Leicestershire County Council

CABINET – 24 JUNE 2022

ANNUAL TREASURY MANAGEMENT REPORT 2021/22

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

PART A

Purpose of Report

1. The purpose of this report is to advise the Cabinet of the action taken and the performance achieved in respect of the treasury management activities of the Council in 2021/22.

Recommendation

2. The Cabinet is asked to note this report.

Reason for Recommendation

3. The Authority's full adoption of the CIPFA Code of Practice for treasury management requires an annual report on Treasury Management activity and performance to be considered by both the Cabinet and the Corporate Governance Committee before the end of September each year.

Timetable for Decisions (including Scrutiny)

4. Under the CIPFA Code of Practice it is necessary to report on treasury management activities undertaken in 2021/22 by the end of September 2022.

5. The Corporate Governance Committee considered the matter at its meeting on 13 May 2022.

Policy Framework and Previous Decisions

6. The Authority adopted the revised CIPFA Code of Practice for treasury management in February 2010. Treasury management issues are now reported to either the Corporate Governance Committee or the Cabinet. Approval of the Annual Treasury Management Strategy remains the responsibility of the County Council which it considers as part of the MTFS each year.

Resource Implications

7. Treasury management is an integral part of the Council's Finances. Interest of £3.5m was generated through treasury management activities and interest paid on external debts was £15.2m.

Circulation under the local Issues Alert procedure

8. None.

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PART B

Background

9. The term treasury management is defined as: -

   "The management of the organisation's 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".

10. The Director of Corporate Resources is responsible for carrying out treasury management on behalf of the County Council, under guidelines agreed annually by the County Council.

Treasury Management 2021/22

11. The Treasury Management Policy Statement for 2021/22 was agreed by full Council on 17 February 2021, in relation to the sources and methods of borrowing and approved organisations for lending temporarily surplus funds.

12. The criteria for lending to Banks are derived from the list of approved counter parties provided by the County Council's Treasury Management advisors, Link Asset Services (Link). The list is amended to reduce the risk to the County Council by removing the lowest rated counterparties and reducing the maximum loan duration.

13. During the year all outstanding loans were repaid on time with the interest due.

14. For local authority lending the policy is unchanged with no loans permitted in excess of 12 months duration or £10 million in value. In 2019, Moody's, one of the world's best-known credit rating agencies, re-affirmed its view that the UK local government sector has a high credit quality. The implication being that the sector continues to be a good risk for lenders. There were no new loans made to Local Authorities during the year.

15. In 2016 it was agreed that any counterparty that was downgraded whilst a loan was active, and where the unexpired period of the loan, or the amount on loan, would then breach the limit at which a new loan could be made to that counterparty, this would be included in the quarterly treasury management report to the Corporate Governance Committee. There were two such Incidents during 2021/22:

    - Firstly, on 24th June 2021 Standard and Poor Global Ratings (S&P) downgraded the long term and short-term ratings of Landesbank Hessen-Thuringen Girozentrale (Helaba). As a result, Link's suggested lending duration was also downgraded from 12 months to six months. At the time of this downgrade the Council had total loans of £20m outstanding with Helaba. These were both subsequently repaid on time with full interest. On 22nd March 2022 S&P upgraded the long term and short-term ratings of Helaba to their previous level.

    - Secondly, on 11th March 2022 the credit default swap (CDS) price for Goldman Sachs increased beyond Link's acceptable range and it reduced the suggested lending duration from six months to 100 days – as per the Annual Investment Strategy (AIS) this meant that Goldman Sachs was no longer an acceptable counterparty. One week later the CDS price had fallen back into Link's acceptable range and Goldman Sachs was back to a suggested lending duration of six months. The Bank's credit rating remained unchanged during this period. The Council had £30m of Loans with the bank at the time of the breach.

16. Investment returns remained close to zero for much of 2021/22. Most local authority lending managed to avoid negative rates and one feature of the year was the continued growth of inter local authority lending. The expectation for interest rates within the Council's Treasury Management Strategy for 2021/22 was that the Bank Rate would remain at 0.1% until it was clear to the Bank of England (BoE) that the emergency level of rates introduced at the start of the Covid-19 pandemic were no longer necessitated.

