South Somerset District Council

2021/22 Treasury Management Mid-Year Performance Report and Strategy Update

Executive Portfolio Holder:	Peter Seib, Finance and Legal Services
SLT Lead:	Karen Watling, Chief Finance Officer
Lead Officers:	Paul Matravers, Lead Specialist – Finance Cheryl Summers, Specialist Finance

Purpose of the Report

1. To present the Council's 2021/22 mid-year treasury performance report as required by CIPFA's Treasury Management Code.

Recommendations

2. The Audit Committee is asked to note the actual and forecast treasury performance and recommend the updated Treasury Management Strategy Statement and Investment Strategy to Council.

Introduction and Background

3. The Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in the Public Services Code of Practice requires the Council to approve an annual Treasury Management Strategy and, report treasury performance mid-year and at the year end.

4. The Council has 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. The successful identification, monitoring and control of risk is therefore central to the Treasury Management Strategy.

5. This report provides information on the performance of the Council's Treasury Investments for the first six months of the 2021/22 financial year. The performance of the Council's Commercial Investments, which are part of the Commercial Strategy, are reported separately through 6-monthly update reports therefore that detail is not included in this report. On this basis, it is worth noting that whilst the treasury income and cost implications of commercial investment acquisitions are included within this report, the investment property income is not.

6. CIPFA has defined Treasury Management as "the management of the organisation's 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."

7. The Council has delegated responsibility for the oversight and monitoring of its treasury management policies and practices to Audit Committee, and for the execution and administration of treasury management decisions to the S151 Officer who will act in accordance with the organisation's policy statement and Treasury Management Practices (TMPs), and CIPFA's standard of Professional Practice on Treasury Management.

8. The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Specific risks are identified in the Council's approved Treasury Management Practices. The risks include:

- Liquidity Risk (Adequate cash resources)
- Interest Rate Risk (Fluctuations in the value of investments and borrowing).
- Inflation Risks (Exposure to inflation)
- Fraud, Error and Corruption, and Contingency Management (Exposure to loss through fraud, error or other eventualities)
- Refinancing Risks (Impact of debt maturing in future years).
- Legal & Regulatory Risk (Compliance with statutory and regulatory requirements).

9. The Local Government Act 2003 requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy; this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

10. When the strategy for 2021/22 was written it took into account the Council's current treasury position and drew upon the forecasts for interest rates provided by the Council's treasury advisors, Arlingclose, leading to the proposed Prudential Indicators included. This has been updated with the most recent forecast as at September 2021.

Revisions to CIPFA Codes

11. 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.

12. 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:

- Clarification that:
  - local authorities must not borrow to invest primarily for financial return
  - it is not prudent for 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
- Categorising investments as those:
  - for treasury management purposes
  - service purposes
  - for commercial purposes
- Defining acceptable reasons to borrow money:
  - financing capital expenditure primarily related to delivering a local authority's functions
  - temporary management of cash flow within the context of a balanced budget
  - securing affordability by removing exposure to future interest rate rises
  - refinancing current borrowing, including replacing internal borrowing
- For service and commercial investments, in addition to assessments of affordability and prudence, an assessment of proportionality in respect of the authority's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services).
- Prudential Indicators:
  - New indicator for net income from commercial and service investments to the budgeted net revenue stream.
  - Inclusion of the liability benchmark as a mandatory treasury management prudential indicator. CIPFA recommends this is presented as a chart of four balances – existing loan debt outstanding; loans CFR, net loans requirement, liability benchmark – over at least 10 years and ideally cover the authority's full debt maturity profile.
  - Excluding investment income from the definition of financing costs.
- Incorporating ESG issues as a consideration within TMP 1 Risk Management.
- Additional focus on the knowledge and skills of officers and elected members involved in decision making.

13. In addition the Department for Levelling Up, Housing and Communities (DLUHC) published a brief policy paper in July outlining the ways it feels that the current Capital Finance Framework framework is failing and potential changes that could be made.

