

# **Somerset West and Taunton Council**

## **Audit and Governance Committee – 12<sup>th</sup> September 2022**

### **Treasury Management Outturn Report 2021/22**

**This matter is the responsibility of the Portfolio Holder for Communications and Corporate Resources, Cllr Benet Allen**

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#### **1 Executive Summary / Purpose of the Report**

- 1.1 To provide Members with an update on the Treasury Management activity of Somerset West and Taunton Council and performance against the Prudential Indicators for 2021/22.
- 1.2 Treasury management performance during the year has reflected the agreed strategy for the Council.

#### **2 Recommendations**

- 2.1 To note the Treasury Management activity for the 2021/22 financial year and compliance with the Prudential Indicators.
- 2.2 To endorse the recommendation made by the meeting of the Executive Committee on 20 July 2022 to Full Council to approve a reduction of £35m to the Approved Borrowing Limits in the Capital, Investment and Treasury Management Strategy for 2022/23 reflecting a reduction in capital financing requirement for expenditure no longer required (as referred to in paragraphs 6.33 and 6.34 of this report).

#### **3 Risk Assessment**

- 3.1 The Council has an agreed Treasury Management Strategy (TMS) and effective management practices to ensure compliance and risks are monitored and managed.

#### **4 Background and Full details of the Report**

- 4.1 The Council's Treasury Management Strategy for 2021/22 was approved at Full Council on 30 March 2021. The Council invests 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.
- 4.2 Treasury risk management at the Council is conducted within the framework of specific Codes of Practice issued by the Chartered Institute of Public Finance and Accountancy,

CIPFA. In abbreviated format, they are referred to as the 'Treasury Management Code of Practice' and the 'Prudential Code'.

- 4.3 The first Code is the Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. The version that is relevant to the start of the financial year 2021/22 was published in 2017 and requires the Council to approve a Treasury Management Strategy before the start of each financial year and to approve, as a minimum, a half-year and annual treasury outturn report. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.
- 4.4 In December 2021, CIPFA published a new release of the 'Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes.' Being a revision of the 2017 Treasury Management Code, it introduces strengthened requirements for skills and training, and for investments that are not specifically for treasury management purposes. Most aspects of the new 2021 update took effect from the time of publication, with the exception of new reporting requirements.
- 4.5 Reports prescribed by the Code are required to be adequately scrutinised by committee before being recommended to the Full Council. This role is undertaken by the Audit and Governance Committee.
- 4.6 Working alongside the Treasury Management Code, the 2017 CIPFA The Prudential Code includes a requirement for local Councils to provide a Capital Strategy. This is a comprehensive and high-profile document approved by Full Council covering capital expenditure and financing, treasury management and non-treasury investments.
- 4.7 Similarly to the Treasury Management Code of Practice, CIPFA published a new release of the Prudential Code in December 2021. The Council's latest Capital Strategy, complying with CIPFA's requirement, was approved by Somerset West and Taunton Full Council on 29<sup>th</sup> March 2022.
- 4.8 For continuity and clarity, CIPFA defines Treasury Management as:

"The management of the local Council's cash flows, its borrowings and its investments, the management of the associated risks, and the pursuit of the optimum performance or return consistent with those risks".
- 4.9 Overall responsibility for treasury management remains with the Council with operational responsibility delegated to the S151 Officer. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

## **5 External Context – Analysis by Arlingclose**

- 5.1 This Council relies on the resources and experience of its appointed Treasury Management advisors, Arlingclose. Commentary relating to the external context and economic analysis by Arlingclose can be found in Appendix A to this report.

## **6 Local Context**

- 6.1 On 31<sup>st</sup> March 2022, the Council had net cash investments of £77.030m 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 components, which stem from the Council's Balance Sheet, are summarised in Table 1 below.

**Table 1: Balance Sheet Summary**

	<b>31.3.22 Actual £m</b>
General Fund CFR	135.243
HRA CFR	113.284
<b>Total CFR</b>	<b>248.527</b>
Less: External borrowing	-180.500
<b>Internal borrowing</b>	<b>68.027</b>
Less: Usable reserves	-87.653
Less: Working capital	-59.404
<b>Net Investments</b>	<b>-79.030</b>

- 6.2 Historically low official interest rates have reduced the cost of short-term, temporary loans and, similarly, reduced investment returns from cash assets that can be used in lieu of borrowing. The Authority pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.
- 6.3 The treasury management position as at 31<sup>st</sup> March 2022 and the change during the year is shown in Table 2 below.