17. The BoE and the Government also maintained various monetary and fiscal measures, supplying the banking system and the economy with massive amounts of cheap credit so that banks could help cash-starved businesses to survive the various lockdowns/negative impact on their cashflow. The Government also supplied huge amounts of finance to local authorities to pass on to businesses. This meant that for most of the year there was much more liquidity in financial markets than there was demand to borrow. Consequently, investment earnings rates remained low until towards the turn of the year when inflation concerns indicated central banks (and not only the BoE) would need to lift interest rates to combat the second-round effects of growing levels of inflation (CPI was 6.2% in February).

18. While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

19. On the debt portfolio, no new loans were taken. A total of £0.5m was repaid in the year which was in respect of three equal instalments of principal loans, thereby reducing the overall balance of the loan portfolio.

20. The Authority has not raised any external loans since August 2010 and external debt is around £100m lower than it was at its peak in November 2006. The most recent MTFS capital programme, for 2022-26, includes a funding requirement of £143m to be funded from borrowing. However, due to the strength of the County Council's balance sheet, it is expected to be possible to use internal balances to fund this on a temporary basis instead of raising new loans.

Position at 31 March 2022

21. The Council's external debt position at the beginning and end of the year was as follows: -

	31 March 2021			31 March 2022		
	Principal	Average Rate	Average Life	Principal	Average Rate	Average Life
Fixed Rate Funding						
- PWLB	£159.6m	6.79%	30 yrs	£159.1m	6.80%	30 yrs
-Market	£ 0.0m	n/a	n/a	£ 0.0m	n/a	n/a
Variable Rate Funding:						
- Market (1)	£103.5m	4.37%	1 yr	£103.5m	4.37%	1 yr
Total Debt	£263.1m	5.84%	20 yrs	£262.6m	5.84%	20 yrs

(1) The lenders all have an option to increase the rates payable on these loans on certain pre-set dates, and if they exercise this option we can either repay or accept the higher rate. The average life is based on the next option date.

22. The position in respect of investments varies throughout the year as it depends on large inflows and outflows of cash. Over the course of the year the loan portfolio (which includes cash managed on behalf of schools with devolved banking arrangements) varied between £347m and £420m and averaged £372m. Investments as at 31 March 2022 were £420m.

Debt Transactions

23. The Council began the financial year £30.8m over-borrowed compared with the amount required to fund the historic capital programme. This is denoted as the Capital Financing Requirement.

24. Although the term 'over borrowed' suggests an unusual situation it is simply caused by the County Council setting aside money each year so that when loans become due they can be repaid. Historically this situation did not arise because new borrowing was undertaken each year. For the last ten years and more, there has been no requirement to borrow to fund the capital programme (which leads to debt financing costs that fall on the revenue budget), and also the Government's change a number of years ago to award grants to fund the capital programme rather than the previous approach of supported borrowing. Ideally the situation would be remedied by repaying loans early. However, given the large penalties that would be incurred from early repayment the position is unlikely to change unless long-term interest rates rise significantly.

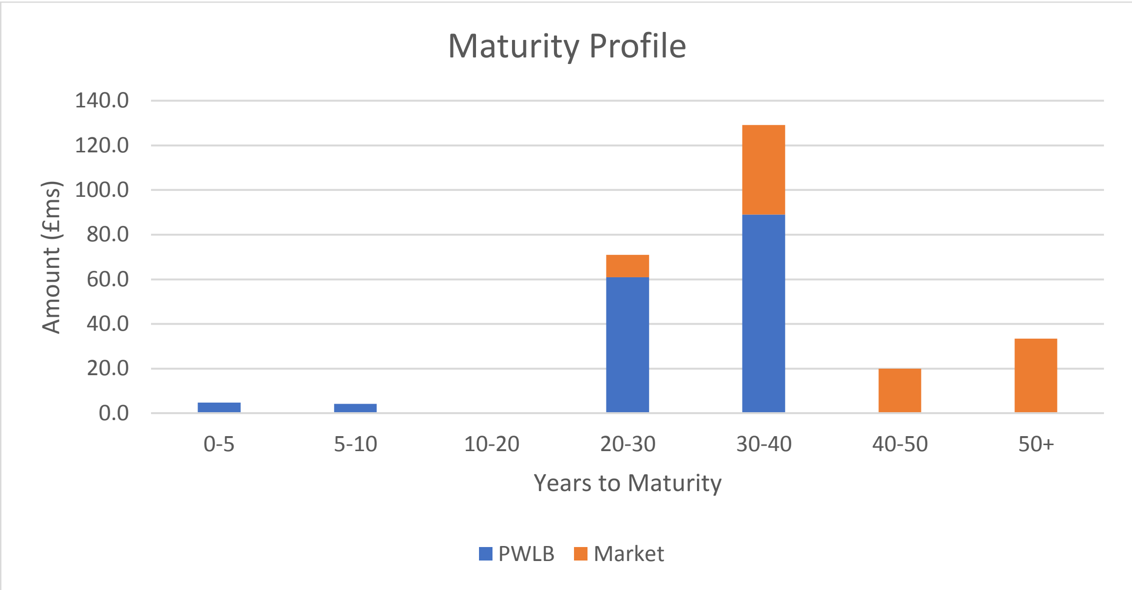
25. It is expected that the overborrowed position will reverse during the MTFS period due to the requirement to fund the new capital programme for 2022-26. As mentioned earlier in the report there is a funding requirement of £143m for the new capital