14. 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". 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)
   - ensuring that the DLUHC regulations enforce guidance from CIPFA and the new PWLB lending arrangements.

15. The consultation period ends on 16 November 2021, the Chief Finance Officer will provide a response to both consultations and an update on the outcome and the implications for the Council will be reported to the committee.

Treasury Management Strategy Statement and Investment Strategy

16. The updated 2021/22 Treasury Management Strategy is attached at Appendix A. There are no amendments to the borrowing strategy, treasury investment strategy, approved counterparties or investment limits.

17. The updated strategy includes a revision to the capital financing requirement figures, with amendments made to reflect the actual capital financing requirement at 31/3/2021 and the revised estimates for the subsequent three years. Please refer to table 1: Balance Sheet Summary and Forecast within Appendix A.

18. The remainder the report provides information on:

   - Treasury Management Position
   - Current Borrowing
   - Treasury Investment Activity
   - Pooled Fund Investments
   - Non Treasury Investments

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Treasury Management Position - Summary

19. The treasury management position as at 30 September 2021 and the change during the year is shown in the Table 1.

Table 1: Treasury Management Position – Summary

	31/03/2021 Balance £000's	Net Movement £000's	30/09/2021 Balance £000's
Long-term borrowing	-	-	-
Short-term borrowing	(98,000)	10,000	(88,000)
Total Borrowing	**(98,000)**	**10,000**	**(88,000)**
Long-term Investments	2,000	(1,000)	1,000
Short-term Investments	-	-	-
Cash and Cash Equivalents	23,980	2,340	26,320
Total Investment	**25,980**	**1,340**	**27,320**
Net Position	**(72,020)**	**11,340**	**(60,680)**

External Borrowing

20. External borrowing has decreased during the first six months of the year due to a significant element of the loan portfolio maturing in this period. Improved cash flow has meant that not all of the matured borrowing needed replacing. In addition, during this period there has been no investment property acquisitions as part of the Commercial Strategy (although some acquisitions are anticipated by the end of this financial year). These acquisitions are financed by external borrowing. In line with Arlingclose advice, and as reported in the MTFP Refresh report to District Executive in October 2021, the Council continues to utilise short term borrowing, which is flexible and keeps our borrowing costs low.

21. The projected value of long term borrowing as at 31 March 2022 was reported to Audit Committee in February 2021 in the Annual Treasury Management Strategy report. The external borrowing requirement at the end of the 2021/22 financial year was anticipated to be £159m.

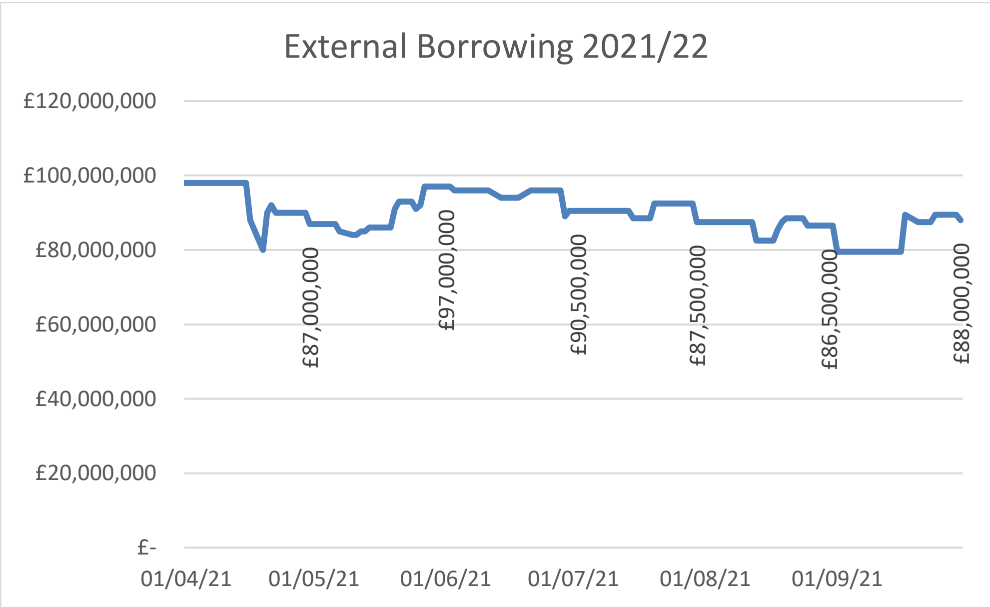
22. The amount of external borrowing is dependent on purchases of commercial property and the projects included in the capital programme progressing as planned, particularly those projects in the Regeneration Programme, and the Council's cash flow position. If project timescales slip and no commercial property purchases are made in the remaining part of the financial year the external borrowing amount will be significantly lower than the figure anticipated in the 2021/22 Annual Treasury Management Strategy.

