Report to the Audit & Governance Committee

Epping Forest District Council

Report reference:
Date of meeting: ***22nd November 2021***

Portfolio:	**Finance, Qualis Client & Economic Development**
Subject:	**Treasury Management Mid-Year Update 2021/22**
Responsible Officer:	**Andrew Small (01992 564278).**
Democratic Services:	**Laura Kirman (01992 564243).**

Recommendations/Decisions Required:

(1) To note the Treasury Management Mid-Year Update 2021/22 ***(Appendix A)*** and pass comment for full Council.

Executive Summary:

The Council's Treasury Management Strategy for 2021/22 was considered at a meeting of the Audit and Governance Committee on 22nd March 2021 and was subsequently agreed by full Council.

In accordance with CIPFA's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) and generally accepted good practice, the Treasury Management Mid-Year Update for 2021/22 (presented in ***Appendix A***) sets out the Council's actual Treasury Management activity for the first six months of 2021/22 (i.e. April to September 2021).

Appendix A begins by setting the external context for first half of 2021/22 by exploring the Economic Background, Financial Markets and Credit Ratings; this includes a discussion on the fundamental impact of the Covid-19 Pandemic.

The Borrowing and Investment position for Epping Forest District Council as at 30th September 2021 shows the following:

- *Borrowing* – external borrowing rose by £9.1 million (from £261.7 million to £270.8 million) during the period April to September 2021; and
- *Investments* – there was an increase of £7.3 million (from £11.8 million to £19.1 million) during the same period.

The CIPFA Code also covers all the financial assets of the Council, as well as other non-financial assets which the Council holds, primarily for financial return. This report therefore also considers the Council's Commercial Property Portfolio, which delivered Net Income of £3.313 million during the first six months of 2021/22 and continues to be a key part of the Council's strategy to minimise Council Tax increases.

Appendix A concludes by considering compliance with the Council's adopted Treasury Management indicators. Full compliance was achieved with all indicators.

Members should further note the Cabinet decision (12th July 2021, Item 8, Decision 2) to extend the loan facility to Qualis – by £35.0 million – for the purposes 'pump priming' new regeneration opportunities. At the time of preparing this report, Qualis has yet to draw down any of the available facility. The facility will be reflected in updated Borrowing Indicators as part of the draft Capital Strategy to be presented to this Committee in January 2022 (in compliance with the revised Prudential Code scheduled for December 2021; presented elsewhere on this agenda).

Reasons for Proposed Decision:

To enable the robust scrutiny the Council's Treasury Management performance in 2021/22 in compliance with CIPFA's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) and generally accepted good practice.

Legal and Governance Implications:

The Local Government Act 2003 created a framework for the financing of capital investments in local authorities which came into operation from April 2004. Alongside this, the Prudential Code was developed by CIPFA as a professional Code of Practice to support local authority decision making in capital investment and financing. Local authorities are required by regulation to have regard to the Prudential Code.

Safer, Cleaner and Greener (SCG) Implications:

None.

Background Papers:

Treasury Management Strategy (including Investment Strategy) 2021/22 (Audit and Governance Committee, 22nd March 2021).

(MHCLG) Statutory Guidance on Local Government Investments (3rd Edition). Issued under section 15(1)(a) of the Local Government Act 2003 and effective for financial years commencing on or after 1st April 2018.

Risk Management:

There are a range of inherent financial risks associated with Treasury Management activity; not least the potential for loss of interest and/or deposits. The Council therefore engages the services of external Treasury Management advisors, Arlingclose Ltd.

Borrowing and Investment decisions are made in accordance with the Council's formally adopted Treasury Management Strategy (including Investment Strategy). The Strategy includes several Risk Management features, including – for example – the overriding priority that security of deposit takes precedence over return on investment.

Appendix A

Treasury Management Mid-Year Update 2021/22

Introduction

The Council has adopted CIPFA's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Council to approve Treasury Management semi-annual ("mid-year updates") and annual reports.

The Council's current Treasury Management Strategy (including Investment Strategy) was considered at a meeting of the Audit and Governance Committee on 22nd March 2021 and was subsequently agreed by full Council. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Council's Treasury Management Strategy.

The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's updated Capital Strategy 2021/22 to 2025/26, complying with CIPFA's requirement, was considered by the Audit and Governance Committee on 22nd March 2021, and has also been subsequently adopted by full Council.

External Context: April to September 2021

Economic Background: The economic recovery from the Coronavirus pandemic continued to dominate the first half of the financial year. By the end of the period, over 48 million people in the UK had received their first dose of a COVID-19 vaccine, and almost 45 million their second dose.

The Bank of England (BoE) held the Bank Rate at 0.1% throughout the period and maintained its Quantitative Easing programme at £895 billion, unchanged since the November 2020 meeting. The BoE announced in September 2021 that it now expected the UK economy to grow more slowly than previously predicted and there were concerns of building inflationary pressure. Government initiatives continued to support the economy during the first 6 months of 2021/22 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.

