Report Number: SWT 113/21

Somerset West and Taunton Council

Audit and Governance Committee – 13th December 2021

Treasury Management Mid-Year Update Report 2021/22

This matter is the responsibility of Cllr Ross Henley, Portfolio Holder for Corporate Resources

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1 Executive Summary / Purpose of the Report

1.1 To provide Members with an update on the Treasury Management activity of Somerset West and Taunton Council and performance against the Prudential Indicators in respect of the first six months of 2021/22.

1.2 It focuses on a review of the Council's borrowing and investment activities and incorporate a range of new charts that summarise the Council's treasury in-year treasury activities.

2 Recommendations

2.1 To note the Treasury Management position as at 30th September 2021 and compliance with the Prudential Indicators.

2.2 To recommend to Full Council that an amendment (effective forthwith) be made to paragraph 5.16 of the Treasury Management Strategy, which was approved on 30 March 2021 as part of the report covering the Council's Capital, Investment and Treasury Strategies 2021/22 to 2025/26 (details of the amendment are set out in paragraph 6.56 of this report).

3 Risk Assessment

3.1 The Council has an agreed Treasury Management Strategy (TMS) and effective management practices to ensure compliance and risks are monitored and managed.

4 Background and Full details of the Report

4.1 The Council invests 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 and investment returns. The successful identification, monitoring and control of risk remains central to the Council's treasury management strategy.

4.2 Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year and, as a minimum, a half-year and annual treasury outturn report. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

4.3 These reports are required to be adequately scrutinised by committee before being recommended to the Council. This role is undertaken by the Audit and Governance Committee.

4.4 The 2017 Prudential Code includes a requirement for local Councils to provide a Capital Strategy, a summary document approved by Full Council covering capital expenditure and financing, treasury management and non-treasury investments. This Council's combined Capital, Investment and Treasury Strategies for 2021/22, complying with CIPFA's requirement, were approved by Full Council on 30th March 2021.

4.5 Treasury management is defined as:

> "The management of the local Council's cash flows, its borrowings and its investments, the management of the associated risks, and the pursuit of the optimum performance or return consistent with those risks".

4.6 Overall responsibility for treasury management remains with the Council with operational responsibility delegated to the S151 Officer. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

5 External Context – Analysis by Arlingclose

5.1 Commentary relating to the external context and economic analysis by Arlingclose, the Council's treasury management advisors, can be found in Appendix A to this report.

6 Local Context

6.1 On 31st March 2021, the Council had net cash investments of £47.736m 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), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.21 Actual £m
General Fund CFR	83.203
HRA CFR	109.717
Total CFR	**192.920**
External borrowing	-162.500
Internal borrowing	**30.420**
Less: Usable reserves	-85.578
Add: Working capital	7.422

Net Investments	**-47.736**

6.2 The Council pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

6.3 The treasury management position as at the mid-point of the financial year, 30 September 2021, alongside the movements over the preceding six months is shown in Table 2, below:

Table 2: Treasury Management Summary

	31.3.21 Balance £m	**Movement £m**	**30.9.21 Balance £m**
Long-term borrowing	-105.500	0	-105.500
Short-term borrowing	-57.000	-1.000	-58.000
Total borrowing	**-162.500**	**-1.000**	**-163.500**
Long-term investments	3	0	3
Short-term investments	3.254	-3.254	0
Cash and cash equivalents	41.641	12.327	53.968
Total investments	**44.898**	**9.073**	**53.971**
Net Borrowing	**-117.602**	**8.073**	**-109.529**

Borrowing Update

6.4 Historically, local councils have predominantly met their borrowing needs by using the Government's Public Works Loan Board (PWLB). PWLB has usually provided better value loans than available in the Money Market. However, a National Audit Office report in 2016 indicated a rapid expansion in authorities' acquisition of commercial property outside their areas for the purposes of generating yield, also usually financed by PWLB borrowing. Following multiple authorities adopting such property investments in more-recent years, in November 2020 new borrowing from PWLB was ceased as a source of financing such investments. The only exceptions are to refinance existing loans or to externalise internal borrowing. The exception benefits this Council as PWLB borrowing taken out for HRA Self-Financing reaches maturity and needs to be refinanced.

6.5 Competitive market alternatives may be available in the open Money Market for authorities with or without access to the PWLB. However, the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders. Furthermore, changes to the CIPFA Prudential Code and Treasury Management Code, expected to be re-published in December 2021, are anticipated to extend to prohibiting borrowing for the primary purpose of commercial return, even where the source of borrowing is not the PWLB.

6.6 As part of its development of a sound capital investment strategy and budget sustainability, this Council has pursued a modest programme of property investment assets to generate yield. The programme to purchase property (at the time of writing this report in mid-November 2021) is planned to have been completed by mid-December 2021. Whilst the Council has been unable to access PWLB borrowing to finance these purchases, it has been successful in obtaining new borrowing from other Local Councils and similar public service organisations, securing low interest, short-term loans. It is anticipated that the availability of PWLB loans will reopen again after a three-year period, although further clarity on this is expected as the new Codes are published.