**Table 2: Treasury Management Summary**

	<b>31.3.21 Balance £m</b>	<b>In-year Movement £m</b>	<b>31.3.22 Balance £m</b>
Long-term borrowing	-115.500	15.000	-90.500
Short-term borrowing	-47.000	-33.000	-90.000
<b>Total borrowing</b>	<b>-162.500</b>	<b>-18.000</b>	<b>-180.500</b>
Long-term investments	0.003	0.000	0.003
Short-term investments	3.254	-3.254	0.000
Cash and cash equivalents	41.507	-1.253	40.388
<b>Total investments</b>	<b>44.764</b>	<b>-4.507</b>	<b>40.391</b>
<b>Net Borrowing</b>	<b>-117.736</b>	<b>-22.507</b>	<b>-140.109</b>

### **Borrowing Update**

- 6.4 Commercial property is any property which the local authority purchases or holds primarily for financial return. The value of the Council's commercial property portfolio as

at 31<sup>st</sup> March 2022 was £96.835m. All purchases were made prior to the revised CIPFA Prudential Code and shaped the Council's new external borrowing for 2021/22. As a result, £54.9m was added to the financing requirement following the in-year property acquisitions.

- 6.5 A requirement of the new CIPFA Prudential Code is that the Council will review the options for exiting these investments before undertaking further additional borrowing. Whilst this does not commit the Council to exit the investments, the ongoing continuation of holding commercial investments will be an ongoing matter for decision-making by the new Somerset Unitary Council after March 2023. Such decisions are expected to form a part of the Council's overall Capital, Investment and Treasury Strategy from 2023/24 and beyond.
- 6.6 **Municipal Bonds Agency (MBA):** The MBA has been working to deliver a new short-term loan solution, available in the first instance to principal local councils in England, allowing them access to short-dated, low rate, flexible debt. The minimum loan size is understood to be £25 million. With alternative sources of borrowing available to it for smaller amounts, this was not an option that was required by SWT Council during 2021/22.
- 6.7 **UK Infrastructure Bank:** £4bn was reported to have been earmarked for lending to local authorities by the UK Infrastructure Bank high-value and complex economic infrastructure projects. The Bank is wholly owned and backed by HM Treasury. It is understood that this service will launch in due course and will scale up its activity incrementally. Whilst SWT Council was, therefore, unable to participate, its borrowing needs did not match the objectives of the UK Infrastructure Bank.

### **Borrowing strategy**

- 6.8 As at 31<sup>st</sup> March 2022 the Council held £180.5m of loans as part of its strategy for funding previous and current years' capital programmes. This represented an increase of £18m compared to the previous financial year-end, 31<sup>st</sup> March 2021. Outstanding loans on 31<sup>st</sup> March are summarised in Table 3 below.

**Table 3: Borrowing Position**

	<b>31.3.21 Balance £m</b>	<b>Net Movement £m</b>	<b>31.3.22 Balance £m</b>
Public Works Loan Board (Long-term)	92.5	-5.0	87.5
Public Works Loan Board (Short-term)	10.0	-5.0	5.0
Banks (Fixed term)	3.0	0.0	3.0
Local Councils (Long-term)	10.0	0.0	10.0
Local Councils (Short-term)	47.0	28.0	75.0
<b>Total borrowing</b>	<b>162.5</b>	<b>18.0</b>	<b>180.5</b>

- 6.9 For clarification, long-term loans are defined as any loan with a maturity date exceeding 365 days from the date of a reported balance. The Council's chief objective when taking new borrowing during 2021/22 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.

- 6.10 The Council has an increasing CFR due to the capital programme and an estimated borrowing requirement as determined by the Liability Benchmark, which also takes into account usable reserves and working capital. Having considered the appropriate duration and structure of the borrowing need based on realistic projections, it was decided to take a mixture of short-term and long-term borrowing. The Council currently has £100.5m of longer-term borrowings in respect of the Housing Revenue Account and General Fund, details of which are below. These loans provide some longer-term certainty and stability to the debt portfolio. It is also worthy of note that loans shown in the table with a higher rate of interest reflect historically higher interest rates at the time when they were advanced to the Council.

