Havering
LONDON BOROUGH

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| **Audit Committee** | **22 February 2022** |
| **Subject Heading:** | **2021/22 Treasury Management Mid Year Report.** |
| **Cabinet Member:** | **Councillor Roger Ramsey**<br>**Cabinet Member for Finance & Property** |
| **SLT Lead:** | **Jane West**<br>**(Chief Operating Officer)** |
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| **Policy context:** | **The code of practice on treasury management 2017 requires that the Authority be provided with a Mid-year report on treasury activities** |
| **Financial summary:** | **There are no direct Financial implications from the report** |
| **Is this a Key Decision?** | **NO** |
| **When should this matter be reviewed?** | **Bi-Annually** |
| **Reviewing OSC:** | **Overview and Scrutiny Board** |

**The subject matter of this report deals with the following Council Objectives**

Communities making Havering []
Places making Havering []
Opportunities making Havering []

**Audit Committee, 22 February 2022**

Connections making Havering []

## SUMMARY

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management Code ("TM Code") require authorities to produce a mid-year report on their treasury management activities.

The Authority's Treasury Management Strategy Statement (TMSS) for 2021/22 was approved at the Cabinet meeting on 26th February 2021 and at Full Council on the 3rd March 2021.

The Authority 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. This report covers activity on treasury managed investments and borrowings and the associated monitoring and control of risk.

**The key highlights of the Mid-Year report are as follows:**

- At the end of November 2021 the investment portfolio return was **0.24%** compared to the bank rate at **0.10%.**
- Net interest outturn is expected to be within budget.
- There was no breach of the Authority's prudential indicators and treasury indicators.
- The authority borrowed £50m fixed rate (av. 1.5%) long term debt close to the year low to fund the capital programme and reduce reliance on short term interest rates.

## RECOMMENDATIONS

- To note the treasury management activities to November 2021 are detailed in the report.
- To note LIBOR ceased to be supported and published by the banks from the 31st December 2021, being replaced by SONIA - this will be Treasury's benchmark reference rate from the 1st January 2022.

# REPORT DETAIL

## Background

### 1.0 Treasury management

1.1 The authority operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operation is to ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

1.2 The other main function of authority's treasury management operation is to help fund its capital plans. These capital plans provide a guide to the borrowing need of the authority, essentially the longer term cash flow planning required to meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet the Authority's risk or cost objectives.

### 2.0 Introduction

2.1 This report has been written in accordance with the requirements of the CIPFA TM Code.

2.2 This is the Mid-Year Review Report required by the TM Code and covers the following:

- Economic update for the first part of the 2021/22 financial year.
- Treasury Management Summary to November 2021.
- Review of the authority's borrowing strategy for 2021/22
- Review of the authority's investment portfolio for 2021/22
- Review of compliance with Treasury and Prudential Limits for 2021/22.

## 3.0 Economics and interest rates

### *3.1 Economics update*

The Monetary Policy Committee (MPC) at its meeting on the 16th December 2021 voted 8-1 to raise Bank Rate by 0.15% from 0.10% to 0.25% and unanimously decided to make no changes to its programme of quantitative easing purchases due to finish in December 2021 at a total of £895bn.
A disappointing 0.1% month on month rise in GDP in October suggested that economic growth had already slowed to a crawl even before the Omicron variant was discovered in late November. Early evidence suggests growth in November might have been marginally better. Nonetheless, at such low rates of growth, the government restrictions across the UK could further limit economic expansion and potentially lead to a contraction in December.

The latest CPI inflation figure at 5.1% confirmed how inflationary pressures have been building sharply. However, Omicron also caused a sharp fall in world oil and other commodity prices; (gas and electricity inflation has generally accounted on average for about 60% of the increase in inflation in advanced western economies). Other elements of inflation are considered transitory e.g. prices of goods being forced up by supply chain shortages and increased shipping costs. Economists remain divided on whether increased inflation is transitory or sustained. Presently the markets seem to agree with the MPC's view that inflation will return to its target rate of 2% in the medium term.