6.7 **Revised PWLB Guidance:** Meanwhile, HM Treasury published further guidance on PWLB borrowing in August 2021 providing additional detail and clarifications predominantly around the definition of an 'investment asset primarily for yield'. The principal aspects of the new guidance are:

- Capital expenditure incurred or committed to before 26 November 2020 is allowable even for an 'investment asset primarily for yield'.
- Capital plans should be submitted by local councils via a DELTA return. These open for the new financial year on 1st March and remain open all year. Returns must be updated if there is a change of more than 10%.
- An asset held primarily to generate yield that serves no direct policy purpose should not be categorised as service delivery.
- Further detail on how local councils purchasing investment assets primarily for yield can access the PWLB for the purposes of refinancing existing loans or externalising internal borrowing.
- Additional detail on the sanctions which can be imposed for inappropriate use of the PWLB loan. These can include a request to cancel projects, restrictions to accessing the PWLB and requests for information on further plans.

6.8 **Changes to PWLB Terms and Conditions from 8th September 2021**: The settlement time for a PWLB loan has been extended from two workings days (T+2) to five working days (T+5). In a move to protect the PWLB against negative interest rates, the minimum interest rate for PWLB loans has also been set at 0.01% and the interest charged on late repayments will be the higher of Bank of England Base Rate or 0.1%.

6.9 **Municipal Bonds Agency (MBA):** The MBA is working to deliver a new short-term loan solution, available in the first instance to principal local councils in England, allowing them access to short-dated, low rate, flexible debt. The minimum loan size is expected to be £25 million. Importantly, local councils will borrow in their own name and will not cross guarantee any other councils.

6.10 If the Council intends future borrowing through the MBA, it will first ensure that it has thoroughly scrutinised the legal terms and conditions of the arrangement and is satisfied with them.

6.11 **UK Infrastructure Bank:** £4bn has been earmarked for lending to local authorities by the UK Infrastructure Bank which is wholly owned and backed by HM Treasury. The availability of this lending to local authorities, for which there will be a bidding process, is yet to commence. Loans will be available for qualifying projects at gilt yields plus 0.6%, which is 0.2% lower than the PWLB certainty rate.

Borrowing Strategy during the period

6.12 At the mid-point of the financial year, 30 September 2021, the Council held £163.5m of loans, an increase of £1.0m compared to 31 March 2021, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30 September are summarised in Table 3, below:

Table 3: Overall Borrowing Position with movement during the first half-year

	31.3.21 Balance £m	**Net Movement £m**	**30.9.21 Balance £m**
Public Works Loan Board (Long-term)	92.500	0	92.500
Public Works Loan Board (Short-term)	10.000	0	10.000
Banks (Long Term)	3.000	0	3.000
Local Councils (Long-term)	10.000	0	10.000
Local Councils (Short-term)	47.000	1.000	48.000
Total borrowing	**162.500**	**1.000**	**163.500**

6.13 The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans, should the Council's long-term plans change, is a secondary objective.

6.14 With short-term interest rates remaining much lower than long-term rates and with surplus of liquidity continuing to feature in the LA to LA market, the Council considered it to be more cost effective in the near-term to use internal resources alongside borrowing through rolling temporary / short-term loans. Thus, as relayed in paragraph 6.6, above, this strategy of short-term borrowing has been adopted during the current year-to-date. Alongside this, internal borrowing (principally using cashflow balances) has also been used as far as possible so that investment risk may be minimised and to protect longer-term investments, which generate favourable levels of yield for the Council.

6.15 The Council has an increasing Capital Financing Requirement (CFR) due to the requirements of new projects in the capital programme. From this, an estimated borrowing requirement is determined by the Liability Benchmark, which also considers usable reserves and working capital. Turning to the Council's complete borrowing portfolio and, having considered the appropriate duration and structure of the borrowing need based on realistic projections, it has been decided over the course of time to take a mixture of short-term and long-term borrowing. The Council currently has £105.50m of longer-term borrowings (over one-year to maturity) in respect of the Housing Revenue Account and General Fund, details of which are shown in Table 4, overleaf. These loans provide some longer-term certainty and stability to the debt portfolio, having taken advantage of historically low longer-term interest rates that will remain secure for longer-term resource planning.

Table 4: Long-term Borrowing Position

Long-dated Loans borrowed	**Amount £m**	**Rate %**	**Start Date**	**Maturity Date**
General Fund				
Buckinghamshire Council	10.000	0.44	22 Feb 2021	22 Aug 2023
HRA				
Public Works Loan Board	5.000	2.56	28 Mar 2012	28 Mar 2023
Public Works Loan Board	7.000	2.70	28 Mar 2012	28 Mar 2024
Public Works Loan Board	6.000	2.82	28 Mar 2012	28 Mar 2025
Public Works Loan Board	7.000	2.92	28 Mar 2012	28 Mar 2026
Public Works Loan Board	16.000	3.01	28 Mar 2012	28 Mar 2027
Public Works Loan Board	7.000	3.08	28 Mar 2012	28 Mar 2028
Public Works Loan Board	5.000	3.15	28 Mar 2012	28 Mar 2029
Public Works Loan Board	5.500	3.21	28 Mar 2012	28 Mar 2030
Public Works Loan Board	1.000	8.38	26 Sep 1996	03 Aug 2056
Public Works Loan Board	1.000	7.38	28 May 1997	06 May 2057
Public Works Loan Board	2.000	6.63	22 Oct 1997	05 Sep 2057
Public Works Loan Board	10.000	1.64	12 Nov 2020	12 Nov 2070
Public Works Loan Board	20.000	1.89	26 Mar 2021	26 Mar 2071
Barclays	3.000	4.25	14 Jun 2007	14 Jun 2077
Total borrowing	**105.500**			

