudent and sustainable.	
5.	The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that authorities report on the performance of the treasury management function at least twice a year (mid-year and at year end).	
6.	The Authority's TM Strategy for 2021/22 was approved at Governance Committee on 15 February 2021. The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 24 February 2021.	
7.	Overall responsibility for treasury management remains with the Council. No TM activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. This report covers treasury activity and the associated monitoring and control of risk.	
8.	The report and appendices highlight that:	
	a)	Borrowing activities have been undertaken within the borrowing limits approved by Governance Committee on 15 February 2021.
	b)	With an increasing borrowing requirement our overall treasury strategy is to minimise both external borrowing and investments and to only borrow to the level of the net borrowing requirement. This will reduce credit risk, take pressure off the Council's lending list, and avoid the cost of carry existing in the current interest rate environment. Throughout the year, capital expenditure levels, market conditions and interest rate levels are monitored to minimise

		borrowing costs over the medium to longer term and to maintain stability.
	c)	For longer term investments the Council will continue to hold assets in more secure and/or higher yielding asset classes. Total Investment returns are estimated to be £1.1M during 2021/22 which is lower than last year and reflects the current financial environment.
	d)	The differential between debt costs and investment earnings continued to be acute, resulting in the use of internal resources in lieu of borrowing often being the most cost effective means of financing capital expenditure. The average rate for repayment of debt, (the Consolidated Loans & Investment Account Rate – CLIA), is 2.85%, in line with budget. We do not currently have any short-term debt, but it is the intention to borrow in the short-term markets during 2021/22 to take further advantage of the current low interest environment.
	e)	Since 2012, the Council has pursued a strategy of internal borrowing – minimising external borrowing by running down its own investment balances and only borrowing short term to cover cash flow requirements. This has both reduced the credit risk exposure and saved the Council money in terms of net interest costs. Rates are monitored and if opportunities arise long term borrowing is considered in consultation with our treasury advisors. As can be seen in Appendix 2, paragraph 18, there was a dip in the benchmark gilt rates for PWLB loans in August and September. To secure these advantageous rates and add some certainty to the HRA debt portfolio, two £11M 20 year EIP (Equal Instalment Payment) loans was taken at an average rate of 1.46%.
	f)	In achieving interest rate savings, the Council is exposed to interest rate risk by taking out variable debt. This was and continues to be very financially favourable in current markets but does mean that close monitoring of the markets is required to ensure that the Council can act quickly should the situation begin to change.
	g)	Net loan debt is expected to increase during 2021/22 from £247M to £435M (£188M) as detailed in Appendix 2, paragraph 5, but currently sits at £211.2M, due to higher than expected cash balances at this point in year and deferral of majority of new borrowing to later in year. Actual debt charges for the year for borrowing (excluding HCC transferred debt and PFI schemes) is forecast at £8.9M at an average interest rate of 2.78%
	h)	The initial reaction to the COVID crisis last March meant that short term liquidity became difficult, and Government sought to assist cash flow by providing up front funding as far as possible, both in terms of the grants to businesses administered by the Council on its behalf and the funding to the local authority itself (under the business rates retention scheme).

		As a result of this grant funding year end investment balances were and have continued to be higher than expected.
	i)	Continued downward pressure on short-dated cash brought net returns on money market funds (MMF) close to zero even after some managers have temporarily lowered their fees. At this stage net negative returns are not the central case of most MMF managers over the short-term, and fee waivers should maintain positive net yields, but the possibility cannot be ruled out. Deposit rates with the Debt Management Account Deposit Facility (DMADF) are currently in line with most MMF (0.01%) and are used as an alternative to spread the risk.
	j)	The impact of COVID-19 will continue during the current financial year and will be reported as part of the quarterly monitoring reports and the mid-year report.
9.	Appendix 1 summarises the economic outlook and events in the context of which the Council operated its treasury function during 2021/22.	
10.	Appendix 2 summarises treasury activity during the year and covers: • Borrowing Requirement and Debt Management • Investment Activity • Non – Treasury Investments	
11.	Appendix 3 summarises quarterly benchmarking produced by our advisors, showing the breakdown of our investments and how we compare to their other clients and other English Unitary authorities. It shows that on average the return on our internal investments at 0.08% is slightly higher than the average of 0.06% and our overall return including the Local Authority Property Fund (income only) is 1.31% as opposed to the average of 0.78%. This has been achieved without impacting on our average credit rating which at AA- is slightly higher than both other Local Authorities and Unitary Authorities.	
COMPLIANCE WITH PRUDENTIAL INDICATORS AND AMENDMENT TO 2021/22 TREASURY STRATEGY		
12.	It can be confirmed that the Council has complied with its Prudential Indicators for 2021/22, approved by Governance Committee on 15 February 2021.	
13.	In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of TM activity during 2021/22. None of the Prudential Indicators has been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield. The table below summarises the Key Indicators, further details can be seen in appendix 4.	

