Council Cabinet
8 December 2021

ITEM 13

Derby City Council

Report sponsor: Simon Riley, Strategic Director of Corporate Resources
Report author: Toni Nash, Head of Finance

Treasury Management Mid-Year Report 2021/22

Purpose

1.1 Council is required for good practice under the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the "CIPFA TM Code") to approve treasury management mid-year and outturn reports.

1.2 This mid-year report outlines the Treasury Management activity for the period 1st April 2021 to 30th September 2021, comprising:

- Summary of the Financial Markets to date in 2021/22;
- Forecast Outturn 2021/22 including Quarter 2 update;
- Borrowing Activity;
- Deposits; and
- Prudential Indicators.

1.3 **Summary**

The Treasury Management forecast outturn for 2021/22 is a net underspend of (£0.925m) as at 30th September 2021. This is mainly made up of a (£0.405m) saving as MRP is less than anticipated due to capital programme slippage, and a net saving of (£0.520m) due to a reduction on estimated borrowing cost relating to a change in interest payable. It is proposed that the final underspend at year end is transferred to the Treasury Management Reserve.

1.4 At the end of September 2021, total debt is £422.39m and total investments are £83.157m compared to £432.75m and £37.159m as at 31st March 2021.

1.5 Treasury Management advice to the Council up to 30th September 2021 has been provided by Arlingclose. Their services include economic and interest rate forecasting, advice on strategy, portfolio structure, debt restructuring, investment policy and credit ratings and technical assistance on treasury matters as and when required.

Recommendations

2.1 To note the forecast outturn position of (£0.925m) underspend. At year-end, any final underspend will be transferred to the Treasury Management Reserve.

2.2 To note the position statement on Treasury Management Activity and compliance against the Prudential Indicators for the period 1st April 2021 to 30th September 2021.

Reasons

3.1 In accordance with CIPFA Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code"), it is considered good Treasury Management practice for members to note the progress and monitor performance at least twice a year. This report covers the progress of this activity. In addition, the report is required to go to Cabinet in the first instance and then Council for approval.

Supporting information

Background

4.1 The Council's Treasury Management Strategy (TMS) for 2021/22 was approved by Full Council on 10th February 2021. 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 are therefore central to the Council's TMS.

4.2 The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy which involves a summary document approved by Full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy, complying with CIPFA's requirement, was approved by Full Council on 10th February 2021.

The Financial Markets to date in 2021/22

5.1 The economic recovery from 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.

5.2 The Bank of England (BoE) held Bank Rate at 0.1% throughout the period. 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.

5.3 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 is this was not sustainable

5.4 Annual CPI inflation rose to 3.2% in August, exceeding expectations for 2.9%, with the largest upward contribution coming from restaurants and hotels. The Bank of England now expects inflation to exceed 4% by the end of the calendar year owing largely to developments in energy and goods prices.

5.5 The information relating to the overall global position of the UK financial markets is provided by Arlingclose, our treasury advisors, who continue to update the Council with on-going market activity and interest rates.

Local Context

6.1 On 31st March 2021, the Authority had net borrowing of £310.559m 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	481.576
HRA CFR	214.819
Total CFR	**696.395**
Less: Other debt liabilities *	(85.342)
Borrowing CFR	**611.053**
Less: Usable reserves	(212.357)
Less: Working capital	(88.137)
Net borrowing	**310.559**

*Finance leases, PFI liabilities and transferred debt that form part of the Council's total debt

6.2 The Council's current strategy is to maintain borrowing and investments below their underlying levels, known as internal borrowing. This is because external borrowing is more expensive than the interest rate that the Council can secure on its investments. It also reduces risk and keeps net interest costs low. This policy is consistent with the Council's Treasury Management Strategy.

6.3 The Treasury Management position at the 30th September 2021 and the change during the period is shown in Table 2 below.

Table 2: Treasury Management Summary

	31-Mar-21 Balance £m	Movement £m	30-Sep-21 Balance £m	30-Sep-21 Rate %
Long-term borrowing	336.927	-	336.927	4.42%
Short-term borrowing	10.791	(10.362)	0.429	2.15%
Total borrowing	**347.718**	**(10.362)**	**337.356**	**4.42%**
Long-term investments	-	-	-	-
Short-term investments	12.000	(12.000)	-	-
Cash and cash equivalents	25.159	57.999	83.158	0.01%
Total investments	**37.159**	**45.999**	**83.158**	**0.01%**
Net Borrowing	**310.559**	**(56.361)**	**254.198**	

6.4 Net borrowing decreased significantly by £56.361m and is a result of a reduction to total borrowing and an increase of total investments between March 2021 and September 2021. As Table 2 shows, total borrowing decreased by £10.362m due to a repayment of a temporary loan of £10m required for day-to-day cash management. Table 2 also illustrates that total investments have increased from £37.159m in March 2021 to £83.158m in September, and thus represents a movement of £45.999m. This is as a result of two receipts in advance received during September, £34.76m for Transforming Cities Fund programme and £1.5m for insurance monies received.