23. The Council's finance team continually review the council's cash flow position and borrowing options in order to keep the cost of borrowing to a minimum. With

interest rates remaining low it remains advantageous to continue to meet the financing requirement using short term rather than long term borrowing, however this is kept under review to strike the appropriate balance between costs and cost certainty. This strategy is also pursued in order to give the maximum flexibility to the new successor council when it comes into being in April 2023.

24. The graph shows the movement in the external borrowing position for 2021/22. It provides the amount of external borrowing on the first day of each month for the April to September period and the value of borrowing at 30 September 2021 (£88m).

Graph 1: External Borrowing 2021/22



25. Table 2 summarises the external borrowing position as at 30 September 2021. It includes the opening position in respect of external loans, loans repaid, new loans and the average interest rate.

Table 2: External Borrowing Summary

	Amount £'000	Average Interest Rate %
External Loans as at 1 April 2021	**98,000**	**0.86**
New Loans	157,500	0.31
Loans Repaid	(167,500)	0.17
Total External Loans as at 30 September 2021	**88,000**	**0.08**

26. The £88m of external borrowing as at 30 September 2021 is detailed in Table 3. The table shows that we have prioritised the inter-authority lending market, with the short-term loan interest rates ranging from 0.02% to 0.45%.

Table 3: External borrowing as at 30 September 2021

Lender	Date Borrowed	Maturity Date	No. of Days	Interest Rate %	Amount £
London Borough of Wandsworth	19/03/21	19/01/22	306	0.45	10,000,000
Nottingham City Council	22/04/21	27/01/22	280	0.14	4,000,000
City & County of Swansea	20/04/21	20/10/21	183	0.05	5,000,000
Northern Ireland Housing Executive	19/04/21	14/04/22	360	0.10	4,000,000
Northern Ireland Housing Executive	20/04/21	14/04/22	359	0.10	5,000,000
East Suffolk Council	20/04/21	20/04/22	365	0.14	3,000,000
Vale of Glamorgan Council	21/04/21	21/10/21	183	0.08	3,000,000
Middlesbrough Borough Council	25/08/21	24/05/22	272	0.07	5,000,000
University of Teeside	25/08/21	25/05/22	273	0.08	4,000,000
Greater Manchester Combined Authority	25/08/21	27/01/22	155	0.03	3,000,000
Greater Manchester Combined Authority	25/08/21	23/12/21	120	0.03	5,000,000
West Suffolk Council	18/08/21	10/01/22	145	0.02	1,000,000
Hampshire Police and Crime Commissioner	18/08/21	18/10/21	61	0.02	2,000,000
Hampshire County Council	19/08/21	18/10/21	60	0.02	2,000,000
Greater Manchester Combined Authority	25/08/21	25/11/21	92	0.02	8,000,000
Wigan Metropolitan Borough Council	25/08/21	25/05/22	273	0.07	5,000,000
Middlesbrough Borough Council	17/09/21	07/04/22	202	0.04	10,000,000
South Lanarkshire Council	20/09/21	20/05/22	242	0.05	2,000,000
South Lanarkshire Council	24/09/21	24/05/22	242	0.05	2,000,000
Tendring District Council	29/09/21	11/04/22	194	0.04	5,000,000
				Total	**88,000,000**

27. The above information shows that the current strategy of utilising short-term inter-authority lending for the Council's treasury borrowing requirement means interest rates and costs are relatively low.