**Table 4: External Long-term Borrowing Position as at 31 March 2022**

Long-dated Loans borrowed	Amount £m	Rate %	Maturity Date
Public Works Loan Board	7.0	2.70	28 Mar 2024
Public Works Loan Board	6.0	2.82	28 Mar 2025
Public Works Loan Board	7.0	2.92	28 Mar 2026
Public Works Loan Board	16.0	3.01	28 Mar 2027
Public Works Loan Board	7.0	3.08	28 Mar 2028
Public Works Loan Board	5.0	3.15	28 Mar 2029
Public Works Loan Board	5.5	3.21	28 Mar 2030
Public Works Loan Board	1.0	8.38	03 Aug 2056
Public Works Loan Board	1.0	7.38	06 May 2057
Public Works Loan Board	2.0	6.63	05 Sep 2057
Barclays	3.0	4.25	14 Jun 2077
Public Works Loan Board	10.0	1.64	12 Nov 2070
Buckinghamshire Council	10.0	0.44	22 Aug 2023
Public Works Loan Board	20.0	1.89	26 Mar 2071
<b>Total borrowing</b>	<b>100.5</b>		

- 6.11 The Council's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short- and long-term borrowing was maintained.
- 6.12 PWLB funding margins have lurched quite substantially and there remains a strong argument for further diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields plus 0.80%. The Council (including the new Unitary Council) will evaluate and pursue such lower-cost solutions and opportunities with its advisor Arlingclose, taking into consideration the amalgamation of the merging five Councils' borrowing and cash balances.

### **Treasury Investment Activity**

- 6.13 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held for a wide range of purposes. During the year, the Council's investment balances ranged between £30.137m and £82.754m due to timing differences between income and expenditure as well as cashflow movements. 2021/22 cashflow movements were unusually pronounced as a result of

Covid grant funding and due to liquidity management ahead of property purchases. The investment position is shown in Table 5 below.

**Table 5: Treasury Investment Position**

	<b>31.03.21 Balance £m</b>	<b>Net Movement £m</b>	<b>31.03.22 Balance £m</b>
Banks and Building Societies (unsecured)	0.867	0.763	1.630
Government (including local authorities)	14.042	-11.144	2.898
Money Market Funds	13.150	4.750	17.900
Cash Plus Funds	1.010	-0.027	0.983
Strategic Bond Funds	2.080	-0.095	1.985
Equity Income Funds	2.011	-0.031	1.980
Property Funds	4.898	0.799	5.697
Multi Asset Income Fund	6.706	0.018	6.688
<b>Total Investments</b>	<b>44.764</b>	<b>-5.003</b>	<b>39.761</b>

- 6.14 The new CIPFA Treasury Management Code of Practice, already referred to above, was published on 20th December 2021. The Code defines treasury management investments as investments that arise from the organisation's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.
- 6.15 During 2021/22 the Council received central government funding to support small and medium businesses during the coronavirus pandemic through grant schemes. £19.71m was received during the year, temporarily invested in short-dated, liquid instruments such as call accounts and Money Market Funds. £18.49m was disbursed by the end of March 2022.
- 6.16 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.
- 6.17 Ultra-low short-dated cash rates, which were a feature since March 2020 when Bank Rate was cut to 0.1%, prevailed for much of the 12-month reporting period which resulted in the return on sterling low volatility net asset value (LVNAV) Money Market Funds being close to zero even after some managers had temporarily waived or lowered their fees. However, higher returns on cash instruments followed the increases in Bank Rate in December, February and March. At 31st March 2022, the 1-day return on the Council's MMFs ranged between 0.51% - 0.58% p.a.
- 6.18 Similarly, deposit rates with the Debt Management Account Deposit Facility (DMADF) initially remained very low with rates ranging from 0% to 0.1% but, following the hikes to policy rates, increased to between 0.55% and 0.85% depending on the deposit maturity. The average return on the Council's DMADF deposits was 0.04% in 2021/22.
- 6.19 The progression of risk and return metrics are shown in the extracts from Arlingclose

quarterly investment benchmarking in Table 6 below.