Labour market data in the three months to July 2021 shows that unemployment fell to 4.6%. The employment rate increased, and economic activity rates decreased, suggesting an improving labour market picture.

CPI inflation rose to 3.2% in August 2021, exceeding expectations of 2.9%. The BoE now expects inflation to exceed 4% by the end of the calendar year owing largely to developments in energy and goods prices.

Financial Markets: Monetary and fiscal stimulus together with rising economic growth and the ongoing vaccine rollout programmes continued to support equity markets over most of the period, albeit with a bumpy ride towards the end. The FTSE 100 saw modest gains over the period and remains below its pre-crisis peak.

Inflation worries continued during the period. Declines in bond yields in the first quarter of the financial year suggested that bond markets were expecting general price increases to be less severe, or more transient, that was previously thought. However, an increase in gas prices in the UK and EU, supply shortages and a dearth of HGV drivers has caused problems for a range of industries and, in some instance, led to higher prices.

Credit Review: Over the period Fitch and Moody's upwardly revised to stable the outlook on several UK banks and building societies, 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 and the improved economic outlook has meant some institutions have been able to reduce provisions for bad loans. 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 now compared to earlier this year and 2020.

Arlingclose has recently completed a full review of its credit advice on unsecured deposits. The outcome included the addition of NatWest Markets plc to the Counterparty List together with the removal of the suspension of Handelsbanken plc. In addition, the maximum duration for all recommended counterparties was extended to 100 days.

The institutions and durations on counterparties recommended by Arlingclose remain under constant review.

Local Context

On 31st March 2021, the Council had net borrowing of £251.231 million 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

	31/03/21 Actual £m
General Fund CFR	143.938
HRA CFR	153.575
Total CFR	**297.513**
Less: Other Debt liabilities	0
Borrowing CFR	**297.513**
Less: External borrowing	-261.706
Internal borrowing:	**35.807**
Less: Usable reserves	-47.156
Less: Working capital	0.874
Net Investments	**10.475**

Lower official interest rates have reduced the cost of short-term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing. The Council has pursued a strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, to reduce risk.

The Treasury Management position as at 30th September 2021 and the change during the first six months of the financial year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31/03/21 Balance £m	Movement £m	30/09/21 Balance £m	30/09/21 Rate %
Long-term Borrowing	199.0	0	199.0	1.60%
Short-term Borrowing	62.7	+9.1	71.8	0.13%
Total Borrowing	**261.7**	**+9.1**	**270.8**	
Long-Term Investments	0	0	0	N/A
Short-term Investments	0	0	0	N/A
Cash and Cash Equivalents	11.8	+7.3	19.1	0.01%
Total Investments	**11.8**	**+7.3**	**19.1**	
Net Borrowing	**249.9**	**+1.8**	**251.7**	

The Council's cash flows during April to September 2021 settled down relative to the unprecedented volatility experienced in 2020/21, although the Council's continued administration of Government Covid-19 grant schemes kept both cash inflows and outflows well above pre-pandemic ('normal') levels. Thus:

- *Long-Term Borrowing* – no further long-term loans were taken out during the period April to September 2021, with the principal outstanding on PWLB maturity loans of £199.0 million remaining unchanged
- *Short-Term Borrowing* – borrowing from other local authorities increased by £9.1 million as the opportunity was taken to secure historically low interest rates on short-term borrowing; and
- *Cash and Cash Equivalents* – following an unprecedented peak in cash holdings during 2020/21 (especially due to the impact of the Covid-19 pandemic), cash balances have stabilised and have returned to more normal levels so far in 2021/22.

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 externalise internal borrowing.

Acceptable use of PWLB borrowing includes Service Delivery, Housing, Regeneration, Preventative Action, Refinancing and Treasury Management.

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. Further changes to the CIPFA Prudential Code – expected in December 2021 – are likely to prohibit borrowing for the primary purpose of commercial return even where the source of borrowing is not the PWLB.

The Council is not planning to purchase any investment assets primarily for yield within the next three years and so is able fully access the PWLB.

Borrowing Strategy

At 30th September 2021 the Council held £270.7 million in loans (an increase of £9.0 million compared to the position as at 31st March 2021), as part of its strategy for funding the Capital Programme. Outstanding loans on 30th September 2021 are summarised in Table 3 below.

Table 3: Borrowing Position

	31/03/21 Balance £m	Net Movement £m	30/09/21 Balance £m	30/09/21 Weighted Average Rate %	30/09/21 Weighted Average Maturity (Years/Days)
Public Works Loan Board	199.0	0	199.0	1.60%	15.40 Years
Banks	0	0	0	N/A	N/A
Local authorities (long-term)	0	0	0	N/A	N/A
Local authorities (short-term)	62.7	+9.1	71.8	0.13%	124.85 Days
Total Borrowing	**261.7**	**9.1**	**270.8**		

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, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

With short-term interest rates remaining much lower than long-term rates, the Council considered it more cost effective in the short term to use internal resources or borrowed rolling temporary / short-term loans instead. The net movement in temporary / short-term loans is shown in Table 3 above.