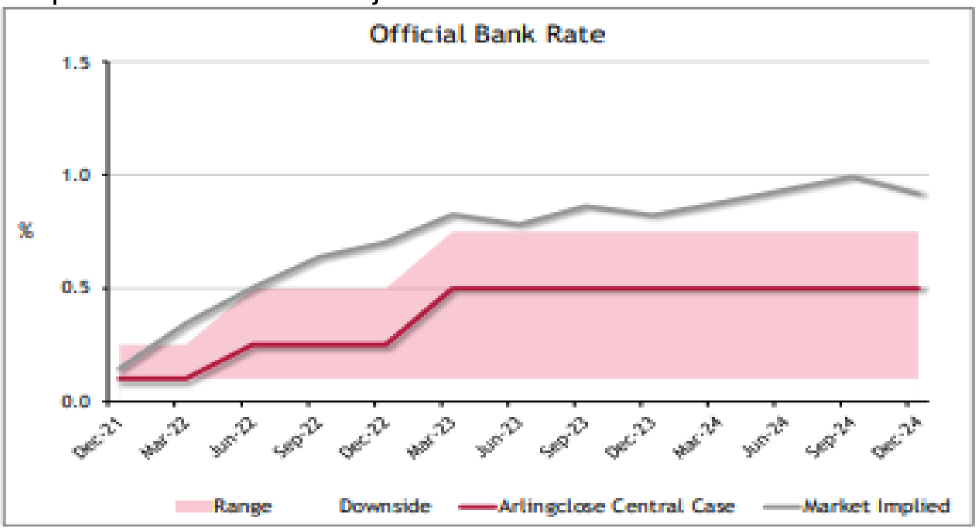
28. The tables demonstrate that rates have significantly reduced in the April to September period and short term borrowing for a 6 month period can now be sourced in the region of 0.01% - 0.05%. Borrowing for short periods takes advantage of the low rates on offer, and accepts an element of interest rate risk at the point of re-financing.

Interest Rates and Inflation

29. The October 2021 economic and interest forecast data provided by the Council's treasury advisors anticipates that inflation is likely to rise to over 4% in the near term (3.2% in August), the continuing increase in inflation has meant that the expectations around a rise in interest rates has also increased.

30. The graph below details the Arlingclose interest rate projection for the period to December 2024.

Graph 2: Interest Rate Projection



31. Arlingclose expects the Bank Rate to rise in Quarter 2 of 2022, with a further rise in March 2023 and rates remaining at 0.50% for the period to December 2024. This assumption is driven as much by the Bank's desire to move from emergency levels as by fears of inflationary pressure.

32. Investors have priced in multiple rises in Bank Rate to 1% by 2024. While there is a belief than the Bank Rate will rise, the Arlingclose assumption is that the rate rise will be to a lesser extent than expected by markets.

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Borrowing Options and alternative funding streams

33. Given changes to PWLB lending terms and intended changes to CIPFA's Prudential Code, Arlingclose, the Council's Treasury Management adviser, was asked earlier this year by the Chief Finance Officer to review the Council's potential borrowing options given that SSDC is, at least for this financial year, actively seeking to undertake further "investment purely for yield" commercial activity and the changes mentioned above would restrict this activity.

34. Arlingclose analysed a range of potential borrowing options including the use of: PWLB (Public Works Loans Board), local authority to local authority short term lending, borrowing from Financial Institutions (e.g. Pension Funds, banks), a Bonds issue (either separately or using the Municipal Bonds Agency), Forward Starting Loans, Interest Rates swaps, and income strip deals (wrapper leases).