### *3.2 Interest rate forecasts*

The authority's treasury advisor, Link Asset Services (LAS), has provided the following updated interest rate forecast for base rate and medium term PWLB issuance in **Appendix A**:

## 4.0 Treasury Management Summary

4.1 The mid year treasury management position is shown in table 1 below.

**Table 1: Treasury Management Summary as at 30th November 2021**

| | 01.04.21 | Movement | 30.11.21 | Weighted Average Rate |
|---|---|---|---|---|
| **Investments** | **£m** | **£m** | **£m** | **%** |
| Fixed Deposit | 90.0 | -6.0 | 84.0 | **0.30** |
| Money Market Funds | 11.1 | 26.9 | 38.0 | **0.01** |
| Call Account | 20.0 | 0 | 20.0 | **0.40** |
| **Total investments** | **121.1** | **20.9** | **142.0** | **0.24** |
| | | | | |
| **Loans** | | | | |
| PWLB | 258.2 | 25.0 | 283.2 | **3.02** |
| Banks (LOBO) | 7.0 | 0 | 7.0 | **3.60** |
| Temporary Borrowing | 10.0 | -10.0 | 0 | **0.10** |
| Other L/T borrowings | 0.5 | 0.4 | 0.9 | **0.38** |
| **Total Loans** | **275.7** | **15.4** | **291.1** | **3.03** |

4.2 The Authority's treasury investments as at 30th November 2021 totalled **£142m** and comprised of **£34m** deposited with local authorities, **£45m** with banks, **£25m** with the Government's Debt Management Office (DMO) and **£38m** in Money Market Funds (MMF).

4.3 Appendix B shows the breakdown of the authority's investments.

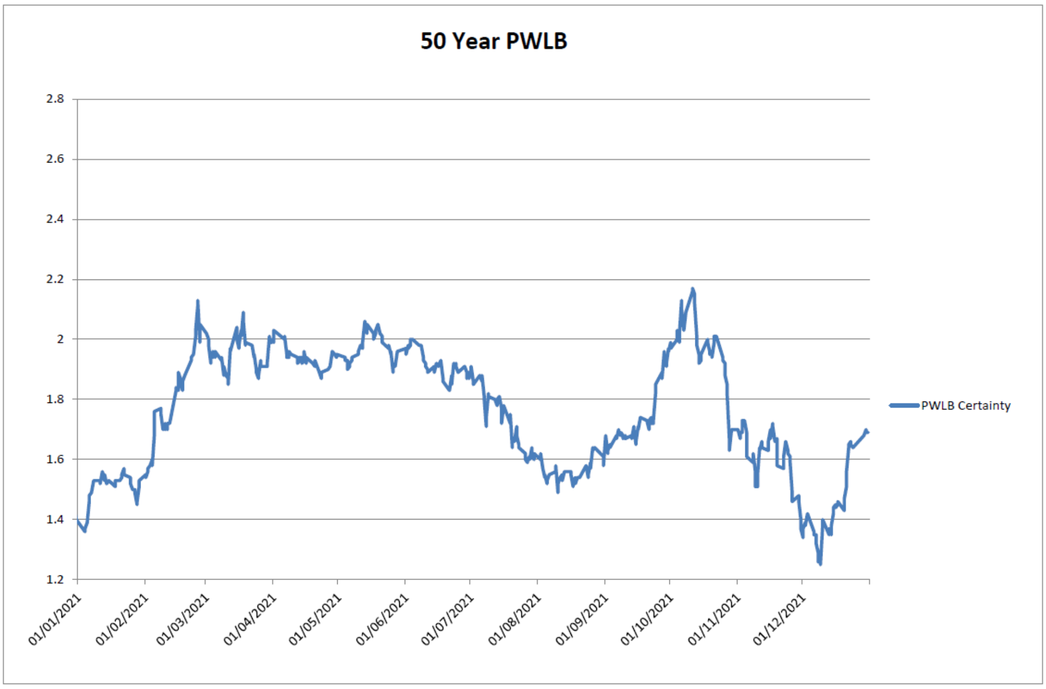
## 5.0 Borrowing Strategy

*5.1 Detail*

The short term strategy involves using the Authority's cash balances to fund the 2021/22 borrowing requirement in the capital programme. The Theme Board in July 2021 recognised that it was appropriate to start considering taking long term PWLB borrowing up to £121m to fund historic capital expenditure. This was partially utilised with the issuance of two £25m 50 year Fixed PWLB trades one in November and one in December at **1.70%** and **1.43%** respectively, bringing the overall funding cost of the debt portfolio to **2.90%**. Cash balances were higher than planned due to capital slippage which limited the need for further long term debt. PWLB debt remained the most economical source of capital finance.