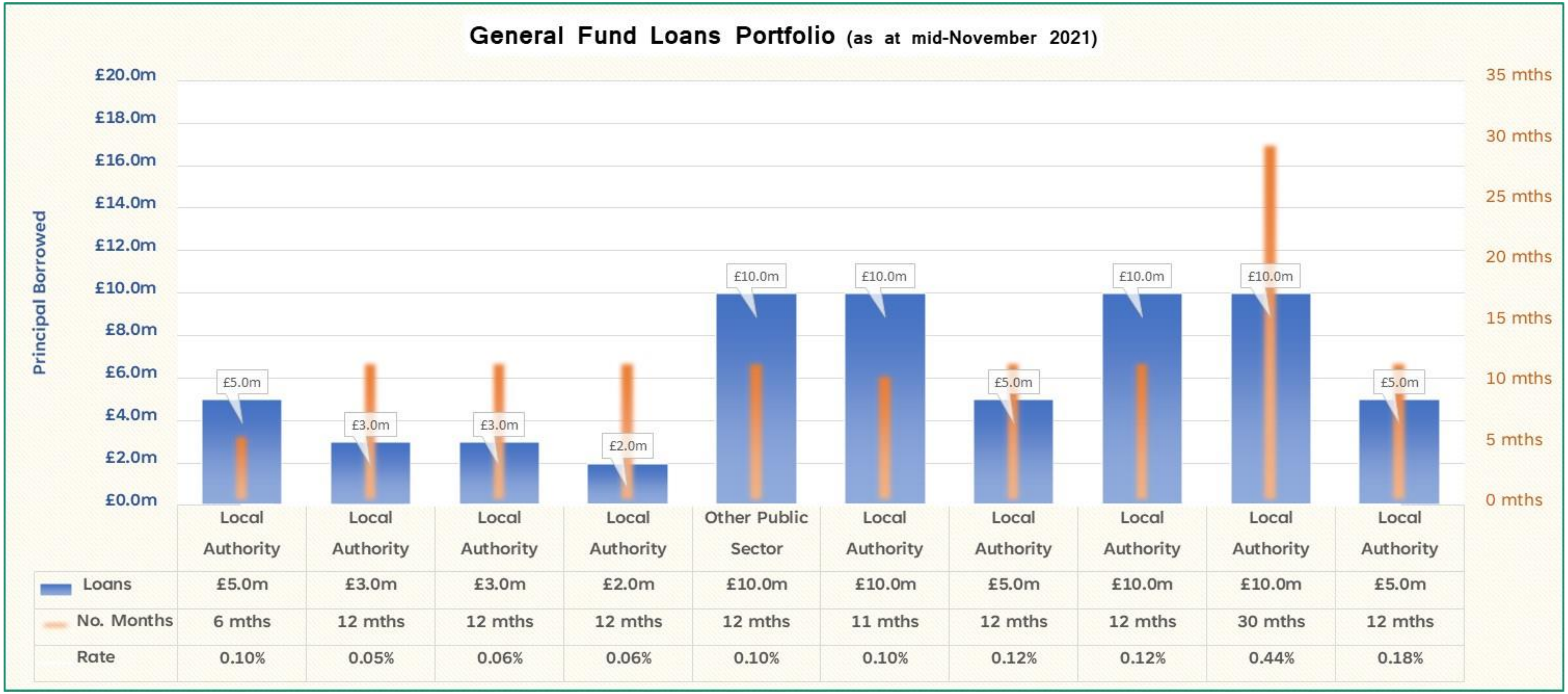
6.16 The Council's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short-term and long-term borrowing was maintained. The bulk of longer-term loans were taken when the Housing Revenue Account was required to adopt the process of Self-Financing by the Government. At that time, the best value option for local authorities was the PWLB. More-recent borrowing has been short-term, in line with the Council's more-recent borrowing strategies. These have been taken out to finance the General Fund borrowing requirements. Local authorities have provided the best value opportunities in the short-term loan market and the aim has been to develop a spread of dates to spread risk and meet liquidity requirements.

6.17 The graphics that follow on the next pages (Graphics A to C) are a new addition to the Treasury Management report. They are intended to provide an at-a-glance view of recent developments in the Council's borrowing portfolios for the General Fund and HRA.

6.18 PWLB funding margins have lurched quite substantially and there remains a strong argument for diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields plus 0.80%. The Council will continue to evaluate and pursue these lower cost solutions and opportunities with its advisor Arlingclose.

