Overview Select Committee

Review of Treasury Management Activities 2021/22

Overview Select Committee

Date of Meeting: 30th June 2022

Lead director: Colin Sharpe, Deputy Director of Finance

Useful information:

- Ward(s) affected
- Report authors: Amy Oliver
  Nick Booth
- Author contact details: Amy.oliver@leicester.gov.uk
  Nick.booth@leicester.gov.uk
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1. Summary

1.1 This report reviews how the Council conducted its borrowing and investments during 2021/22.

1.2 During 2021/22 we continued to see disruption as a consequence of the pandemic with continued lockdowns, which although reduced still significantly impacted the economy. Then towards the end of the year, the Russian invasion of Ukraine also created further disruption and uncertainty.

1.3 The year started with record low interest rates with a base rate of just 0.1% and an expectation that they would remain lower for longer. There was even a concern that rates would turn negative. However, towards the end of the year rates started to rise significantly for the first time since the banking crisis of 2008, with three rises in base rate by the Bank of England to 0.75%. This was in response to increased inflationary pressures. This rise in interest rates (and the expectation of further rises) has allowed the Council to take advantage of better returns in the market particularly as a number of 2 year loans to other local authorities made in 2019/20 came to maturity. Income received from investments has also held up due to high levels of cash balances as a result of receiving grant ahead of need.

1.4 The outlook for the economy remains uncertain with the emergence of strong inflationary pressures (including increased energy prices) and tax rises.

2. Background

2.1 Treasury management is the process by which our borrowing is managed, and our cash balances are invested. Whilst there are links to the budget, the sums in this report do not form part of the budget. Cash balances reported here cannot be spent, except to the extent shown in the budget report and revenue outturn report.

2.2 The Council has incurred debt to pay for past capital expenditure.

2.3 The Council also has cash balances. These are needed for day to day expenditure (e.g. to pay wages when they are due). A substantial proportion can only be used to repay debt but (because of Government rules) it is prohibitively expensive to repay debt early. Thus, they are held in investments.

2.4 The report commences with an overview of treasury management, including loans and investments at key dates. It then reviews the credit worthiness of investments and implementation of our strategy, provides outcomes on key performance measures and concludes by reviewing compliance against limits set by the Council.

2.5 Reports reviewing treasury management activities are submitted twice a year. The previous report was presented to your committee on 16th December 2021.

3. **Recommendations**

3.1 Members of the Overview Select Committee are recommended to note the report and make comments to the Deputy Director of Finance and the Executive as they wish.

4. **Overview of Treasury Management**

Main elements of Treasury Management

4.1 There are two main elements to treasury management. The first is managing our borrowings which have been taken out to finance capital expenditure. Most capital schemes are now financed by grant, and only a limited number of schemes are financed by borrowing (generally those which pay for themselves). In the past the Government expected us to borrow but allowed for the cost of borrowing in our grant settlement, and we still have a lot of debt which was taken to meet this capital expenditure.

4.2 Historic debt can sometimes be restructured to save money (i.e. repaying one loan and replacing it with another) and this is always given active consideration. In recent years, Government rule changes have normally made it prohibitively expensive to repay loans borrowed from the Public Works Loans Board earlier than the scheduled maturity date.

4.3 The revenue budget approved by the Council for each financial year includes provision for the interest payable on this borrowing. It also includes a provision for repaying the borrowing over a number of years (broadly speaking over the economic life of the assets acquired).

4.4 The second element is cash management which involves managing the Council's investments to ensure the optimum amount of money is in the bank account on a day-to-day basis – so that there is enough money in the account to cover the payments made on the day but no more (cash held in the bank account earns negligible interest).

4.5 The Council has substantial investments but this is not "spare cash". There are four reasons for the level of investments:-

(a) Whilst the Government no longer supports capital spending with borrowing allocations, we are still required to provide money in the budget each year to repay debt. Because of the punitive rules described above, we are not usually able to repay any long-term debt, and therefore have to invest the cash;

(b) We have working balances arising from our day to day business (e.g. council tax received before we have to pay wages, and capital grants received in advance of capital spending);

(c) We have reserves, which are held in cash until we need to spend them;

(d) This year, investments have been bolstered by grants received for the pandemic prior to need to spend.

