



POLICY AND RESOURCES SCRUTINY COMMITTEE – INFORMATION ITEM

**SUBJECT: TREASURY MANAGEMENT AND CAPITAL FINANCING
PRUDENTIAL INDICATORS QUARTER 2 MONITORING
REPORT (1ST APRIL 2021 TO 30TH SEPTEMBER 2021)**

**REPORT BY: CORPORATE DIRECTOR FOR EDUCATION AND
CORPORATE SERVICES**

1. PURPOSE OF REPORT

- 1.1 To present Members with details of Treasury Management activities and Capital Financing, together with the related Prudential Indicators for the period 1st April 2021 to 30th September 2021.
- 1.2 To review the Treasury Management Strategy for 2021/22 as set out in the Annual Investment Strategy and Capital Financing Prudential Indicators Report.

2. SUMMARY

- 2.1 The Code of Practice on Treasury Management in the Public Services 2009, which was adopted by the Council on 12th October 2010, sets out a framework of operating procedures, which is encompassed in the Treasury Management Practices (TMPs). TMP6 (Reporting Requirements and Management Information Arrangements) which requires the Authority to approve treasury management semi-annual and annual reports.
- 2.2 Under the provisions of the Local Government Act 2003, The Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 [The Capital Regulations], and the CIPFA's "The Prudential Code for Capital Finance in Local Authorities" [the Code], the Authority is obliged to approve and publish a number of indicators relevant to Capital Finance and Treasury Management.
- 2.3 The updated Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, which is to be a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The capital strategy for 2021/22 was submitted to Full Council on the 24th February 2021.
- 2.4 The Authority's Annual Treasury Strategy and Capital Financing Prudential Indicators for 2021/22 were also approved by Council on the 24th February 2021.

3. RECOMMENDATIONS

3.1 Members are asked to note the contents of this report.

4. REASONS FOR THE RECOMMENDATIONS

4.1 Compliance with the CIPFA “Code of Practice for Treasury Management in the Public Services”.

5. THE REPORT

5.1 Treasury Management

5.1.1 Borrowing Activity

The current policy of internal borrowing is not sustainable in the long-term, but where prudent the policy of internal borrowing will be utilised. As at the 31st March 2021 the internal borrowing position was £72m.

The Annual Treasury Management Strategy was approved by Council in February 2021. As part of the strategy approval was given to borrow £37.2m in 2021/22 to part fund the General Fund capital programme if required. A further £52.0m was approved for the HRA to fund the WHQS and Affordable Housing capital programme. During the reported period no external borrowing has taken place and internal funds have been used. There was a further drawdown of £827k from the Salix Loan Facility during the reported period. Total Salix drawn down to date is £4.1m.

During the period covered by this report, PWLB loans to the value of £1.6m were repaid on maturity. Such loans had an average interest rate of 4.43%. £30k of the WRU Loan was also repaid. Total debt outstanding as at 30th September 2021 was £318.8m and comprised of £254.7m PWLB loans; £30m market loans (LOBOs); £10m Bank loan; £20m WG loan, £60k WRU loan; and a £4.1m Salix Energy Finance loan.

With respect to LOBO loans the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. During the reporting period our total LOBO portfolio with a value of £30m had a rate option reviewed, and the lenders chose not to exercise the option. LOBO loans will be further reviewed again later in 2021/22 by lenders, with our total LOBO portfolio of £30m exposed to variable interest rate movement. This represents 9.4% of the Authority's debt portfolio, which is exposed to interest rate risk. The Authority acknowledges there is an element of refinancing risk even though in the current interest rate environment lenders are unlikely to exercise their options.

5.1.2 Rescheduling

The Annual Strategy allows for the utilisation of debt rescheduling providing for both in year and future year savings and additional revenue resources. No rescheduling opportunities were utilised during the period covered by this report.

5.1.3 Investments

During the reported period the Authority was holding £36.5m of long-term investments where the maturity date is greater than 365 days. These investments are in accordance with the approved Investment Strategy. The long-term investments comprise of UK Gilts, Loans to Registered Providers, Real Estate Investment Trusts (REITS) and pooled funds. The value of short-term deposits as at 30th September 2021 was £121.2m.