Graphic A

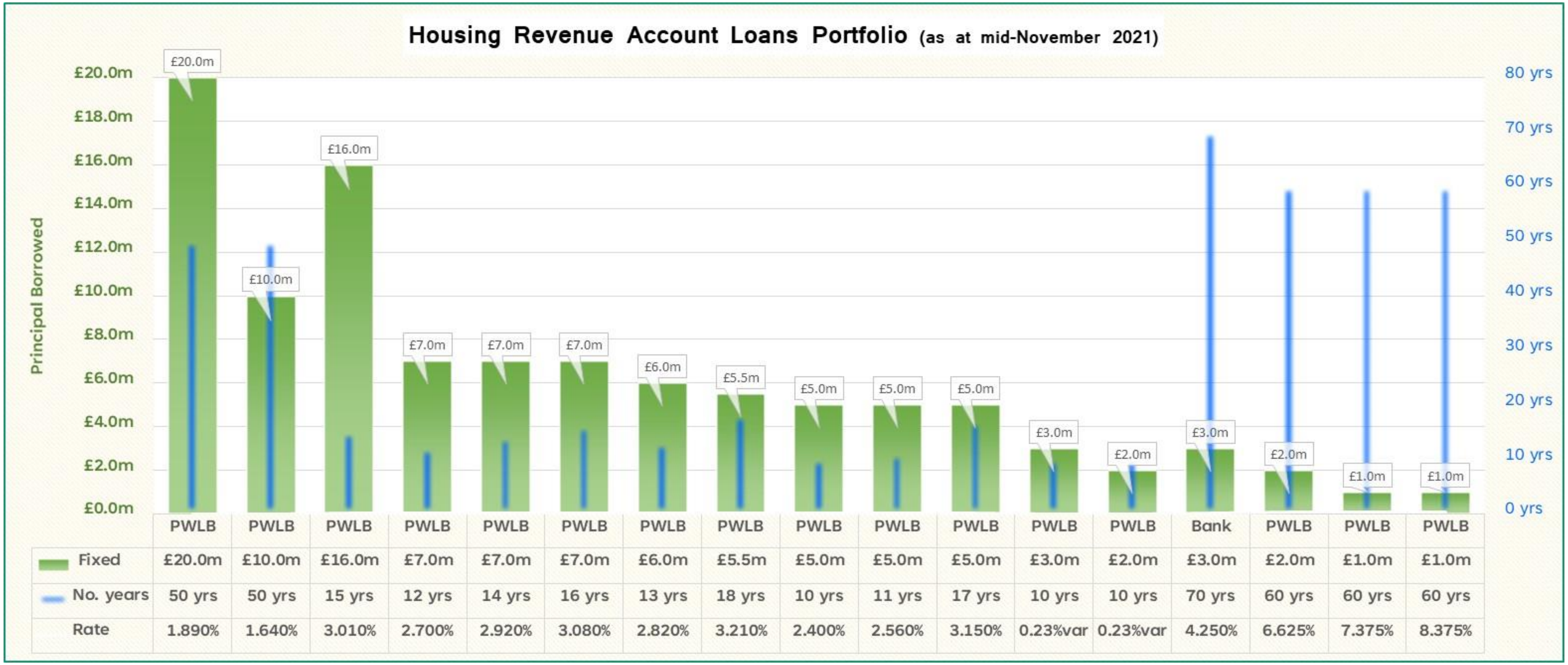
The following graph illustrates the General Fund borrowing portfolio as at the time of writing this report (mid-November 2021). It identifies sums borrowed, the term of each loan (from date of advance to maturity) and the rates secured. All but one loans were advanced by other local authorities, the exception being from a public sector housing authority.



The wide blue bars indicate amounts borrowed, measured against the vertical left-hand axis, whilst the faint orange lines indicate the duration of each loan, measurable against the right-hand vertical axis.

Graphic B.

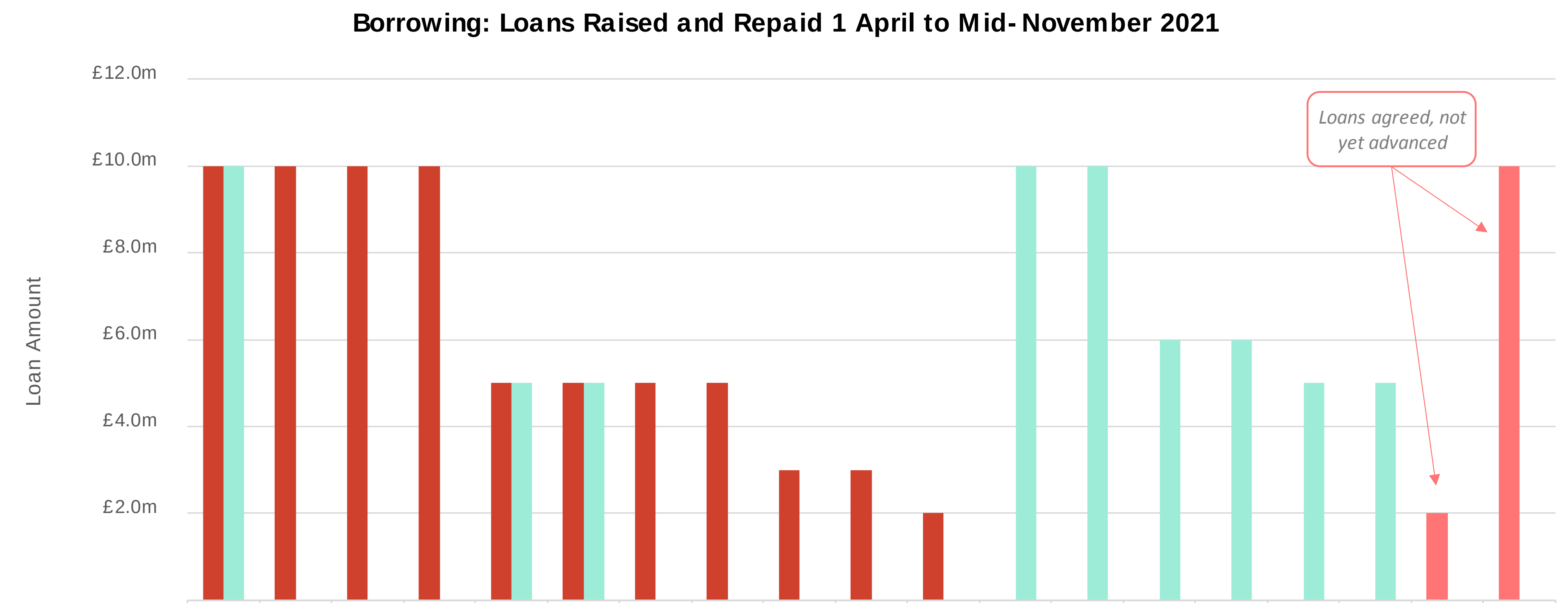
As with Graphic A, above, the following graph illustrates the borrowing portfolio of the Housing Revenue Account as at mid-November 2021. Showing sums borrowed, the term of each loan and the interest rates on those, we can clearly see that advantage was taken of long-term borrowing when Self-Financing was brought in for the HRA. All but one loans were advanced by the Public Works Loan Board, the exception being from a UK Bank.