Other Debt Activity

The Council did not raise any other capital finance in the first six months of 2021/22.

Treasury Investment Activity

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held, and money borrowed in advance of need. During the first six months of 2021/22, as is normal, the Council's investment balances varied due to timing differences between income and expenditure. The investment position is shown in Table 4 below.

Table 4: Treasury Investment Position

	31/03/21 Balance £m	Net Movement £m	30/09/21 Balance £m	30/09/21 Income Return %	30/09/21 Weighted Average Maturity Days
Banks & Building Societies (unsecured)	2.7	-0.7	2.0	0.01	Instant Access
Government (incl. local authorities)	0	0	0	N/A	N/A
Money Market Funds	9.1	8.0	17.1	0.01	Instant Access
Total Investments	**11.8**	**7.3**	**19.1**		

Both the CIPFA Code and Government guidance requires local authorities to invest 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.

Non-Treasury Investments

The definition of investments in CIPFA's Treasury Management Code 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 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.

The Council also holds a significant commercial property portfolio on its Balance Sheet, which are summarised in Table 5 below.

Table 5: Commercial Property Investments

Category	31/03/21 Balance Sheet Value	Net Income 2021/22 (6 months April - September) *** Estimated
Shops*	£92.363m	£2.557m
Industrial Units	£35.996m	£0.632m
Other**	£18.946m	£0.124m
Total Value/Net Income	**£147.305m**	**£3.313m**

*Includes Public Houses and a Petrol Station
**Includes North Weald Airfield and Tennis Centre
***Excludes (year-end) recharges

The Council received total net income of £3.313 million from Commercial Property Investments in the first 6 months of 2021/22.

The Committee should note that the numbers reflect the accrued position currently in the Council's books, which does not take account of the collectability of income. So far, there have been no write-offs due to the Covid-19 pandemic, with the Council's portfolio appearing reasonably resilient at this stage (e.g. anecdotally, demand from prospective tenants for void properties seems to be holding up). However, an increase in write-offs cannot be ruled out in the future given continued volatility in some business sectors such as retail.

Compliance

The Strategic Director and Section 151 Officer reports that all Treasury Management activities undertaken during the first six months of the year complied fully with the CIPFA Code of Practice. Compliance with the approved Treasury Management Strategy was as follows:

- *Investment Limits* – full compliance achieved
- *Security* – full compliance achieved
- *Liquidity* – full compliance achieved
- *Interest Rate Exposure* – full compliance achieved
- *Maturity Structure* – full compliance achieved
- *Long-Term Investments* – full compliance achieved.

Table 8: Investment Limits

Sector	Time Limit	Counterparty Limit	Sector limit	30/09/21 Actual	Complied? (Yes/No)
The UK Government	50 years	Unlimited	N/A	£0	Yes
Local authorities & other government entities	25 years	£10.0 million	Unlimited	£7.0 million	Yes
Banks (unsecured)*	13 months	£5.0 million	£20.0 million	£2.0 million	Yes
Building Societies* (unsecured)	13 months	£2.0 million	£2.0 million	£0	Yes
Registered Providers* (unsecured)	5 years	£3.0 million	£3.0 million	£0	Yes
Money Market Funds*	N/A	£10.0 million	Maximum of 3 Funds (£10m each)	£17.0 million	Yes

***** *Minimum Credit Rating*
Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken account of.

Treasury Management Indicators

The Council measures and manages its exposures to Treasury Management risks using the following indicators.

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average 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.

	30/09/21 Actual	2021/22 Target	Complied?
Portfolio average credit rating	A	A-	Yes

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.

	30/09/21 Actual	2021/22 Target	Complied?
Total cash available within 3 months	£19.1 million	£3.0 million	Yes

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

Interest rate risk indicator	30/09/21 Actual	2021/22 Limit	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates (Borrowing)	£318,000	£318,000	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates (Investments)	£19,000	£120,000	Yes

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates. The table shows that Interest Rate Exposure on Borrowing and Investments were within limits. Interest Rate Exposure on Borrowing is an especially important measure, with net variable rate exposure of £299,000 (£318,000 minus £19,000) focused on Borrowing.

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:

	30/09/21 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	16%	50%	0%	Yes
12 months and within 24 months	0%	50%	0%	Yes
24 months and within 5 years	0%	50%	0%	Yes
5 years and within 10 years	13%	50%	0%	Yes
10 years and within 15 years	0%	50%	0%	Yes
15 years and within 20 years	50%	50%	0%	Yes
20 years and within 25 years	14%	50%	0%	Yes
25 years and above	7%	50%	0%	Yes

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.

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:

	2021/22 (April – Sept)
Actual principal invested beyond year end	£0
Limit on principal invested beyond year end	£15.0 million
Complied?	Yes

Other

IFRS 16: CIPFA/LASAAC has proposed delaying the implementation of the new IFRS 16 Leases accounting standard for a further year to 2021/22.