During 2021 50 year PWLB rate peaked at 2.16%. The Authority borrowed close to the PWLB rate low in 2021.

**Graph 1: 50 Year PWLB borrowing rate 2021**




*5.2 Debt Rescheduling*

The possibility of debt rescheduling is regularly discussed with our treasury adviser. However opportunities have been almost non-existent in the current economic climate. The current PWLB rules on redemption are prohibitive and costly.

*5.3 LOBO's*

The Authority holds a £7m LOBO loan with Danske Bank that has the option to propose an increase in the interest rate at set dates, while the Authority has the option to either accept the new rate or to repay the loan at no additional cost. LAS stated there is a low probability that the lender will propose an increased rate in the foreseeable future. Officers will continue to monitor and discuss with Danske Bank going forward.

## 6.0 Budgeted Income and Return

6.1 The Authority measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 2 below:

**Table 2: 2021-22 Treasury Investment Performance to 30th November 2021**

| Period | Benchmark Average 3 month LIBOR | Budget Rate % | Actual Rate % |
|---|---|---|---|
| **1/4/21 to 30/11/21** | 0.08 | 0.42 | 0.24 |

6.2 The authority outperformed its benchmark during the period. This was achieved by locking into longer term deposits to mitigate the impact of lower short term interest rates. This strategy has achieved a better return for 2021-22 investment income.

6.3 It is expected that the average 3 month LIBOR will rise slightly by year end as liquidity remains abundant in the markets even after the recent base rate increase. Investments are being kept in shorter maturities so funds are available to finance the forecasted CFR spend during the remainder of the financial year.

6.4 The deferral of long term borrowing and the delays to capital expenditure due to the ongoing pandemic has meant investment balances are running higher than planned earlier in the year, this has offset the lower short term interest rates available. This has also contributed to savings in the interest payable budget.

6.5 From the 1st January 2022 LIBOR will cease to be supported and published by the banks being replaced by SONIA, see explanation in appendix D. Accordingly treasury will use SONIA going forward to benchmark activities and performance.

## 7.0 Current Investment Opportunities

7.1 The Authority is occasionally made aware of long term investment opportunities within oneSource, brokers or investment advisers. By extending the number of regulated brokerage firms it provided more competition and resulted in deals being agreed that best meets the authority’s requirements.

7.2 Cabinet on the 26th February 2021 approved changes to the Treasury Management Strategy Statement (TMSS) which facilitate investment in a wider range of products.

## 8.0 Changes in risk appetite

8.1 The 2017 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy will be brought to members' attention in treasury management update reports.

## 9.0 Compliance with Prudential and Treasury Indicators

9.1 It is a statutory duty for the Authority to determine and keep under review the affordable borrowing limits. The Authority's approved 2021/22 Treasury and Prudential Indicators (affordability limits) were included and approved by Full Council as part of the TMSS 26th February 2021.

9.2 During the period, the Authority has operated within the treasury limits and Prudential Indicators set out in the authority TMSS and in compliance with the authority's Treasury Management Practices. An update on indicators and limits are reported in **Appendix C** of this report.

## IMPLICATIONS AND RISKS

### Financial implications and risks:

Year to date treasury activity is in accordance with the Authority's approved TMSS. There have been no breach in the Authority's treasury indicators and prudential indicators set out in the TMSS.

It is expected that the authority's net interest costs will be within budget in 2021/22 and any new borrowing undertaken for the capital programme for remainder of 2021/22 will be in accordance with the Authority's treasury limits and prudential indicators.

### Legal implications and risks:

The Committee is required to have a full understanding of all financial risks and be satisfied that they are commensurate to its overall budget and that the Council is not exposed to any unacceptable, unnecessary or disproportionate risk in the management of its financial affairs.

Members also need to feel assured that there has been no breach of the Authority's prudential indicators and treasury indicators.

### Human Resources implications and risks:

There are no HR implications from this report

## Equalities Implications and Risks:

The Public Sector Equality Duty (PSED) under section 149 of the Equality Act 2010 requires the Council, when exercising its functions, to have due regard to:

(i) The need to eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Equality Act 2010;
(ii) The need to advance equality of opportunity between persons who share protected characteristics and those who do not, and;
(iii) Foster good relations between those who have protected characteristics and those who do not.