The wider green bars indicate amounts borrowed whilst the blue lines indicate the duration of each loan.

Graphic C, overleaf, highlights all new borrowing (red bars) and all borrowing repaid (green bars) during the financial year to date (mid-November 2021). Two further loans (light red) had been agreed but not advanced at the time of writing this report.

Graphic C.



	[1]	[2]	[3]	[4]	[5]	[4]	[6]	[7]	[8]	[9]	[10]	[11]	[12]	[13]	[14]	[6]	[15]	[16]	[3]
	2mths	12mths	12mths	11mths	3mths	3mths	12mths	6mths	12mths	12mths	12mths	4mths	2mths	6mths	6mths	6mths	6mths	6mths	12mths
	0.04%	0.10%	0.12%	0.10%	0.04%	0.04%	0.12%	0.10%	0.06%	0.05%	0.06%	0.02%	0.05%	0.12%	0.12%	0.12%	0.12%	0.12%	0.15%
New Loans YTD	10.0m	10.0m	10.0m	10.0m	5.0m	5.0m	5.0m	5.0m	3.0m	3.0m	2.0m							2.0m	10.0m
Repaid YTD	10.0m				5.0m	5.0m						10.0m	10.0m	6.0m	6.0m	5.0m	5.0m		

Key to Lenders

[1] Gtr Manchester Combined Auth'
[2] Northern Ireland Hsg Executive
[3] West of England Combined Auth'
[4] West Yorkshire Combined Auth'
[5] Bridgend County BC
[6] Halton, Knowsley, Liverpool, St Helens, Sefton and Wirral Council
[7] Nottingham CCC
[8] Barrow BC
[9] Vale of Glamorgan Council
[10] Ryedale District Council
[11] Gtr Manchester Pension Fund
[12] Tameside Met' BC
[13] Isle of Wight Council
[14] Northern Ireland Hsg Exec'
[15] London Borough of Redbridge
[16] Tendering DC

Treasury Investment Activity

6.19 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the six months to 30th September 2021, the Council's investment balances ranged between £30.157m and £73.287m, due to timing differences between income and expenditure flows. The investment position is shown in table 5 below.

Table 5: Treasury Investment Position

	31.03.21 Balance £m	Net Movement	30.09.21 Balance £m
Banks and Building Societies (unsecured)	0.867	-0.656	0.211
Government (including local authorities)	14.042	-3.850	10.192
Money Market Funds	13.150	13.550	26.700
Cash Plus Funds	1.010	-0.013	0.997
Strategic Bond Funds	2.080	-0.002	2.078
Equity Income Funds	2.011	-0.003	2.008
Property Funds	4.898	0.179	5.007
Multi Asset Income Fund	6.706	-0.001	6.705
Total Investments	**44.764**	**9.204**	**53.968**

6.20 Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council'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.

6.21 Ultra-low short-dated cash rates, which have been a feature since March 2020 when Bank Rate was cut to 0.1%, have resulted in the return on sterling low volatility net asset value money market funds (LVNAV MMFs) being close to zero even after some managers have temporarily waived or lowered their fees. At this stage net negative returns are not the central case of most MMF managers over the short-term, and fee cuts or waivers should result in MMF net yields having a floor of zero, but the possibility cannot be ruled out.

6.22 Deposit rates with the Debt Management Account Deposit Facility (DMADF) are also largely around zero.

6.23 The progression of risk and return metrics are shown in the extracts from Arlingclose quarterly investment benchmarking in Table 6 below.

Table 6: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
31.03.2021	4.37	AA-	49%	7	4.36%
30.09.2021	**4.48**	**AA-**	**73%**	**5**	**3.62%**
Similar Local Authorities	4.66	A+	69%	32	3.65%
All Local Authorities	4.69	A+	69%	10	2.35%

6.24 Arlingclose provided the Council with a report as at 30th September 2021 which shows that £13.90m of the Council's investments are held in externally managed strategic pooled funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds generated dividends of £591k in the six months to 30th September 2021, an annualised income return of 4.60% which is used to support services in year, and an unrealised capital loss of £108k since purchase.