Forecast Outturn 2021/22

7.1 The Council budgets for the net cost of its Treasury Activities (Borrowing and Investments) through its Treasury Management Budget. At 30th September, the budget is forecasting an underspend of (£0.925m). This is mainly made up of a (£0.405m) saving relating to MRP which is less than anticipated due to the capital programme slippage, and a net saving of (£0.520m) due to a reduction to estimated borrowing cost involving a change of interest payable.

7.2 It is proposed that any final underspend will be transferred to the Treasury Management Reserve that smooths volatility in the treasury management activity at year-end.

Treasury Borrowing Activity

8.1 At the 30th September 2021, the total external debt portfolio of the Council (including HRA debt and other long- term liabilities) was £422.385m. The analysis of external debt outstanding as at 30th September 2021 is shown in the Table 3 below:

Table 3: Treasury Borrowing Summary

	£m	£m
	As at 31st March 2021	**As at 30th Sept 2021**
External Borrowing:		
- Fixed Rate PWLB	291.236	291.038
- Fixed Rate Market	20.000	20.000
- Other Local Authorities	35.000	25.000
- SALIX Energy Efficiency	0.882	0.719
- University of Derby	0.600	0.600
Total External Borrowing	**347.718**	**337.357**
Other Long-term Liabilities:		
- Transferred Debt from other Local Authorities	0.318	0.318
- PFI Financing	83.414	83.414
- Finance Lease Liabilities	1.296	1.296
Total Gross External Debt	**432.746**	**422.385**

8.2 If the Council needs to borrow at any point, it will strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required.

Treasury Investment Activity

9.1 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the six-month period to 30th September 2021, the Council's daily investment balance ranged between £32.657m and £97.157m due to timing differences between income and expenditure. The investment position is shown in Table 4 below.

Table 4: Treasury Investment Summary

Counterparty	31st March 2021 Balance £m	Net Movement £m	30th Sept 2021 Balance £m
Banks & building societies (unsecured)	3.690	(0.502)	3.188
Local authorities	10.000	(3.000)	7.000
Money Market Funds	16.969	24.002	40.970
Debt Management Office	6.500	25.500	32.000
Total investments	**37.159**	**45.999**	**83.158**

The Section 151 Officer during the year has made temporary changes to the investment criteria agreed by Council in February 2021. This was in response to spreading a higher level of investments over permitted investment categories; mitigating against negative interest rates offered by the Debt Management Office which would have resulted in negative return for the Council and finally to reflect the impact of not having the ability to invest inter-authority for the period required. Any changes are documented by the S151 Officer and continue to balance the overriding principles of Risk, Return and Liquidity.

9.2 The investment activity to the 30th September 2021 together with a comparison for the previous year is summarised in Table 5 below:

Table 5: Treasury Investment Activity

	2020/21	2021/22 to 30th September 2021
Number of fixed-term deposits made	184	68
Number of instant access and money market accounts used	10	6
Number of deposits/withdrawals from money market funds/ call accounts	94	107
Value of deposits/ investments held	£37.159m	£83.157m
Average size of deposit/ investment portfolio	£95.288m	£57.863m
Average size of Lloyds Balance (operational)	£11.978m	£6.976m
Total interest earned on deposits/ investments (including Lloyds)	£0.199m	£0.007m
Average Return on deposits/ investment portfolio	0.15%	0.01%

9.3 The average size of Lloyds' Bank operational limit has significantly decreased due to the new investment limit as prescribed under the TMS for 2021/22. The limit was set to £15m in 2020/21, compared to an operational limit of £7m for this financial year. This is because of changes to the Council's and Derby Homes' respective banking requirements as mandated by Lloyds' Bank and upon subsequent advice from our external treasury advisors, Arlingclose.

9.4 The total interest earned on deposits/investment shows a large reduction compared to last year due to economic conditions which have negatively affected interest rates globally.

9.5 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.

9.6 The credit risk and return metrics for the Council's investments extracted from Arlingclose's quarterly investment benchmarking is shown in Table 6.