35. The Chief Finance Officer will be proposing to February 2022 Council (in the Treasury Management Strategy) that we keep to our current approach to borrowing namely: to (a) only borrow externally when cash flow requires this and to (b) only borrow short term from other councils. Obviously we will continue to review this approach with Arlingclose in light of any changes in market/economic conditions but the intention is that for the next two financial years SSDC will not enter into any long term borrowing arrangements.

36. The rationale for proposing this approach can be given as follows:
    - Short term borrowing from other councils is currently by far the cheapest option and is readily available and quick to administer.
    - Whilst there is a risk to SSDC if interest rates rise, this is assessed as a low risk by Arlingclose and other economic forecasters.
    - Other options, e.g. bond issues, interest rate swaps, will take officer time and cost to implement.
    - Income strip deals (wrapper leases) are intrinsically risky.
    - HM Treasury have recently clarified their new PWLB lending terms and have confirmed that PWLB lending is available to finance existing debt arising from past "investment purely for yield" commercial activity and to finance the council's capital programme the year after it ceases such commercial activity, if the Council so wishes.
    - The Chief Finance Officer advises that it would be wrong to fetter the future flexibility of the successor unitary authority in this matter if there is no immediate need for SSDC to enter into long term borrowing arrangements.

Treasury Investment Activity

37. The Council holds significant invested funds, representing income received in advance of expenditure plus cash balances and reserves held. In the first six months of the financial year, the Council's investment balance has ranged between £24.5 million and £29.5 million.

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Table 4: Breakdown of Investments as at 30 September 2021

	Date Invested	Maturity Date	Interest Rate %	Nominal Amount £
Corporate Bonds				
National Australia Bank *Covered*	10/11/16	10/11/21	1.10	1,000,000
Business Reserve Accounts				
Santander Business Reserve	Various	Not fixed	0.04	2,820,000
Property & Pooled Funds				
Schroders Income Maximiser (UK Equity)	Various	Not fixed	5.97	6,250,000
CCLA Property Fund	Various	Not fixed	4.91	6,000,000
Fidelity Global enhanced income (Global Equity)	Various	Not fixed	4.74	250,000
Ninety One Diversified Income	Various	Not fixed	4.15	5,000,000
Columbia Threadneedle Strategic Bond	Various	Not fixed	2.25	5,000,000
Royal London Enhanced Cash Plus Fund	Various	Not fixed	0.75	1,000,000
			Total	27,320,000

38. The Council has maintained its strategic fund investments at £23.5m and it is estimated that the level of strategic investments as at 31 March 2022 will remain in the region of £23.5m. The long term strategy is to invest up to £30m in strategic investments if cashflow permits.