6.25 The Council is invested 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 capital values of the Council's equity and multi-asset income funds in the Council's portfolio. The prospect of higher inflation and rising bond yields resulted in muted bond fund performance. The capital values of these funds are shown in Table 5, above.

6.26 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 Authority'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. Investments within these funds have been maintained during the six months to 30th September 2021.

Non-Treasury Investments

6.27 The definition of investments in CIPFA's current 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 the Investment Guidance issued by the (previously) Ministry of Housing, Communities and Local Government (MHCLG), in which the definition of investments is further broadened to also include all such assets held partially for financial return.

6.28 The Council also holds £68.625m as investments in directly owned property and £5.567m as loans to local businesses, charities, partnerships and sports clubs as at 30th September 2021. The investments in directly owned property have generated £5.105m in annual rental income, with a net yield of 7.44%. The loans to local businesses, charities, partnerships and sports clubs have generated £91,289 of investment income for the Council, representing an average rate of return of 3.28% in the six months to 30th September 2021.

Treasury Performance

6.29 The Council measures the financial performance of its treasury management activities in terms of its impact on the revenue budget, combining investment and borrowing portfolios for both the General Fund and Housing Revenue Account. The mid- year projections are shown in Table 7 overleaf, which also plots how the budget has moved in-year on the back of new borrowing expectations.

Table 7: Performance

2021/22 Interest	Original Budget £m	Revised Budget £m	Forecast (mid-year) £m	Variance (Forecast v Revised Budget) £m
Interest Payable on Borrowing	2.981	3.506	3.262	-0.244 (favourable)
Interest Receivable on Investments	-0.515	-0.595	-0.719	-0.124 (favourable)

6.30 Some movements have occurred in interest on borrowing, the budget for which has been revised from £2.9m to £3.5m in 2021/22. This was in anticipation of the need for new borrowing to finance the Council's property purchases. The Treasury Team has been particularly successful in using internal borrowing (i.e. cashflow availability from its bank and investment balances) in place of external borrowing. This has been partly helped by utilising COVID grant balances not yet applied or returned to the Government, as well as other sources of liquidity. It has proven to be advantageous because, not only have borrowing costs been delayed and therefore reduced, but the security of the Council's balances has also been optimised (i.e. lower investments result in a reduced risk of losses from the potential failure of financial institutions). Hence, the forecast outturn cost of borrowing is currently £244k below the revised budget for the current financial year. With rising interest rates, this forecast is subject to change as the year progresses.

6.31 The Treasury Team has been active in forecasting and optimising its timing to take advantage of favourable interest rates when opportunities have arisen. Whilst officers are mindful that there is currently a high risk of increases in interest rates, borrowing to finance investment properties is currently planned to comprise short-term loans, and an interest rate rise has been built into the current year's forecast.

6.32 Forecast interest estimates will continue to be closely monitored, especially given the growing pressure on Money Market rate rises.

6.33 With investment rates extremely low and substantial cashflow movements to finance the capital programme, the favourable forecast variance on investments remains modest; it has been maintained at expected levels by high-performing longer-term investments and delays in property transactions having generated some additional investment returns.

Compliance

6.34 The Section 151 Officer reports that all treasury management activities undertaken during the year fully complied with the CIPFA Code of Practice, and all except one of the Council's approved Treasury Management Strategy parameters – see Table 8 and paragraphs 6.35 to 6.37, below.

Table 8: Investment Limits

	2021/22 Maximum	30.9.21 Actual	2021/22 Limit	Complied
Any single organisation, except the UK Government	£1.000m	£0.211m	£7m	Yes
UK Government	£31.624m	£10.192m	Unlimited	Yes

	2021/22 Maximum	30.9.21 Actual	2021/22 Limit	Complied
Any group of organisations under the same ownership	£0.000m	£0.000m	£7m per Group	Yes
Any group of pooled funds under the same management	£16.926m	£16.866m	£21m per Manager	Yes
Negotiable instruments held in a broker's nominee account	£0.000m	£0.000m	£21m per Broker	Yes
Foreign Countries	£0.000m	£0.000m	£7m per Country	Yes
Registered providers and registered social landlords	£0.000m	£0.000m	£21m in Total	Yes
Unsecured investments with building societies	£0.000m	£0.000m	£7m in Total	Yes
Loans to unrated corporates	£0.000m	£0.000m	£7m in Total	Yes
Money Market Funds	£28.000m	£26.000m	£42m in Total	Yes
Real Estate Investment Trusts	£0.000m	£0.000m	£21m in Total	Yes

6.35 During the first six months to 30 September 2021, there were 5 occasions when the Council exceeded its overnight limit of £500k with NatWest due to unexpected monies being received late in the day; when monies are received after the cut-off time for remitting funds to other investment institutions, the Council is unable to take corrective action hence, on this occasion the markets had ceased trading for the day. Meanwhile, between 30th September and the date on which this report was finalised (end November 2021), three other occasions arose where the current limit was exceeded. In each of the total of eight events, no monies were lost, and corrective action took place the working day following each occurrence.

6.36 The impact of exceeding the overnight limit on these occasions has been carefully reviewed. It has been found to have presented only very negligible risk to the Council. As a result, this report includes a recommendation that the limit for overnight balances, as contained within the Treasury Management Strategy Statement, be amended. Details of the review findings and the subsequent recommendation are set out towards the end of this report, starting at paragraph 6.52.