Treasury Management Policy and Monitoring

4.6 The activities to which this report relates were governed by the Treasury Strategy for 2021/22 which was approved by the Council on 17th February 2021. This establishes an outline plan for borrowing and investment. The strategy for 2022/23 was approved by the Council on 23rd

February 2022 and governs the treasury strategy from that point. The Treasury Strategy is drawn up in the light of the Council's expected borrowing requirements, its expected cash balances, the outlook for interest rates and the credit worthiness of the banks with whom the Council might invest its cash balances.

4.7 A twice-yearly report is submitted to your Committee reviewing the treasury activity undertaken in the year. This report is the final report for 2021/22

Loans and Investments at Key Dates

4.8 Table 1 below shows the loans (money borrowed by the Council) and investments (money invested by the Council) as at 30/09/2021 and at 31/03/2022. The rates shown are the averages paid and received during 2021/22.

4.9 The level of gross debt (total loans borrowed) has remained unchanged. No new long-term loans have been borrowed and no debt restructuring has taken place during the year.

4.10 Investments have decreased by £32m from £353m to £321m. This change is within the range of what is normal (for example if grant income has been spent) and reflects the usual pattern of balances declining towards the end of the financial year, though the decline in balances during the second part of the financial year was somewhat less than experienced in recent years.

4.11 There was a deliberate shift since the second half of the 2019/20 financial year to increase investments held by other local authorities and reduce investments held by banks. This was in part to take advantage of some good rates offered by local authorities for fixed periods up to 3 years and in part to reduce exposure to individual banks. At the end of the 2021/22 financial year, the Council's deposits with banks were restricted to a secured deposit with Nationwide plus exposure to Barclays who act as our bankers. We may in the future look to increase our deposits with banks if they can be secured by other assets.

4.12 The Council has continued to make use of Money Market Funds which comprise a basket of a number of short dated (usually no more than 90 days) loans. The funds that we use are very low risk and comprise only of securities with very high credit ratings and provide liquidity. We have never lost any money in investing in these funds, but the downside of their safety is that returns are generally quite low.

Table 1- Loans & Investments

	Position at 30/09/2021 Principal £M	Position at 31/03/2022 Principal £M	Average Rate
Long Term Fixed Rate Loans Public Works Loan Board (PWLB) Bank Loans	 134 25	 134 25	 4.2% 4.5%
LOBO Loans Bank Loans	 20	 20	 4.5%
Short Term (less than 6 months) Loans Local Authority Loans	NIL	NIL	N/A _
Gross Debt	**179**	**179**	**4.3%**
Treasury Investments Banks and Build Soc Other Local Authorities Government Debt Management Office Money Market Funds Property Funds	 5 175 73 92 8	 5 188 NIL 120 8	
Total Treasury Investments	**353**	**321**	**0.6%**
NET INVESTMENTS	**174**	**142**	

4.12 The investments include £8m in property unit trusts. These are unit trusts which invest in property (as opposed to more traditional unit trusts that invest in shares). These trusts have recovered in value during 2021-22 having declined during the previous year. This is not reflected in the table above because our strategy is to hold the investments long term for income and that short-term changes in capital values are not the prime focus of our investment.

4.13 The dividends received on the units in the year totalled £285,830 which have held up remarkably well during the covid lockdown.

4.14 The treasury strategy permits investments in property funds up to a total value of £30M but no further such investments have been made during the last year. However, we shall continue to review this position.

4.15 The Council's (Non-Treasury) Investment Strategy also allows the authority to spend capital or make loans to a third party where it is intended to (at least partly) achieve a return. Since 30th September, the Council has made no further loans to third parties. The Council has now incurred expenditure totalling £15.8m on the Haymarket Shopping Centre and Pioneer Park. These schemes are now complete and operating successfully. A summary of loans and investments made under the Investment Strategy is shown in table 2 below.

Table 2- Loans & Investments under the Investment Strategy

Investment	Total Capital Expenditure or loans outstanding £m	Percentage Return 2021/2022
Loans		
Ethically Sourced Products	£1.2m	4%
Leicestershire County Cricket Club	£2.3m	5%
Other Investments		
Haymarket Centre Redevelopment	£10.42m	2.3%
Pioneer Park*	£5.36m	2%
Total All Loans & Investments	£19.28m	2.6%

* It should be noted that Pioneer Park received some grant funding towards the capital cost, so that the actual return on the Council's own funding was greater than the 2% shown.

4.16 At the end of 2021 the Council also acquired the Haymarket Shopping Centre for just under £10 million including Stamp Duty Land Tax. This was funded through revenue reserves specifically set aside for property purchases and required no loan funding.