The Council is committed to all of the above in the provision, procurement and commissioning of its services, and the employment of its workforce.

## Health and Wellbeing Implications and Risks:

The Council is committed to improving the quality of life and wellbeing for all Havering employees and residents in respect of socio-economics and health determinants. There are no direct implications to the Council's workforce and resident's health and wellbeing as a result of this report.

**BACKGROUND PAPERS**

## Appendix A

### Interest Rate Forecast

Provided by Link asset services

| Link Group Interest Rate View 20.12.21 | 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 | Mar-25 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| BANK RATE | 0.25 | 0.25 | 0.50 | 0.50 | 0.50 | 0.75 | 0.75 | 0.75 | 0.75 | 1.00 | 1.00 | 1.00 | 1.00 | 1.25 |
| 5 yr PWLB | 1.40 | 1.50 | 1.50 | 1.60 | 1.60 | 1.70 | 1.80 | 1.80 | 1.80 | 1.90 | 1.90 | 1.90 | 2.00 | 2.00 |
| 10 yr PWLB | 1.60 | 1.70 | 1.80 | 1.80 | 1.90 | 1.90 | 2.00 | 2.00 | 2.00 | 2.10 | 2.10 | 2.10 | 2.20 | 2.30 |
| 25 yr PWLB | 1.80 | 1.90 | 2.00 | 2.10 | 2.10 | 2.20 | 2.20 | 2.20 | 2.30 | 2.30 | 2.40 | 2.40 | 2.50 | 2.50 |
| 50 yr PWLB | 1.50 | 1.70 | 1.80 | 1.90 | 1.90 | 2.00 | 2.00 | 2.00 | 2.10 | 2.10 | 2.20 | 2.20 | 2.30 | 2.30 |

## Appendix B

### Table 1 breakdown of Investments as at 30th November 2021

| Start Date | Maturity Date | Counterparty | Broker | Rate | Principal (£) |
|---|---|---|---|---|---|
| 02/12/20 | 01/12/21 | Wrexham County Borough Council | Tradition | 0.2500% | 5,000,000. |
| 18/11/21 | 01/12/21 | Uttlesford District Council | Tullett Prebon | 0.0200% | 4,000,000. |
| 10/12/20 | 09/12/21 | London Borough of Haringey | BGC | 0.2000% | 5,000,000. |
| 18/12/20 | 17/12/21 | Slough Borough Council | BGC | 0.2500% | 5,000,000. |
| 15/07/21 | 31/12/21 | Goldman Sachs International | Tullett Prebon | 0.1650% | 5,000,000. |
| 05/01/21 | 04/01/22 | Wokingham Borough Council | Tradition | 0.2000% | 5,000,000. |
| 19/11/21 | 19/01/22 | DMO (Debt Management Account Deposit Facility) | direct | 0.0300% | 10,000,000. |
| 02/08/21 | 01/02/22 | Goldman Sachs International | Tradition | 0.1750% | 5,000,000. |
| 18/11/21 | 18/02/22 | DMO (Debt Management Account Deposit Facility) | direct | 0.0500% | 15,000,000. |
| 24/11/21 | 24/02/22 | Nationwide Building Society | BGC | 0.0500% | 5,000,000. |
| 22/06/21 | 21/06/22 | London Borough of Southwark | BGC | 0.1000% | 5,000,000. |
| 29/09/21 | 29/06/22 | Australia and New Zealand Banking Group Limited | Tullett Prebon | 0.2800% | 5,000,000. |
| 05/07/21 | 01/07/22 | Mid Suffolk District Council | Tradition | 0.1000% | 5,000,000. |
| 15/10/21 | 15/07/22 | Goldman Sachs International | Tradition | 0.5100% | 5,000,000. |
| **Deposit Total** | | | | **0.1492%** | **84,000,000.** |
| Call - 95 day notice | | Santander UK plc | | 0.4000% | 20,000,000. |
| **Call Account Total** | | | | **0.4000%** | **20,000,000.** |
| MMF | | Federated Prime Rate Sterling Liquidity 3 | ICD Ltd | 0.0100% | 20,000,000. |
| MMF | | BlackRock ICS | ICD Ltd | 0.0100% | 18,000,000. |
| **MMF Total** | | | | **0.0100%** | **38,000,000.** |
| | | | | | **142,000,000.** |

## Appendix C

## Compliance Report

All treasury management activities undertaken during the period complied fully with the CIPFA Code of Practice and the authority's approved Treasury Management Strategy. Compliance with specific treasury limits is demonstrated in tables below.