programme. Due to the level of cash balances held, it is expected that the additional funding requirement will be funded internally without raising any new external debt.

26. At the end of the financial year, after the repayment of debt and setting aside funding for the Minimum Revenue Provision (MRP) - (£6.2m) to ensure that loans raised to finance capital expenditure are paid off over the longer term, the Council was £37m over-borrowed.

27. The lack of opportunity to reduce the debt portfolio, because of historic stagnant interest rates, makes the punitive redemption costs prohibitive. The debt portfolio stands at £262.6m and the average pool rate 5.84%.

28. The maturity profile of the Council's debt portfolio is shown in the chart below. This illustrates the long-term nature of the historic debt.



29. Debt repayments of £0.5m were made during the year meaning that the average pool rate was stagnant.

Investments

30. The loan portfolio produced an average return of 0.25% in 2021/22, compared to an average base rate of 0.19% and a Sterling Overnight Index Average (SONIA) of 0.14%. SONIA, published daily by the BoE, is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors. It is therefore a good proxy for the risk-free rate of investing surplus cash.

31. The loan portfolio has outperformed both the average base rate and the average SONIA in every one of the last five years. The average rate of interest earned on the portfolio in the last five years is 0.62%, and this compares to an average base rate and the SONIA which have produced returns of 0.40% and 0.36% respectively.

32. The variability of balances makes it difficult to calculate the excess interest that the over performance has achieved over the whole of the five year period, but it is estimated to be at least £3m.

33. Appendix A shows the weighted average rate of return for Leicestershire County Council (0.56%) against other councils in its benchmarking group (0.51%) and an average for other County Council's (0.50%) as at 31 March 2022. This shows the Council is currently performing in line with its peers and represents an improvement in performance compared to last year; Leicestershire County Council (0.17%) against other councils in its benchmarking group (0.18%) and other County Council's (0.23%).

34. During the first quarter of 2020/21, amidst the uncertainty surrounding the COVID-19 pandemic and its impact on financial markets, the Council took the prudent decision to limit money market fund transactions and reduce lending durations to other institutions until the markets stabilised. This decision to prioritise security over yield accounted for much of the performance gap between the Council and its peers last year. As the Council's strategy has normalised over the last year performance has improved, and returns are now in line with its peers.

35. The above paragraphs exclude investments relating to private debt. The capital value of private debt investment as at 31st March 2022 was £10.2m. Since inception (January 2018) the Council has received interest payments totalling £2.8m from the private debt investment and the current performance as measured by the internal rate of return is 4.65% - which is in line with expectations.

Summary

36. Treasury Management is an integral part of the Council's overall finances, and the performance of this area is very important. Whilst individual years obviously matter, performance is best viewed on a medium / long term basis. The action taken in respect of the debt portfolio in recent years has been extremely beneficial and has resulted in significant savings. Short term gains might, on occasions, be sacrificed for longer term certainty and stability.

37. The loan portfolio has produced a strong level of over performance in the period in which performance figures have been calculated. Adding significant value in a period of extremely low interest rates is very difficult. Ironically a period in which there begins to be differentiation in expectations for both the pace and extent of future base rate rises will make the cash sums that can be gained larger, whilst also giving a higher level of risk that the decisions taken might retrospectively prove to be sub-optimal.

Equality and Human Rights Implications

38. None.

Background Papers

Report to County Council on 17 February 2021 – 'Medium Term Financial Strategy 2021-25. Appendix N, 'Treasury Management Strategy 2021-25':
https://politics.leics.gov.uk/ieListDocuments.aspx?CId=134&MId=6476&Ver=4

Appendix

Leicestershire County Council Investment Portfolio Benchmarking Analysis March 2022