Table 6: Investment Benchmarking

	Credit Score*	Credit Rating	Bail-in Exposure	WAM** (days)	Rate of Return
31/03/2021	4.51	AA-	52%	22	0.06%
30/09/2021	4.42	AA-	54%	12	0.01%
Similar LAs	4.67	AA-	63%	30	2.82%
All LAs	4.69	A+	69%	10	2.35%

*The lower the credit score the lower risk
** Weighted Average Maturity

9.7 The benchmarking shows that the Council's Weighted Average Maturity (WAM) for investments reduced by 18 days between 31st March 2021 and 30th September 2021. Consistent with the spirit of CIPFA's TM Code, our low WAM demonstrates that the Council placed security, liquidity and low risk above yield when deciding investment outcomes throughout and towards the end of the global pandemic. This approach enabled the Council to sustain an appropriate level of working capital in order to deliver public services with little or no disruption during these unprecedented times. It also allowed us to adhere to the Council's strategy of using internal resources to offset the need to borrow and therefore maintain our under-borrowed position.

However, our low-risk appetite is reflected in the rate of return generated from our investments. The rate of return earned by similar Local Authorities is higher compared to Derby City Council due to a higher risk-appetite with correspondingly lower perception and management of financial risk, a treasury management framework conducive of generating higher returns with different counterparties and investments limits, and a greater reliance on strategic funds and other interest-bearing financial instruments.

Non-Treasury Investments

10.1 The definition of investments in the revised "CIPFA TM Code" now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return. The Council's Non-Treasury Investments are shown in Table 7:

Table 7: Non-Treasury Investments as at 30th September 2021

Type of investment	**Investment value £m**	**Return £m**	**Rate of Return %**
Directly owned investment property*	3.710	0.067	1.81%
Loans to local businesses	1.638	0.104	4.97%
Loans to subsidiaries (Derby Homes)**	2.859	0.157	5.27%

* Investment value and return taken from the 2020/21 statement of accounts as an indication of 2021/22.

** This is the full year position as an annual interest is charged.

Compliance Report

11.1 A number of Treasury Management Prudential Indicators are prescribed under the Council's Treasury Management Strategy 2021/22 which was approved by Full Council Cabinet on 12th February 2020, and within CIPFA's Prudential Code for Capital Finance in Local Authorities. With the exception for one indicator, all Treasury Management activities have been satisfied as at the 30th September 2021.
Compliance with specific investment limits is demonstrated in Table 8 below.

Table 8: Investment Limits

	2021/22 Maximum to date	30/09/2021 Actual	2021/22 Limit	Complied
The Councils Banking Provider – Lloyds	£39.7m	£7m	£7m	✗
Any single organisation, except the UK Central Government (excluding the operational bank)	£7m	£7m	£7m	✓
Any group of pooled funds under the same management	£9.4m	£9m	£20m	✓
Money Market Funds (MMF)	£7m	£7m	£7m	✓

The limit of £7m total cash invested with Lloyds, our banking provider, has not been met on three occasions during Quarters 1 and 2.

Event 1:

During Quarter 1, the operational limit was exceeded due to Derby Homes holding more than the full limit of £7m in their Lloyds' Current Account. Although forming part of the indicator, balances held by Derby Homes are outside the control of the Council. Since the beginning of Quarter 2, Derby Homes have now brought their balances down. The S151 Officer was informed of these incidences and approved the variations from this indicator.

The remaining two events occurred during Quarter 2 and in the month of September.

Event 2:

On the 7th, an unexpected capital grant receipt of £36.26m for the Transforming Cities Fund programme arrived late after the dealing cut-off times with the Council's approved counterparties. Given that this matter was external and therefore uncontrollable, a decision was made by senior officers to breach the operational limit on this day to enable the Treasury Team to make the appropriate considered decisions for the cash surplus for the next working day.

Event 3:

A similar incident to the above occurred on the 30th. A sum of £1.5m unexpectedly arrived from an Insurance company around 3pm. The Treasury Team, however, were unaware of this receipt and therefore were unable to make the necessary investment-related decision to ensure compliance with this indicator.

To mitigate repeated occurrences of such events, the Treasury Team has communicated with Service Areas emphasising that their respective activities affect cash flows and the Council's overall cash balance on any given day, and instructed team leaders to notify the Treasury Team of any payments or receipts which can materially impact cash balances when they become known.

11.2 Compliance with the authorised limit and operational boundary for external debt is demonstrated in Table 9 below.

Table 9: Debt Limits

	2021/22 Maximum £m	30/09/21 Actual £m	2021/22 Operational Boundary £m*	2021/22 Authorised Limit £m*	Complied
Borrowing	347.7	337.4	711.0	878.2	✓
PFI & finance leases	85.0	85.0	96.8	116.2	✓
Total debt	**432.7**	**422.4**	**807.8**	**994.4**	✓

*Breakdown of limits realigned between Borrowing and PFI & Finance Leases to reflect business need. No change to overall limits.