### 1.1 Interest Rate Exposure

1.1.1 This indicator is set to limit and control the Authority's exposure to adverse movements in short term interest rates during the current financial year and over the forecasted period. The upper limit on fixed and variable rate interest rate exposures, expressed as the proportion of gross principal borrowed are as follows:

**Table1: Interest rate exposure activity**

| | 2021/22 Limit % | 2021/22 Actual 30/11/21 % | 2022/23 Limit % | 2023/24 Limit % |
|---|---|---|---|---|
| Upper limit on fixed interest rate exposure | 100 | 99.6 | 100 | 100 |
| Upper limit on variable interest rate exposure | 25 | 0.4 | 30 | 35 |

*Fixed rate borrowings are those borrowings where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.*

1.1.2 Having larger amounts of fixed interest rate borrowing gives the Authority greater stability with regards to its interest payments and reduces the risk of higher interest costs should interest rates rise. Traditionally local authorities have taken advantage of fixing interest rates long term to reduce interest rate exposure. The table excludes Salix Finance loans as these are held at zero interest hence no interest rate exposure.

## 1.2 Maturity Structure of Borrowing

1.2.1 This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing are as follows:

**Table 2: Loan maturity structure as at 30th November 2021**

| | Upper % | Lower % | Actual % |
|---|---|---|---|
| Under 12 months | 40 | 0 | 0.38 |
| 12 months and within 24 months | 60 | 0 | 0.00 |
| 24 months and within 5 years | 80 | 0 | 1.38 |
| 5 years and within 10 years | 100 | 0 | 29.39 |
| 10 years and above | 100 | 0 | 68.85 |

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.

## 1.3 Principal Sums Invested for Periods Longer than 365 days

1.3.1 The purpose of this indicator is to control the authority's exposure to the risk of incurring losses by seeking early repayment of its investments.

1.3.2 The limits set in the 2021/22 treasury management strategy in comparison to the half year are set below. It is the authority's policy to classify available for sale investments with maturities exceeding one year as short term investments.

**Table 3: Investments for periods longer than 365 days**

| | 2021/22 Limit £m | 2021/22 Actual 30.11.21 £m | 2022/23 Limit £m |
|---|---|---|---|
| Limit on principal invested beyond year end | 75 | 0 | 75 |

## 1.4 Gross Debt and the Capital Financing Requirement (CFR)

1.4.1 In order to ensure that over the medium term debt will only be for a capital purpose, the Authority should ensure that debt does not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. This is a key indicator of prudence.

**Table 4: Gross debt and the CFR**

| | 31.03.21 Actual £m | 31.03.22 Estimate £m | 31.03.23 Estimate £m | 31.03.24 Estimate £m |
|---|---|---|---|---|
| Long Term External Debt | 275.7 | 291.1 | 291.1 | 291.1 |
| CFR | 401.5 | 587.8 | 874.8 | 1,039.8 |
| Internal Borrowing | 125.8 | 296.7 | 583.7 | 748.7 |

1.4.2 Total debt is expected to remain below the CFR during the year. The actual debt levels are monitored against the Operational Boundary and authorised Limit for External Debt, below. Officers will replace internal borrowing with external borrowing when it is favourable to do so.

## 1.5 Operational Boundary for External Debt

1.5.1 The operational boundary is based on the authority's estimate of most likely, i.e. prudent, but not worst case scenario for external debt. The Authority long term debt as at 30.11.2021 is £291.1m and no limit has been exceeded.

**Table 5: Operational Boundary**

| **Operational Boundary** | **2021/22 £m** | **2022/23 £m** | **2023/24 £m** |
|---|---|---|---|
| Borrowing | 465.0 | 558.0 | 631.0 |
| Other long-term liabilities | 10.0 | 10.0 | 10.0 |
| **Total** | 475.0 | 568.0 | 641.0 |

## 1.6 Authorised Limit for External Debt

1.6.1 The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

**Table 6: Authorised limit for external debt**

| **Authorised Limit** | **2021/22 £m** | **2022/23 £m** | **2023/24 £m** |
|---|---|---|---|
| Borrowing | 698.0 | 837.0 | 946.0 |
| Other long-term liabilities | 10.0 | 10.0 | 10.0 |
| **Total Debt** | 708.0 | 847.0 | 956.0 |
| Long Term Debt | 291.1 | 291.1 | 291.1 |
| **Headroom** | **416.9** | **555.9** | **664.9** |

**Appendix D**

## Glossary of Terms

**A bond** is a debt instrument in which an investor lends money for a specified period of time at a fixed rate of interest. The issuing entity could be corporate, financial or government.