**Table 6: Investment Benchmarking – Treasury investments managed in-house**

	<b>Credit Score</b>	<b>Credit Rating</b>	<b>Bail-in Exposure</b>	<b>Weighted Average Maturity (days)</b>	<b>Rate of Return %</b>
31.03.2021	4.37	AA-	49%	7	4.36%
<b>31.03.2022</b>	<b>4.54</b>	<b>A+</b>	<b>87%</b>	<b>1</b>	<b>1.83%</b>
Similar Local Authorities	4.37	AA-	61%	43	1.18%
All Local Authorities	4.39	AA-	60%	14	0.97%

- 6.20 Arlingclose provided the Council with a report as at 31<sup>st</sup> March 2022 which shows that £14.380m of the Council’s investments are held in externally managed strategic pooled funds where short-term security and liquidity are lesser considerations, and the objectives are, instead, regular revenue income and long-term price stability. These funds generated dividends of £0.563m in 2021/22, an income return of 4.15% which is used to support services in year, and an unrealised capital gain of £0.804m (5.93%).
- 6.21 In the nine months to December improved market sentiment was reflected in equity, property and multi-asset fund valuations and, in turn, in the capital values of the Authority’s property, equity and multi-asset income funds in the Authority’s portfolio. The prospect of higher inflation and rising bond yields did, however, result in muted bond fund performance. In the January to March quarter the two dominant themes were tighter UK and US monetary policy and higher interest rates, and the military invasion of Ukraine by Russia in February, the latter triggering significant volatility and uncertainty in financial markets.
- 6.22 In light of Russia’s invasion, Arlingclose contacted the fund managers of our MMF, cash plus and strategic funds and confirmed no direct exposure to Russian or Belarusian assets had been identified. Indirect exposures were immaterial. It should be noted that any assets held by banks and financial institutions (e.g. from loans to companies with links to those countries) within MMFs and other pooled funds cannot be identified easily or with any certainty because that level of granular detail is unlikely to be available to the fund managers or Arlingclose in the short-term, if at all.
- 6.23 Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council’s medium to long-term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rates. Investments within these funds have been maintained during 2021/22.

### **Non-Treasury Investments**

- 6.24 The definition of investments in CIPFA’s revised 2021 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. Investments that do not meet the

definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).

- 6.25 Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) also broadens the definition of investments to include all such assets held partially or wholly for financial return. This represented a significant feature of CIPFA's new Code of Practice published in December 2021.
- 6.26 The Council holds £96.835m of such commercial property investments held as directly owned property and £5.069m as loans to local businesses, charities, partnerships and sports clubs as at 31 March 2022.
- 6.27 Commercial property investments generated £5.557m of gross investment income representing an average rate of return of 5.74% and the loans to local businesses generated £181k of investment income representing an average rate of return of 4.41%.
- 6.28 The Commercial Property Investment Strategy was developed to invest £100million between 2020/21 and 2021/22 to create a diversified, cross-sector, institutional grade property portfolio which will bring in gross additional income to the General Fund. The Strategy follows a reduction in Council income streams and increasing volatility around other funding sources, requiring Somerset West and Taunton Council to generate new sources of additional revenue to support front line services. Acquisition of the Council's capital investment portfolio of commercial properties was successfully completed on 17 December 2021. The Council has no plans to extend its investment in this field any further.

### **Treasury Performance**

- 6.29 The Council measures the financial performance of its treasury management activities in terms of its impact on the revenue budget as shown Table 7 below.

**Table 7: Performance**

	<b>Budget 2021/22 £m</b>	<b>Actual 2021/22 £m</b>	<b>Variance 2021/22 £m</b>
Interest Paid	3.507	2.940	-0.567
Interest Received	-0.594	-0.786	-0.192

- 6.30 The above excludes interest paid relating to commercial properties. Using a notional average interest rate of 1.5% for the year, £567k of interest costs was applied to the Council commercial property investment fund (compared to budget estimate of £525k).

### **Compliance**

- 6.31 The Section 151 Officer is pleased to report that all treasury management activities undertaken during the year fully complied with the CIPFA Code of Practice and with every one of the Council's approved Treasury Management Strategy parameters – see Table 8, below.