Pooled Fund Investment - Values

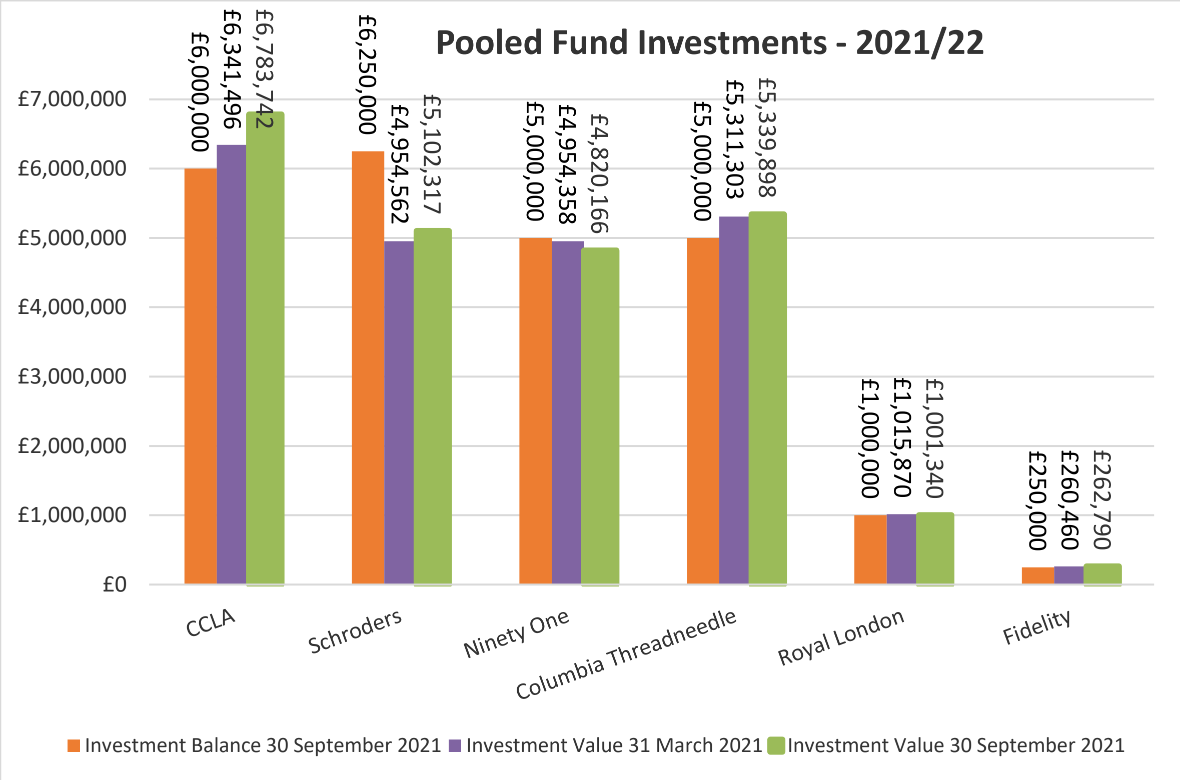
39. The Council's pooled fund investments are held in externally managed funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. This fits with the objectives of the Council's overall Financial Strategy.

40. The Council has investments in bond, equity, multi-asset and property funds. The improved market sentiment in the past 6 months is reflected in equity, property and multi-asset fund valuations and, in turn, in the overall increase in capital values of the Council's pooled fund investments.

41. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's medium to long term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rates.

42. The investment balance as at 30 September 2021 and the value of each investment as at 1 April and 30 September are detailed in the chart below.

Graph 3: Pooled Fund Investments 2021/22



Note: Pooled fund investments are revalued to reflect the fair value of the investment, the second and third bars in the graph signifies this value at 1 April and 30 September. The first bar represents the nominal investment balance in each fund at 30 September.

43. Table 5 below includes the opening and closing investment balances for each pooled fund investment. The investment fair value signifies the individual value of the investments after the year-end and mid-year valuation. The table shows that the 'fair value' of the portfolio has increased by £472k, which is an increase of 2.07% between 1 April and 30 September, reflecting volatility in market value. The strategy works on the basis that investment values will go up and down but annual income return remains positive, and the Council would not plan to redeem the investment when its value is below the nominal balance unless this would be a prudent course of action.

Table 5: Pooled Fund Investments as at 30 September 2021

Investment	Investment Balance 30/09/2021 £	Investment Value 01/04/2021 £	Investment Fair Value 30/09/2021 £
CCLA	6,000,000	6,341,496	6,783,742
Schroders	6,250,000	4,954,562	5,102,317
Ninety One	5,000,000	4,954,358	4,820,166
Columbia Threadneedle	5,000,000	5,311,303	5,339,898
Royal London	1,000,000	1,015,870	1,001,340
Fidelity	250,000	260,460	262,790
Total	**23,500,000**	**22,838,049**	**23,310,253**

Pooled Fund Investment – Income Return

44. The income generated from pooled fund investments for the first six months of 2021/22 and the rate of return is detailed in the following Graph 4 and Table 6. This demonstrates that the investment in the Schroder Income Maximiser, Ninety One and CCLA Funds have performed well in terms of income and rate of return on investment.

