East Lothian Council

REPORT TO:	Audit and Governance Committee
MEETING DATE:	30 November 2021
BY:	Executive Director for Council Resources
SUBJECT:	Treasury Management – Mid Year Review 2021-22

1 PURPOSE

1.1 To update the Committee on Treasury Management activity during the first half of 2021-22.

2 RECOMMENDATIONS

2.1 The Committee is asked to note the content of the report.

3 BACKGROUND

3.1 A main function of treasury management operations is to ensure that the cash flow is adequately planned, with cash being available when it is required. Surplus monies are invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

3.2 In addition, the treasury management service manages the accounting and funding of the Council's capital plans. The approved capital plans provide a guide to the borrowing need of the Council, including setting out the longer-term cash flow planning to ensure the Council can meet its capital spending obligations in future years. This management of longer-term cash may involve arranging long or short-term loans or using longer-term cash flow surpluses. On occasion, any debt previously incurred may be restructured to meet wider risk or cost objectives.

3.3 Treasury management is therefore defined as being the management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks. This mid-year report is reviewed against the current Treasury Management Strategy that was approved by Council in March 2021.

3.4 This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

A. An economic update for the first part of the 2021-22 financial year;
B. A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
C. The Council's capital position (prudential indicators);
D. A review of the Council's investment portfolio for 2021-22;
E. A review of the Council's borrowing strategy for 2021-22;
F. A review of any debt rescheduling undertaken during 2021-22.

Part A – Economic Update

3.5 The Monetary Policy Committee (MPC) left the bank rate unchanged at 0.10% at the September meeting. The rate has been held at 0.10% since the emergency rate reduction in March 2020. The MPC is to continue the programme of quantitative easing until the end of 2021.

3.6 The MPC has indicated a tightening of monetary policy may be required to stem inflation, which is currently above the 2% target, implying an interest rate increase is now more likely in the near future. Employment market concerns are being closely monitored. Global supply chain issues continue to have a disruptive effect on the economy and this is contributing to goods/materials shortages, delays and price increases.

3.7 The MPC's thoughts and the economic conditions informed our treasury advisors forecast given in table 3.1. It shows projected increases in the bank rate from 0.10% in December 2021 rising to 0.25% in June 2022, with other increases projected to 0.50% in June 2023 and 0.75% in March 2024.

Table 3.1

Link Group Interest Rate View	29.9.21									
	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.75
3 month ave earnings	0.10	0.10	0.20	0.20	0.30	0.40	0.50	0.50	0.60	0.70
6 month ave earnings	0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.60	0.70	0.80
12 month ave earnings	0.30	0.40	0.50	0.50	0.50	0.60	0.70	0.80	0.90	1.00
5 yr PWLB	1.40	1.40	1.50	1.50	1.60	1.60	1.60	1.70	1.70	1.70
10 yr PWLB	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10
25 yr PWLB	2.20	2.20	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.60
50 yr PWLB	2.00	2.00	2.10	2.20	2.20	2.20	2.20	2.30	2.30	2.40

Part B – Review of Treasury Management Strategy Statement and Annual Investment Strategy

3.8 The Treasury Management Strategy Statement (TMSS) sets out the wider Treasury and Investment Strategy, and was approved by Council on 2 March 2021. The Strategy includes a number of key treasury management indicators. This report provides an update on the Treasury Management activity undertaken by the Council relative to the approved strategy taking account of the updated economic position and budgetary changes already approved.

3.9 Table 3.2 below provides a summary of the current position relative to approved indicators, with more details around the position on each indicator set out in the remainder of this report.

Table 3.2

Prudential Indicators 2021-22	**Approved £m**	**Current Estimated Prudential Indicator £m**
Capital Financing Requirement	541	539
Operational Boundary	541	539
Authorised Limit	590	590

Includes long term liabilities for PPP arrangements and finance leases

Part C - The Council's Capital Position (Prudential Indicators)

3.10 The current projections set against the approved indicators are set out below.

<u>Capital Expenditure and Financing of the Capital Programme</u>

3.11 Table 3.3 below sets out the current projected outturns for the Council's capital investment programmes for 2021-22 relative to the approved budget as at 2 March 2021. The table sets out how the programme is financed, highlighting the supported and unsupported elements and the expected financing arrangements. The borrowing requirement increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR). This in part will be offset by any revenue charges for the repayment of debt.