14. ***Table1: Key Prudential Indicators***

Indicator	Limit	Actual at 30/9/2021
Authorised Limit for external debt	£805M	£312M
Operational Limit for external debt	£705M	£312M
Maximum external borrowing year to date	£640M	£251M
Limit of fixed interest debt	100%	80.8%
Limit of variable interest debt	50%	19.2%
Limit for long term investments	£100M	£30M

15. Due to the current low interest environment banks are no longer paying interest for call accounts and as detailed in paragraph 8 (i) above the DMADF and MMF are currently the best option even though yields are low at 0.01% – 0.02%.

There is a limited inter LA market for short term deposits as the market is currently cash rich and we are likely to be in a borrowing position in January so cannot lend out for too long. Rates are between 0.01% and 0.03% without the ability to access the cash during term of investment.

REVISION TO CIFPA CODES

16. 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 and in September CIPFA issued revised Codes and Guidance Notes in draft form and opened further consultation process on the proposed changes.

17. We are currently reviewing the impact of the proposed changes, which includes the introduction of the liability benchmark (which we already utilise) and borrowing at net position which could have an impact on us holding long term investments such as CCLA.

Early indications are that future long term investments will be prohibited but we will not need to unwind existing investments. A further update will be included in the Strategy report once the consultation has been concluded and any impact for the council is known.

MGCLG IMPROVEMENTS TO THE CAPITAL FINANCE FRAMEWORK

18. MHCLG published a brief policy paper in July outlining the ways it feels that the current framework is failing and potential changes that could be made. The paper found that “while many authorities are compliant with the framework, there remain some authorities that continue to engage in practices that push the bounds of compliance and expose themselves to excessive risk”.

19.	The actions announced include greater scrutiny of local authorities and particularly those engaged in commercial practices; an assessment of governance and training; a consideration of statutory caps on borrowing; further regulations around Minimum Revenue Provision (MRP) and ensuring that MHCLG regulations enforce guidance from CIPFA and the new PWLB lending arrangements. A further consultation on these matters is expected soon.
RESOURCE IMPLICATIONS	
Capital/Revenue	
20.	This report is a requirement of the TM Strategy, which was approved at Governance Committee on 15 February 2021 and as part of the Capital Strategy by Council on 24 February 2021.
21.	The interest cost of financing the Authority's long term and short term loan debt is charged corporately to the Income and Expenditure account. The interest cost of financing the Authority's loan debt is estimated at £8.9M for 2021/22. This is slightly lower than budgeted (£9.1M) mainly due to deferral of most of the borrowing to the later part of the year.
22.	In addition, interest earned on temporary balances invested externally is credited to the Income and Expenditure account. The current forecast for 2021/22 is £1.1M which is in line with budget but lower than last year due to the current interest environment.
23.	The expenses of managing the Authority's loan debt consist of brokerage and internal administration charges. These are pooled and borne by the HRA and General Fund proportionately to the related loan debt. Debt management expenses are currently in line with budget and expected to be £0.2M in 2021/22 but will be dependent on actual borrowing taken in year.
Property/Other	
24.	None.
LEGAL IMPLICATIONS	
Statutory power to undertake proposals in the report:	
25.	Local Authority borrowing is regulated by Part 1, of the Local Government Act 2003, which introduced the new Prudential Capital Finance System. From 1 April 2004, investments are dealt with, not in secondary legislation, but through guidance. Similarly, there is guidance on prudent investment practice, issued by the Secretary of State under Section 15(1)(a) of the 2003 Act. A local authority has the power to invest for "any purpose relevant to its functions under any enactment or for the purposes of the prudent management of its financial affairs". The reference to the "prudent management of its financial affairs" is included to cover investments, which are not directly linked to identifiable statutory functions but are simply made in the course of treasury management. This also allows the temporary investment of funds borrowed for the purpose of expenditure in the reasonably near future; however, the speculative procedure of borrowing purely in order to invest and make a return remains unlawful.

<u>Other Legal Implications</u>:	
26.	None.
RISK MANAGEMENT IMPLICATIONS	
27.	Not Applicable
POLICY FRAMEWORK IMPLICATIONS	
28.	This report has been prepared in accordance with the CIPFA Code of Practice on TM.

KEY DECISION?	~~Yes~~/No
WARDS/COMMUNITIES AFFECTED:	NONE

<u>SUPPORTING DOCUMENTATION</u>

Appendices

1.	2021/22 Economic Background
2.	Treasury Activity during 2021/22
3.	Southampton Benchmarking 30th September 2021
4.	Compliance with Prudential Indicators
5.	Glossary of Treasury Terms

Documents In Members' Rooms

1.	None.

Equality Impact Assessment

Do the implications/subject of the report require an Equality and Safety Impact Assessments (ESIA) to be carried out.	~~Yes~~/No

Privacy Impact Assessment

Do the implications/subject of the report require a Privacy Impact Assessment (PIA) to be carried out.	~~Yes~~/No

Other Background Documents

Equality Impact Assessment and Other Background documents available for inspection at:

Title of Background Paper(s)		Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)
1.	The Medium Term Financial Strategy, Budget and Capital Programme 2021/22 to 2023/24 – reported to Council 24 February 2021	