4.17 The repayments of loans to Ethically Sourced Products and Leicestershire County Cricket Club are up to date.

4.18 Also governed by the Investment Strategy is the Council's investment property portfolio. The performance of the Corporate Estate at the time of writing was expected to be reported separately to scrutiny committee.

5. Credit Worthiness of Investments & Interest Rate Outlook

5.1 During 2021/22 we continued to see uncertainty in the economy as a consequence of the pandemic, the Russian invasion of Ukraine and increasing inflationary pressures. However, despite this, we did not see the financial system like fail like it did in the financial crisis of 2008. This indicated that the corrective measures undertaken then to strengthen the banks have worked.

5.2 The core expectations of the Council's treasury advisors, Arlingclose, at the beginning of 2021-22 financial year was that base rate would remain very low and rise slowly to 0.5% by March 2023. However, following a significant increase in inflationary pressures particularly relating to energy prices, the Bank Rate has already risen to 0.75% and is expected to rise to at least 1.25% in 2022/23 and possibly higher. This increase in rates (most of which has occurred at the beginning of 2022) has allowed the Council to increase its income from investments which should become more pronounced in the 2022-23 financial year.

5.3 The governments of the largest world economies, including the UK, have implemented measures to make banks less likely to fail but also to reduce the impact on the financial system and on tax payers if they do fail. The measures for dealing with a failing bank see investors who have lent or deposited money (which includes us) taking significant losses before there is any tax payer support ("bail in"). Our assessment of risk is based both on the risk that banks fail (as measured by credit ratings) and also on the level of losses that we might face should the banks require capital support to prevent failure.

5.4 These developments are reflected in the Council's approach to managing credit risk in its treasury strategies for 2021/22 and 2022/23. It has adopted a cautious stance over the whole period covered by this report and has only directly lent to strong UK banks, other local authorities and the UK Government. Other lending has been part of pooled funds (see 5.7 below).

5.5 The position is continually under review. One factor is that other regulatory developments are continuing to require or push banks towards greater financial robustness. One change has been that banks are now required to "ring fence" bank deposits from other riskier activities.

5.6 More than two years ago, we sought to reduce our exposure to bank deposits, partly to reduce risk, and partly to increase liquidity. The monies withdrawn from banks have mostly been placed in money market funds and on deposit with other Local Authorities.

5.7 The Council has an indirect exposure to non-UK banks through its investment in money market funds. Money market funds are like "unit trusts" but rather than investing in company shares these funds invest in interest bearing investments such as bank deposits. When we open such funds, they are vetted to ensure that they have strong investment and risk management processes, and we receive advice from our treasury advisor, Arlingclose. Investing in this way helps manage credit risk by having a high level of diversification amongst the underlying banks and institutions to whom money is lent. Interest rates on these funds are low, because we have immediate access to the funds.

5.8 The Treasury Strategies for 2021/22 & 2022/23 permit investment in property funds. Investments of £8m are held in two funds, the Lothbury Property Trust and the Threadneedle Property Unit Trust.

6. **Implementation of Borrowing & Investment Strategy**

6.1 The strategy approved by Council for 2021/22 envisaged using cash balances instead of borrowing. This strategy has been adhered to.

6.2 Total investment income during 2021/22 was £1.99 million. This was £560k better than originally budgeted due to rising interest rates and because cashflow proved to be greater than anticipated.

6.3 Given that the Council continues to have a high level of investments, active consideration is given to the possible early redemption of a limited amount of debt. This, however, is not straightforward as debt repayment usually involves the payment of a premium. The level of such premia is generally high and premature debt redemption is usually not financially viable.

6.4 As at 31/03/2022 we held £20m of "LOBO" loans. These are fixed rate, but permit the lender to ask for a rate rise. We have the option to repay if they do. Members may be aware of some criticism of LOBOs nationally, principally in respect of authorities which have complex mechanisms for calculating interest rates (we do not). We do not expect the lender to ask us for a rate rise, though we would be pleased to receive a request as we would then take the opportunity to repay. To all intents and purposes, they are simply fixed rate loans.

7. **Key Performance Measures**

7.1 The most important performance measures are the rate of interest on the Council's borrowings, the timing of borrowing decisions, the timing of decisions to prematurely repay debt and the return on investments. No new long-term loans have been borrowed and no further loans have been prematurely repaid.

7.2 The Council benchmarks its investments and the latest data for the investment portfolio as at 31st March 2022.

7.3 Treasury investments comprise internally managed investments, and longer maturity externally managed funds.

7.4 The following table compares our performance against that of participating authorities. This information is available for internally managed investments (including money market funds) and externally managed funds. It is a "snapshot" of investments held at 31st March 2022 (table 3 above shows the average for the year).