The total investments held as at 30th September 2021 were £157.7m and had a total average rate of return equating to 0.69% which is a significant improvement over placing deposits with the Debt Management Office (DMO) whose rates were typically 0.01% during the reporting period and going into negative territory towards the end of the reporting period. The rate of return is above the target rate, as detailed in the Annual Treasury Management Strategy report to Council, of 0.10%. Investment rates continued to remain low during the reporting period on our traditional style investments e.g. Covered Bonds and Inter-LA lending. As a result of additional monies being received due to Covid-19 most Local Authorities held surplus cash balances and the inter-LA market was virtually non-existent.

During the reporting period, the Authority made a further investment of £7.5m into their pooled funds. These funds allow the Authority to generate enhanced returns and the intention is to hold them for a minimum of five years as per the Treasury Strategy 2021-22. These investments generated an income return of 4.42% during the reporting period.

Due to the low rates on offer it proved more beneficial to the Authority to maintain our cash surpluses to subsidise our capital programme and delay any borrowing during this time of uncertainty. Our overall income return of 0.69% compared to a rate of 0.48% for 9 other Welsh Authorities as per the quarterly figures provided by our Treasury Advisors.

The portfolio as at 30th September 2021 comprised of the following types of investments:

Counterparty	Investment Product	Sector	£m
Banks & Building Societies	Covered bonds	Financial	4.0
Banks	Instant Access	Financial	24.2
Money Market Fund	Cash Pooled Fund	Financial	40.0
UK Government	Gilts	UK Government	10.0
UK Government	Fixed-Term Cash Deposit	UK Government	50.0
Local Authorities and Housing Associations	Fixed-term cash deposits	Local Government	11.0
External Fund Managers	Property Pooled Fund	Property	10.0
External Fund Managers	Bond Pooled Fund	Mixed	2.5
External Fund Manager	Equity Pooled Fund	Mixed	2.5
External Fund Manager	Multi Asset Pooled Fund	Mixed	2.5

REIT	Pooled Fund	Property	1.0
Total Investments as at 30th September 2021			157.7

5.1.4 Economic Outlook

The economic recovery from the coronavirus pandemic continued to dominate the first half of the financial year. Government initiatives continued to support the economy over the quarter but came to an end on 30th September 2021, with businesses required to either take back the 1.6 million workers on the furlough scheme or make them redundant.

The Bank of England (BoE) held Bank rate at 0.1% throughout the period and maintained its Quantitative Easing Programme at £895 billion, unchanged since the November 2020 meeting. In its September 2021 policy announcement, the BoE noted it now expected the UK economy to grow at a slower pace than was predicted in August, as the pace of the global recovery had shown signs of slowing and there were concerns inflationary pressures may be more persistent.

The path of CPI inflation is increasing and reached 5.1% in November 2021, due to higher energy prices and core goods inflation.

The easing of restrictions boosted activity during the second quarter of 2021 helping push GDP up by 5.5%. Bank expectations for GDP growth for the third quarter were revised down to 2.1% from 2.9% in part reflecting tighter supply conditions.

Globally, the US economy grew by 6.3% in Q1 2021 and then by an even stronger 6.6% in Q2 as the recovery continued. The Federal Reserve maintained the Federal Funds rate at between 0% and 0.25% over the period.

The European Central Bank maintained its base rate at 0% and deposit rate at -0.5%.

The 5-year UK bench gilt yield began the financial year at 0.36% but rose to 0.64% by the 30th September 2021. 10 year and 20-year gilt yields were 1.03% and 1.37% respectively at the end of the reporting period.

The Sterling Overnight Rate (SONIA) averaged 0.05% over the quarter.

Arlingclose expects Bank Rates to rise further during 2022 as per table below.

Official Bank Rate	Upside Risk	Arlingclose (Central case)	Downside Risk
2022/23 Q1	0.00	0.50%	-0.25
2022/23 Q2	0.25	0.50%	-0.25
2022/23 Q3	0.25	0.50%	-0.25
2022/23 Q4	0.50	0.50%	-0.25
2023/24	0.50	0.50%	-0.25
2024/25	0.50	0.50%	-0.25

5.1.5 Borrowing Update

Local Authorities can borrow from the PWLB provided they can confirm they are not planning to purchase 'investment assets primarily for yield' in the current or next two financial years with confirmation of the purpose of capital expenditure from the Section 151 Officer. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or to externalise internal borrowing. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

HM Treasury published further guidance on PWLB borrowing in August 2021 providing additional detail and clarification predominantly around the definition of 'investment asset primarily for yield'.