**A floating rate note** (FRN) is a money market instrument with a Floating/variable rate of interest, which re-fixes over a reference rate, for example 3 month LIBOR.

**Bail in** is rescuing a financial institution on the brink of failure by making its creditors and depositors take a loss on their holdings. A bail-in is the opposite of a bail-out, which involves the rescue of a financial institution by external parties, typically governments using taxpayer's money.

**Certificates of deposit** (CDs) are a negotiable form of fixed deposit, ranked pari passu with fixed deposits. The difference is that you are not obligated to hold the CD to maturity, you can realise the cash by selling in the secondary market.

**Coupon** is the total amount of interest a security will pay. The coupon period depends on the security. A CD will often pay interest at maturity, while a bond may pay semi-annually or annually and an FRN will most likely pay every 3 months.

**Covered bond** Covered bonds are conventional bonds (fixed or floating) issued by financial institutions, that are backed by a separate group of loans, usually prime residential mortgages. This lowers the creditor's exposure to default risk, enhancing the credit. This is why the issue is usually rated AAA, higher than the rating given to the issuer reduces exposure to bail-in risk.

**Credit rating** A measure of the credit worthiness of a borrower. A credit rating can be assigned to country, organisation or specific debt issue/ financial obligation.

There are a number of credit ratings agencies but the main 3 are Standard & Poor's, Fitch or Moody's.

**GDP** the monetary value of all finished goods and services made within a country during a specific period.

**MIFID** is the Markets in Financial Instruments Directive. A European Union Directive.

Principal is the total amount being borrowed or lent.
**Spread** is the difference between the buy and sell price of a security. It can also be the gap, usually in basis points, between the yield of a security and the benchmark security.
**Monetary Policy Committee** (**MPC**) is a committee of the Bank of England, which meets for three and a half days, eight times a year, to decide the official interest rate in the United Kingdom (the Bank of England Base Rate).

**CPIH (Consumer Prices Index including owner occupiers' housing costs)** The new additional measure of consumer price inflation including a measure of owner occupiers' housing costs (OOH).

**Treasury bills (T-bills)** are UK government rated, short-dated form of Government debt, issued by the Debt Management Office (DMO) via a weekly tender. T-bills are normally issued for one, three or six month duration.

**Borrowing Requirements** The principal amount the Council requires to borrow to finance capital expenditure and loan redemptions.

**Capital Financing Requirement (CFR)** Capital Financing Requirement- a measure of the Council's underlying need to borrow to fund capital expenditure.

**Counterparties** Organisations or Institutions the Council lends money to e.g. Banks; Local Authorities and MMFs.

**Credit Default Swap (CDS)** A kind of protection that can be purchased by MMF companies from insurance companies (for their investment) in exchange for a payoff if the organisation they have invested in does not repay the loan i.e. they default.

**Credit Watch** A scoring system issued by credit rating agencies such as Fitch, Moody's and Standard & Poors that indicate the financial strength and other factors of a bank or similar Institution.

**Interest Rate Exposures** A measure of the proportion of money invested and what impact movements in the financial markets would have on them.

**LIBOR** London interbank offer rate, the average of a daily submission by various banks for where they offer funds in different maturities.

**Market Loans** Loans from banks available from the London Money Market including LOBOS (Lender Option, Borrowing Option) which enable the authority to take advantage of low fixed interest for a number of years before an agreed variable rate comes into force.

**Money Market Fund (MMF)** A 'pool' of different types of investments managed by a fund manager that invests in lightly liquid short term financial instruments with high credit rating.

**Minimum Revenue Provision (MRP**) This is the amount which must be set aside from the revenue budget each year to cover future repayment of loans.

**SONIA** sterling overnight interest average rate, the average rate at which banks offer funds in the overnight sterling market.