6.37 There was also one occasion in the six-month period to 30th September 2021 when the Council went into an unforeseen overnight overdraft position. This event was due to settlement information on a property purchase becoming available after the cut-off time for drawing down from Money Market Funds (the key source of daily cashflow requirements at that time). Corrective action was taken the next day to restore the overdrawn balance. Further processes have subsequently been put in place to mitigate against similar instances arising, especially given the substantial activity in property purchases during this financial year. A weekly property transaction briefing is supplied to the Treasury Team that is updated on the back of purchase negotiations as well as legal and settlement processes.

6.38 Compliance with the authorised limit and the operational boundary for external debt is demonstrated in Table 9 overleaf:

Table 9: Debt Limits

	2021/22 Maximum £000	30.9.21 Actual £000	2021/22 Operational Boundary £000	2021/2022 Authorised Limit £000	Complied
Borrowing	163,500	163,500	300,000	340,000	Yes
Total debt	**163,500**	**163,500**	**300,000**	**340,000**	

Treasury Management Indicators

6.39 The Council measures and manages its exposures to treasury management risks using the following indicators.

6.40 **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	30.9.21 Actual	2021/22 Target	Complied
Portfolio average credit rating	AA-	A-	Yes

6.41 **Liquidity:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

	30.9.21 Actual	2021/22 Target	Complied
Total cash available within 3 months	£53.97m	£20.00m	Yes

6.42 **Interest Rate Exposures:** This indicator is set to control the Council's exposure to interest rate risk in the General Fund. The upper limits on the one-year revenue impact of a 1% rise or fall in interest were:

Interest rate risk indicator	30.9.21 Actual	2021/22 Limit	Complied
Upper limit on one-year revenue impact of a 1% rise/ fall in interest rates	£47,648	£50,000	Yes

6.43 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current market rates. It is also assumed, for the purpose of this indicator, that there is no impact from the business cases for commercial properties (costs and income) and that borrowing, and returns are absorbed within the financial structures aligned with those properties.

6.44 **Maturity Structure of Borrowing:** This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were (see overleaf):

	30.9.21 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	35.47%	100%	0%	Yes
12 months and within 24 months	9.17%	100%	0%	Yes
24 months and within 5 years	12.23%	100%	0%	Yes
5 years and within 10 years	20.49%	100%	0%	Yes
10 years and above	22.64%	100%	0%	Yes

6.45 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.

6.46 **Principal Sums Invested for Periods Longer than a year:** The purpose of this indicator is to control the Council'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 as follows:

	2021/22	2022/23	2023/24
Actual principal invested beyond year end	£0m	£0m	£0m
Limit on principal invested beyond year end	£30m	£25m	£25m
Complied	Yes	Yes	Yes

Other Matters

6.47 **Revisions to CIPFA Codes:** 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 to be applied to the Codes that it is revising.

6.48 Thus, 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:
  - a) local councils must not borrow to invest primarily for financial return
  - b) it is not prudent for councils 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 council.
- Categorising investments as those for:
  - a) treasury management purposes,
  - b) service purposes and
  - c) commercial purposes.
- Defining acceptable reasons to borrow money, being:
  - (i) financing capital expenditure primarily related to delivering a local authority's functions,

(ii) temporary management of cash flow within the context of a balanced budget,
(iii) securing affordability by removing exposure to future interest rate rises and
(iv) 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 that informs about the authority's funding requirement for the near, medium, and long term. CIPFA recommends this covers at least 10 years and ideally covers the authority's full debt maturity profile, and is presented as a chart of four balances setting out:
    - existing loan debt outstanding,
    - loans CFR,
    - net loans requirement (being the authority's gross loan debt, less treasury management investments, at the last financial year-end, projected into the future based on its approved debt funded capital expenditure, planned MRP and any other forecasts of major cash flows),
    - liability benchmark (being the Net Borrowing Requirement of a local authority plus a liquidity allowance).
  - Excluding investment income from the definition of financing costs.
- Incorporating Environmental, Social and Governance (ESG) issues as a consideration within the Treasury Management Practices (TMP 13, ESG Risk Management).
- Additional focus on the knowledge and skills of officers and elected Members involved in decision making.

6.49 **MHCLG Improvements to the Capital Finance Network:** MHCLG (before the department was renamed Department for Levelling Up, Housing and Communities) 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".

6.50 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.

6.51 These matters are part of a consultation process.

6.52 **Review of maximum balance held in Operational bank accounts:** Paragraph 5.16 of the current Treasury Management Strategy (TMS) states:

> "**Operational bank accounts:** The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £500,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity."

6.53 The TMS was approved by Full Council on 30 March 2021 as part of a wider report covering the Council's Capital, Investment and Treasury Strategies 2021/22 to 2025/26.

6.54 As reported in paragraph 6.35 of this report, further above, the TMS operational limit was exceeded on five occasions during the first half of this financial year.