45. Overall, the return on pooled funds has positively averaged 3% during the first six months of the financial year.

Graph 4: Interest Received and Rate of Return 1 April to 30 September

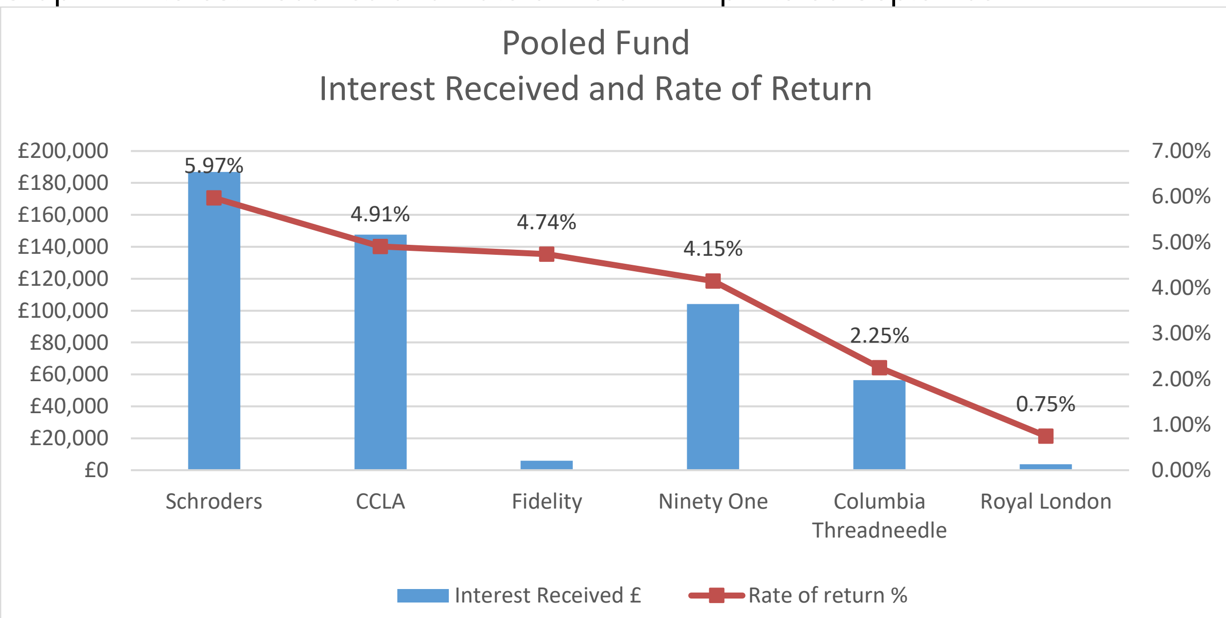


Table 6: Pooled Fund Investment Interest at 30 September 2021

Fund	Interest Received £	Rate of return %
Schroders	186,974	5.97
CCLA	147,630	4.91
Fidelity	5,943	4.74
Ninety One	104,057	4.15
Columbia Threadneedle	56,400	2.25
Royal London	3,756	0.75
Total	**504,760**	

Non-Treasury Investments

46. The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

47. In addition to its treasury investments, the Council also holds £36.23m in other investments in the form of loans to third parties. The loans values are detailed below:
    - Loan to Community Organisation - £0.14m
    - Loan to Trading Company - £0.08m
    - Loan to Local Authority Partnership - £4.36m
    - Loan for Commercial Activities - £31.55m

48. The detail of the Council's total investment in commercial investment property is reported separately. As part of its Commercial Strategy, investment in property has increased significantly in the past three years. The value of investment properties held on the balance sheet as at 31 March 2021 (including some properties held for a substantial period of time) was £79.8m. This has increased by £2.6m during this year, to £82.4m as at 30 September 2021 (not including the loan shown in the previous paragraph).

Financial Implications

49. There are no additional financial implications in reviewing the attached treasury management strategy.

Background Papers

- Treasury Management Strategy 2021/22 (Full Council February 2021)