Since the operational boundary is a management tool for in-year monitoring, it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

Treasury Management Indicators

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

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

12.3 Local Authorities are unrated, therefore fixed term deposits with Local Authorities must be assigned a score. The score assigned is AAA=1, this means the investments are of the highest credit quality. This is due to Local Authorities not being subject to bail-in and having an insignificant risk of insolvency linked to its covenant strength.

12.4 Table 10 shows the target for the portfolio average credit score and the actual to 30th September 2021/22:

Table 10: Security Indicator - Portfolio average credit score

	Target	Actual
Portfolio average credit score	3.00	1.19

12.5 The actual credit score is below the target showing the exposure to credit risk for the year to date has been lower than the target set, due to higher credit quality investment being used over lower credit quality investment. This is as a result of using fixed term deposits with Local Authorities and the DMO and high credit quality Money Market Funds (MMF’s).

12.6 **Interest rate exposure indicator:** The other locally-set prudential indicator relates to interest rate exposure which allows the Council to manage the extent to which it is exposed to changes in interest rates. It shows the split of borrowing and investments between fixed and variable rates, and the maturity profile of long-term loans. Fixed investments and borrowings are those where the rate of interest is fixed for the whole financial year or from the transaction date if later. Instruments that mature during the following financial year are classed as variable rate.

The split in respect of borrowing and investments as at 30th September 2021, and the comparative figures for the previous year, are shown in Table 11 below:

Table 11: Interest Rate Exposure

This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest is shown below:

Interest rate risk indicator	30.9.21 Actual	2021/22 Limit	Complied
Upper limit on one-year revenue impact of a 1% rise in interest rates	£0.000m	£0.420m	✓
Upper limit on one-year revenue impact of a 1% fall in interest rates	£0.686m	£0.800m	✓

12.7 For the purposes of the above indicator, it has been assumed that investment interest rates could be negative.

12.8 **Maturity Structure of Borrowing:** This indicator is set to control the Council's exposure to refinancing risk. The indicator is calculated as the amount of projected borrowing that is maturing in each period expressed as a percentage of total projected borrowing. For each maturity period, an upper and lower limit is set.

The actual maturity structure of borrowing as at 30th September 2021 has been compared to the loan maturity limit profile that was approved in the Treasury Management Strategy 2021/22. Table 12 below shows that this indicator has been met as follows:

Table 12: Maturity Structure of Borrowing

Number of Years to Maturity	**Upper limit per 2021/22 Strategy**	**Actual position for 31/09/2021**
	%	**%**
Up to 1 year	10	0.08%
Up to 2 years	20	3.39%
Up to 5 years	30	7.35%
Up to 10 years	50	13.83%
Up to 20 years	70	29.88%
Up to 30 years	80	49.05%
Up to 40 years	95	91.34%
Up to 50 years	100	100.00%

12.9 **Principal Sums Invested for Periods Longer than 365 days**: 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:

Table 13: Principal Sums Invested for Periods Longer than 365 days

	2021/22 £m
Actual principal invested for longer than 364 days	0.00
Limit on principal invested for longer than 364 days	20.00
Complied?	✔

Economic Outlook for the remainder of 2021/22

13.1 The global economy continues to recover from the pandemic but has entered a more challenging phase. The resurgence of demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. This is particularly apparent in the UK due to the impact of Brexit.

13.2 Arlingclose expects the Bank Rate to rise for the remainder, from 0.25% in Q2 2022 through to 0.5% by December 2024.

From Table 14 below, they believe this is driven as much by the Bank of England's desire to move from emergency levels as by fears of inflationary pressure. The Council will monitor inflation along with other treasury-related risks and take appropriate strategies to manage their impact on our treasury activities.

Table 14: Arlingclose's Forecast Interest Rate for the remainder of 2021/22:

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Official Bank Rate													
Upside risk	0.00	0.15	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.10	0.10	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	0.00	0.15	0.15	0.15	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40

Public/stakeholder engagement

14.1 None arising directly from this report.

Other options

15.1 None arising directly from this report.

Financial and value for money issues

16.1 As described in report.

Legal implications

17.1 None arising directly from this report.

Climate Implications

18.1 None arising directly from this report.

Other significant implications

18.2 None arising directly from this report.

This report has been approved by the following people:

Role	Name	Date of sign-off
Legal	Olu Idowu: Head of Legal Services	16/11/2021
Finance	Toni Nash: Head of Finance	15/11/2021
Service Director(s)		
Report sponsor	Simon Riley: Strategic Director of Corporate Resources & S151 Officer	15/11/2021
Other(s)		
Background papers:	Shane Chaddha – Accountancy Officer for Treasury (01332 643368) Shane.Chaddha@derby.gov.uk	
List of appendices:		