6.55 The circumstances and risks posed by these events have been carefully examined. The conclusions of the review are set out as follows:

- The nature of income transactions to the Council's bank account are such that large remittances received on any given business day can result in breaching the current bank deposit threshold of £500,000 with no scope for correction. The early cut-off time for the Council to register and transfer monies from its bank to other facilities (e.g. Money Market Funds) prevents the transfer of late remittances. Whilst every endeavour is made to obtain information of forthcoming remittances in advance so that appropriate cashflow forecasting can be made, the Council cannot control the timing of all remittances, particularly in view of the number and nature of remitting organisations; effectively these receipts remain out of the Council's control.
- Given the significant number of occasions on which the threshold has been breached, this is indicative that the current threshold is not adequate. This being the case, it is necessary to identify an increased threshold that will service operational needs, yet which presents minimal risk of financial loss to the Council.
- The relevant section of the TMS appears to have (rightly) been composed when the Council's bank (NatWest, being part of the Royal Bank of Scotland Group) had faced a substantial downgrading of its credit rating.
- The Royal Bank of Scotland Group underwent a substantial restructuring in 2017, with NatWest reverting back to being the Group's primary bank in England, Wales and Western Europe; it was, effectively, ringfenced from RBS with RBS's core business focussing on Scotland. Subsequently, the financial standing of NatWest has improved substantially. The NatWest credit rating is now typically "A" rated, comfortably above "BBB-" rating cited in the existing TMS.
- Officers have consulted the Council's Treasury Management advisors, Arlingclose, who have raised no concerns and have reviewed data, routinely supplied by Arlingclose, which recommends maximum investment parameters.

- As a result of the above actions and applying a conservative approach to recommending a more-appropriate threshold, it is now proposed to amend the TMS to allow a maximum balance of £1,200,000 at the Council's own operational bank before a breach is considered to have occurred. It is also considered best practice to review this limit each year and mid-year to capture any issues that may give rise to adjusting this threshold.
- The calculation for the recommended new threshold of £1.2m remains substantially below the investment limits and investment duration recommended by Arlingclose. It is also important to recognise that balances held in the Council's bank account effectively represent an overnight deposit, which may be moved to a safer deposit-taker on the next working day in the event of any risks of catastrophic bank failure becoming apparent.
- This recommendation does have the added advantage of providing capacity for the Council's banking arrangements over the Christmas break, when it is usual to minimise banking transactions.
- On a practical day-to-day basis, the requirement for an "operational target" of between nil and £500k would remain as being most appropriate, although the higher threshold of £1.2m presents increased efficiency in daily treasury dealings and would form the ultimate control threshold.

6.56 Therefore, it is recommended to amend paragraph 5.16 of the TMS to read as follows:

> "**Operational bank accounts:** The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to the UK bank appointed to supply the Council with its main banking service. Whilst balances held at the appointed bank are not classed as investments, they remain subject to the risk of a bank bail-in. Nevertheless, in order to provide a suitable platform for the Council to conduct its day-to-day banking transactions and receive remittances, a threshold of £1,200,000 will be applied to the daily bank balance, above which balances should not be held after concluding each day's treasury and dealing activities. This threshold will be the subject of review at least twice each year, to coincide with annual Treasury Management reporting to Members. At his/her discretion, the Assistant Director Finance (S151 Officer) may introduce a reduction to this threshold if circumstances in the banking sector indicate the need.

7 Links to Corporate Aims / Priorities

7.1 The Capital, Investment and Treasury Management Strategies support the delivery of the Corporate Aims.

8 Finance / Resource Implications

8.1 The Treasury Management function has been well-managed during the year in compliance with the Treasury Management Strategy. As interest rates remain low the opportunities to generate significant income through short-term investments has been limited; however, the use of cashflow balances to provide internal borrowing as an alternative to external borrowing is envisaged to be beneficial in reducing borrowing costs during 2021/22.

8.2 This report provides full details of the Treasury Management activity during the year. A summary of the key points follows:

- As at 31st March 2021, Somerset West and Taunton Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £192.920m; usable reserves and working capital, which were the underlying resources available for investment, were £85.578m and £7.422m respectively.

- As at 30th September 2021, Somerset West and Taunton Council had external borrowing of £163.5m, with £105.5m attributable to the Housing Revenue Account and £58.0m attributable to the General Fund.

- Somerset West and Taunton Council also had £53.968m of investments as at 30th September 2021.

- The Council's current strategy was to maintain borrowing and investments below their underlying levels, referred to as internal borrowing.

- The forecast for interest on borrowing and investment income in 2021/22 indicates a favourable variation of approximately £600k; however, the market for borrowing and investments has recently become more volatile with rising inflation and UK domestic and international trading concerns.

- An amendment to the Treasury Management Strategy is recommended to accommodate operational requirements when large deposits are posted to the Council's bank account without prior notice being supplied to the Treasury Team.

9 Legal Implications

9.1 The S151 Officer has a statutory responsibility to ensure appropriate arrangements are in place to adequately control the Council's resources. The Council is required to have regard to the Prudential Code, Treasury Management Code and relevant statutory guidance.

10 Climate and Sustainability, Safeguarding and/or Community Safety, Equality and Diversity, Social Value, Partnership, Health and Wellbeing, Asset Management, Data Protection and Consultation Implications

10.1 None in respect of this report.

Democratic Path:

- **Audit and Governance Committee – Yes**
- **Full Council – Yes**

Reporting Frequency: Annually

List of Appendices

Appendix A	External Context – Analysis by Arlingclose
Appendix B	List of Investments as at 31 March 2021
Appendix C	Arlingclose’s Economic Outlook for the remainder of 2021/22 (based on the October 2021 interest rate forecast)

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