Table 3.3

Capital Expenditure	2021-22 Approved Budget £m	2021-22 Projected Outturn * £m
General Services	91.5	88.5
HRA	29.7	34.7
Total capital expenditure	**121.2**	**123.2**
Financed by:		
Capital receipts	12.4	11.8
Capital Grants	32.7	30.6
CFCR	2.5	2.5
Total financing	**47.6**	**44.9**
Borrowing requirement	**73.6**	**78.3**

** Projected outturn is based on the position as reported in the November Council update and remains subject to change*

Impact on Prudential Indicators

3.12 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. Table 3.4 below, sets out the CFR and the expected debt position over the period, which is termed the Operational Boundary.

3.13 In summary, the Council is currently projecting to be under the approved limits for both CFR and Operational Boundary. This is largely due to the re-profiling of capital expenditure to align with estimated construction timescales. Future years Treasury indicators will be revised to take cognisance of the 2021-22 projected outturn, and the Council is expected to remain well within the Authorised Limit.

Table 3.4

	2021-22 Approved Limits £m	2021-22 Projected Outturn £m
Prudential Indicator – Capital Financing Requirement		
CFR – General Services	314	312
CFR – HRA	227	227
Total CFR	**541**	**539**
Prudential Indicator – the Operational Boundary for external debt		
Borrowing	507	506
Other long term liabilities*	34	33
Total debt (year-end position)	**541**	**539**

** PPP arrangements and finance leases*

Limits to Borrowing Activity

3.14 One of the main key controls over the treasury activity is to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, (except in the short term), exceed the total of CFR in the previous year plus the estimates of any additional CFR for 2021-22 and next two financial years. This allows some flexibility for limited early borrowing for future years should the need arise.

3.15 Table 3.5 below sets out that the Council is currently managing to operate within this limit and maintains an under-borrowed position. The table states that at the end of this year the Council expects to have external borrowings of £453m and utilise £53m of cash flow funds (under-borrowing) in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate and remains consistent with the approved Treasury Management Strategy.

Table 3.5

	2020-21 Estimate £m	**2020-21 Actual £m**	**2021-22 Original Estimate £m**	**2021-22 Revised Estimate £m**
External borrowing	398	366	469	453
Other long term liabilities*	35	35	34	33
Total external debt	433	401	503	486
CFR* (year end position)	**474**	**467**	**541**	**539**
Under-borrowing	**41**	**66**	**38**	**53**

** Includes PPP arrangements and finance leases etc.*

3.16 The Authorised Limit is a statutory requirement that represents the limit beyond which borrowing is prohibited and sets an overall control on the level of borrowing. This limit reflects the level of borrowing which while not desired, could be afforded in the short term, but is not sustainable in the longer term. The approved Authorised Limit is £590 million and as highlighted in the table above, the Council continues to operate well within approved limits, and therefore there is no change to the overall strategy required.

Part D - Investment Portfolio 2021-22

3.17 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return consistent with the Council's risk appetite. Wider loan interest rates remain low and in line with the current 0.10% Bank Rate. It is anticipated that any future increases in Bank interest rates will be gradual and given this, investment returns are likely to remain low.

3.18 The Council's investment decisions are made in accordance with the approved strategy. No short term investments were placed during this time. Any surplus cash balances are held in the Council's bank account.

3.19 An external investment management company, Investec, manages East Lothian Council Common Good funds and Charitable Trust funds in two separate portfolios. The returns on these investments continue to be closely monitored during the year.

- At 30 September 2021, the East Lothian Charitable Trust portfolio was valued at £3.849m, which represents an increase of £0.206m over the 6-month period. The performance of this portfolio for the first 6 months is in line with the benchmark.
- The Common Good portfolio was valued at £3.900m, an increase of £0.221m over the 6 month period. The expectation is that this portfolio should grow the fund and generate the best income at the minimal risk and the increase in the first 6 months is line with this expectation given the current market conditions. The performance of this portfolio for the first 6 months in line with the benchmark.

Part E – Borrowing Strategy 2020-21

3.20 In recent years, the Council has predominately used PWLB as its main source of funding partly due to the level of risk and interest rates available. Consideration is given to both the maturity profile and interest rates to manage cost and refinancing risk. With regard to the interest rate forecast discussed in Part A, a gradual increase in interest rates has been included within the current approved capital investment and borrowing plans, and therefore any increases are unlikely to impact in this financial year. Going forward however, the Council will need to consider further both the affordability of capital investment plans and potentially seek alternative sources of borrowing in order to achieve the best rates and terms. Whilst it remains unclear as to the extent of any further increase in borrowing rates, the Council's treasury advisor, Link Asset Services provides regular forecasting of PWLB rates so that an informed decision can be made on the timing of the borrowing for the capital programme.