Table 3 – Key Performance Data

Investment	**Leicester City Council Revenue return**	**All Authorities' Revenue return(1)**
Internally managed	0.54%	0.46%
Longer term investments	3.80%	3.90%
Total	**0.63%**	**0.97%**

1. per Arlingclose

7.5 The average rate of interest on all investments for participating authorities at 31st March 2022 is 0.97% whilst the Council's own rate is 0.63%. This is mainly explained by differences on income from longer term investments, in that the Council has fewer longer dated strategic funds invested in assets such as property and equities than many other authorities. These strategic funds performed well in 2021-22 as the economy recovered from the pandemic.

7.6 The Council has a lower proportion of longer-term investments than the average authority. Whilst this will reduce income returns, it also reduces our risk from capital losses which is particularly important following recent events.

7.7 As at 31st March 2022 the Council's own longer term investments comprised units in property unit trusts. These carry less risk than some other investment types and the lower risk equates to a lower investment return. In addition, we selected property fund managers that invested in good quality properties with reliable tenants and such funds have a lower rate of return than more adventurous property funds or (for example) funds that invest in the shares of companies.

7.8 Higher investment returns are always available if higher risk is accepted. Risk can take the form of credit risk (money due is not paid) or market risk (the value of investments fall). However, the trade-off between risk and reward was considered when investment strategies were set for 2021/22 and in the current economic climate continues to be a most important consideration.

7.9 In practice, there is no such thing as a representative "average" authority. The benchmarking data shows a division between the authorities that use longer term and more risky assets (about half of all authorities) and those adopting a more cautious approach. We fall between the two as we have only a small proportion of longer-term assets.

8. Use of Treasury Advisors

8.1 The Council are advised by Arlingclose Ltd. They advise on all aspects of treasury management but their main focus is on providing advice on the following matters:

- the creditworthiness of banks
- the most cost effective ways of borrowing
- appropriate responses to Government initiatives
- technical and accounting matters.

9. Compliance with the Council's Treasury Strategy

9.1 As required by the statutory borrowing framework, the Council is required to set a number of prudential limits and indicators. These limits are set annually and can be found within the budget and treasury strategy.

9.2 For the operational implementation of the Council's treasury management strategy the most important limits and indicators that need to be monitored throughout the year are:

- The authorised limit – the maximum amount of borrowing that the Council permits itself to have outstanding at any one time
- The operational limit – a lower limit to trigger management action if borrowing is higher than expected.
- The maximum proportion of debt that is fixed rate.
- The maximum proportion of debt that is variable rate.
- Limits on the proportion of debt maturing in a number of specified time bands.
- Limits on sums to be invested for more than 364 days.

9.3 These limits are monitored and have been complied with. However, on the 29th of November 2021 the Council did breach its limit on money held with Barclays Bank when it unexpectedly without notice received £26.9m late in the day with no time to lend it out. Consequently, the Council had a balance overnight of £34.6m with Barclays in our deposit account which was nearly £20m over our £15m limit. This £15m limit is not set in law but is self-imposed by the Council. The breach was corrected the next day and in practice was not a major risk. It did not result in any loss to the Council.

10. Financial and Legal Implications

10.1 This report is solely concerned with financial issues. Kamal Adatia, Legal Services, has been consulted as Legal Advisor and there are no legal issues.

11. **Other Issues**

OTHER IMPLICATIONS	YES/NO	Paragraph References Within Supporting information
Equal Opportunities	No	
Policy	No	
Sustainable and Environmental	No	
Crime and Disorder	No	
Human Rights Act	No	
Elderly/People on Low Income	No	
Corporate Parenting	No	
Health Inequalities Impact	No	

12. **Background Papers**

12.1 The Council's Treasury Management Strategy - "Treasury Strategy 2021/22" (Council 17th February 2021) and Treasury Management Strategy 2022/2023" (Council 23rd February 2022) and The Council's Treasury Policy Document – "Framework for Treasury Decisions" – Council 19th February 2020.

13. **Consultation**

13.1 Arlingclose Ltd (the Council's Treasury Management advisers).

14. **Author**

14.1 The authors of this report are Nick Booth, Treasury Manager, on extension 37 4063 & Amy Oliver, Head of Finance, on extension 37 5667.

Colin Sharpe
Deputy Director of Finance.