Competitive market alternatives may be available 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.

The authority is not planning to purchase any investment assets primarily for yield within the next 3 years and so is able to take advantage of the reduction in the PWLB borrowing rate.

The UK Infrastructure Bank, which is wholly owned and backed by HM Treasury, has been set up with £4bn of funding earmarked to lending to Local Authorities. Loans will be available for qualifying projects at gilt yield plus 0.6%, which is 0.2% lower than the PWLB certainty rate.

5.1.6 Counterparty Update

Credit Default Swap (CDS) spreads were flat over the period and are broadly in line with their pre-pandemic levels. The gap in spreads between UK ringfenced and non-ringfenced entities continued to narrow. Over the period Fitch and Moody's upwardly revised to stable the outlook on a number of UK banks and building societies on our counterparty list, recognising their improved capital positions compared to last year and better economic growth prospects in the UK.

The successful vaccine rollout programme is credit positive for the financial services sector in general. While there is still uncertainty around the full extent of the losses banks and building societies will suffer due to the pandemic-related economic slowdown, the sector is in a generally better position compared to earlier this year and 2020.

At the end of this period Arlingclose had completed its full review of its credit advice on unsecured deposits. The maximum duration limit for UK bank entities was extended to 100 days whilst Nationwide BS and non-UK institutions remain on 35 days.

5.1.7 Non-Treasury Investments

The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. Such investments can comprise of property; shared ownership housing; loans to local businesses/ subsidiaries; and shareholdings. During the reported period the Authority did not hold any non-treasury related investments.

5.2 **Prudential Indicators**

5.2.1 Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose. In accordance with best professional practice, the Authority does not associate borrowing with particular items or types of expenditure. In practice, the raising and repaying of loans is determined primarily by professional / expert advice and may not necessarily take place in the relevant year. In order to create an operating environment within which the Treasury Manager can legitimately react to appropriate advice, the various authorised limits as identified in Appendix 1 are set at a level in excess of the CFR. In the financial year to date, the Authority has been operating within the approved limits.

Appendix 1 shows a projected CFR value of £390.9m as at 31st March 2022. The actual CFR as at 31st March 2021 was £375.7m. Due to the pandemic certain capital schemes have been delayed or the scheme extended which has resulted in a lower funding requirement than budgeted.

5.2.2 Prudential Indicators – “Prudence”

The Prudential Indicators for Treasury Management are shown in Appendix 1, and the Authority is currently operating within the approved limits.

5.2.3 Prudential Indicators – “Affordability”

There is a requirement to analyse and report the capital financing costs and express those costs as a percentage of the net revenue streams of the Authority. These are identified in Appendix 2 and currently show a projected reduction from the original budget as a consequence of deferred borrowing for the General Fund.

5.2.4 Capital Expenditure and Funding

A summary of capital expenditure and funding is attached at Appendix 3 and shows that there will be an underspend on the core capital budget for HRA due to delays as a result of Covid-19.

6. **ASSUMPTIONS**

- 6.1 The details set out in the report are based on actuals that have occurred between 1st April 2021 and 30th September 2021 (period 6).

7. SUMMARY OF INTEGRATED IMPACT ASSESSMENT

7.1 This report is for information only and no Integrated Impact Assessment is required.

8. FINANCIAL IMPLICATIONS

8.1 As detailed throughout the report.

9. PERSONNEL IMPLICATIONS

9.1 There are no personnel implications arising from this report.

10. CONSULTATIONS

10.1 There are no consultation responses that have not been reflected in this report.

11. STATUTORY POWER

11.1 Local Government Acts 1972 and 2003.

Author: Rhiann Williams – Group Accountant- Treasury & Capital
E-mail: willirh@caerphilly.gov.uk

Consultees:

S. Harris – Head of Financial Services and S151 Officer

A. Southcombe – Finance Manager, Corporate Finance

R. Edmunds – Corporate Director for Education and Corporate Services

Cllr E. Stenner – Cabinet Member for Performance, Economy & Enterprise

Appendices:

Appendix 1 – Treasury Management Prudential Indicators – Prudence

Appendix 2 – Capital Finance Prudential Indicators – Affordability

Appendix 3 – Capital Expenditure and Funding