3.21 Four long term external loans were taken in the first 6 months of the financial year and details are set out in Table 3.6 below. From the borrowing set out, one loan amounting to £3m was made available at a specific discounted infrastructure rate in relation to the Wallyford Learning Campus.

Due to the overall financial position and the underlying need to borrow for capital purposes (the capital financing requirement – CFR, currently £539m), it is anticipated that additional new external borrowing of £83m will be required during the second half of this financial year.

Table 3.6

Loan	Loan Date	Principal	Maturity	Interest rate
PWLB	30/09/21	£10m	50 years	1.72%
PWLB	30/09/21	£10m	49 years	1.72%
PWLB	30/09/21	£2m	48 years	1.74%
PWLB	30/09/21	£3m	48 years	1.54%

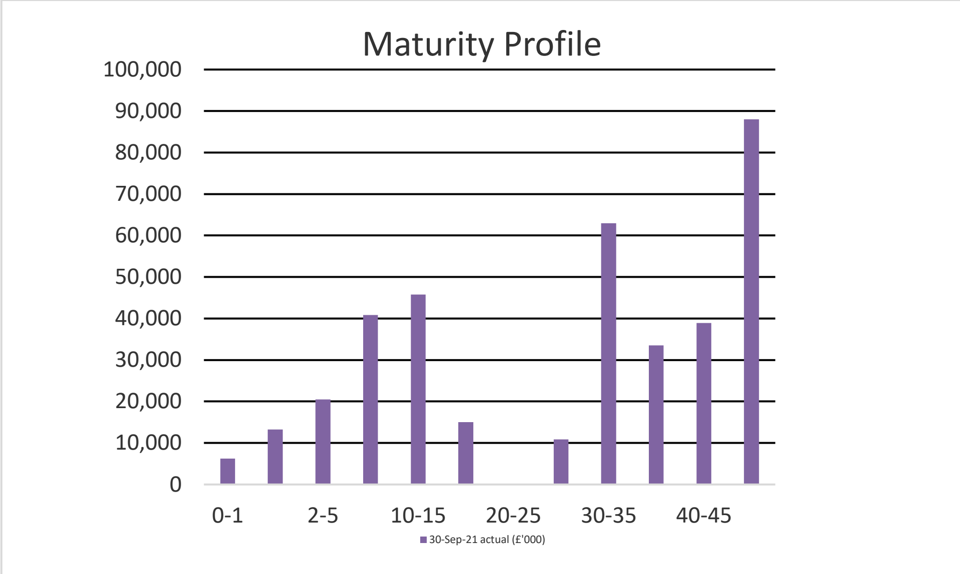
3.22 Three PWLB loans matured during the first six months and were repaid as set out in Table 3.7 below. One short term loan was also repaid during this time.

Table 3.7

Loan	Date repaid	Principal	Maturity	Interest rate
PWLB	01/05/21	£2.5m	25 years	8.125%
PWLB	24/09/21	£10m	11 years	3.58%
PWLB	03/08/21	£0.662m	27 years	8.5%
Renfrewshire Council	16/08/21	£10m	0.5 years	0.08%

Current Loan Maturity Profile

3.23 The graph below sets out the current loan maturity profile for the Council, which remains consistent with the approved Strategy.



Part F – Debt Rescheduling

3.24 Debt rescheduling opportunities have been very limited in the current economic climate and as such, no debt rescheduling has been undertaken to date in the current financial year.

Part G - Introduction of Reporting Standard IFRS16

3.25 International Financial Reporting Standard 16 – Leases will come into operation from 1 April 2022. The standard brings the value of assets where the Council has the right of use including lease agreements onto the Council's balance sheet. The standard also requires that these values are reflected in both capital and debt calculations. This standard has implications on treasury prudential indicators, particularly the Capital Financing Requirement as well as the Operational Boundary and Authorised Limit.

3.26 Work is progressing on the implementation of the new standard and an update of the likely implications will be incorporated into future reporting and in the 2022-23 Treasury Strategy.

4 POLICY IMPLICATIONS

4.1 There are no direct policy implications associated with this report, however the Council's treasury management activity is determined by the policy framework set out in the approved Treasury Management Strategy.

5 INTEGRATED IMPACT ASSESSMENT

5.1 The subject of this report has been considered and given there is no change in policy direction, there is no requirement to undertake any further impact assessment.

6 RESOURCE IMPLICATIONS

6.1 Financial - There are no direct financial implications associated with this report however the Council's Treasury Management activity clearly has a significant impact on the management of the Council's financial resources.

6.2 Personnel - none

6.3 Other – none

7 BACKGROUND PAPERS

7.1 Treasury Management Strategy 2021/22 to 2025/26 – East Lothian Council 2 March 2021

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