**Table 8: Investment Limits**

	<b>2021/22 Maximum</b>	<b>31.3.22 Actual</b>	<b>2021/22 Limit</b>	<b>Complied</b>
Any single organisation, except the UK Government	£7.0m	£5.5m	£7m	Yes
UK Government	£36.966m	£2.898m	Unlimited	Yes
Any group of organisations under the same ownership	£7.0m	£5.5m	£7m per Group	Yes
Any group of pooled funds under the same management	£5.0m	£5.0m	£21m per Manager	Yes
Negotiable instruments held in a broker's nominee account	nil	Nil	£21m per Broker	Yes
Foreign Countries	nil	Nil	£7m per Country	Yes
Registered providers and registered social landlords	Nil	Nil	£21m in Total	Yes
Unsecured investments with building societies	Nil	Nil	£7m in Total	Yes
Loans to unrated corporates	nil	Nil	£7m in Total	Yes
Money Market Funds	£28.0m	£17.9m	£42m in Total	Yes
Real Estate Investment Trusts	nil	nil	£21m in Total	Yes

- 6.32 Compliance with the authorised limit and the operational boundary for external debt is demonstrated in Table 9 below, relating to 2021/22:

**Table 9: Debt Limits**

	<b>2021/22 Maximum</b>	<b>31.3.22 Actual</b>	<b>2021/22 Operational Boundary</b>	<b>2021/22 Authorised Limit</b>	<b>Complied</b>
Borrowing	£180.5m	£180.5m	£300.0m	£340.0m	Yes
<b>Total debt</b>	<b>£180.5m</b>	<b>£180.5m</b>	<b>£300.0m</b>	<b>£340.0m</b>	Yes

- 6.33 For the purpose of updating the Capital Investment and Treasury Strategy for 2022/23, at the meeting of the Executive on 20 July 2022 it was agreed to recommend to Full Council that a reduction is made to the approved capital programme budget for reported underspends totalling some £35.312m. Of this sum, £1m was on the Commercial Investment portfolio and £252k on vehicle acquisitions. In addition, in September 2020 Full Council, through a confidential report, approved a large capital investment of over £33m for town centre regeneration development in Taunton. Agreement for land acquisition was not concluded with the owners for a variety of reasons including purchase and development costs, and the impact of phosphates on new schemes that incorporate overnight accommodation. We are no longer in an active negotiation on the purchase of the site and conclude that the capital programme should be updated to

reflect the removal of this scheme (further information was provided in confidential Appendix F to the report for the July meeting of the Executive Committee).

- 6.34 Members of the Audit and Governance Committee are therefore requested to endorse the recommendation from the Executive Committee to reduce the overall capital programme for budget allocations no longer required and, as a consequence, it is now recommended that Full Council approves a reduction of £35m in the Authorised Limit for borrowing in 2022/23 and subsequent years' estimates within the Capital, Investment and Treasury Management Strategy, which was approved by Council in March 2022. If approved, the effect would be to reduce the Authorised Limit for borrowing for each of the three years' estimates to the following:

<b>Authorised limit &amp; Operational boundary for external debt</b>			
	<b>2022/23 Estimate £'000</b>	<b>2023/24 Estimate £'000</b>	<b>2024/25 Estimate £'000</b>
Operational Boundary:			
Borrowing	265,000	315,000	335,000
Leases	10,000	10,000	10,000
<b>Total Operational Boundary</b>	<b>275,000</b>	<b>325,000</b>	<b>345,000</b>
Authorised limit:			
Borrowing	315,000	315,000	335,000
Leases	20,000	20,000	20,000
<b>Total Authorised limit</b>	<b>335,000</b>	<b>335,000</b>	<b>355,000</b>

### Treasury Management Indicators

- 6.35 The Council measures and manages its exposures to treasury management risks using the following indicators.
- 6.36 **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating 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.

	<b>31.3.22 Actual</b>	<b>2021/22 Target</b>	<b>Complied</b>
Portfolio average credit rating	A+	A-	Yes

- 6.37 **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.

	<b>31.3.22 Actual</b>	<b>2021/22 Target</b>	<b>Complied</b>
Total cash available within 3 months	£39.76m	£20.00m	Yes

6.38 **Interest Rate Exposures:** This indicator is set to control the Council's exposure to interest rate risk in the General Fund. The upper limits on the one-year revenue impact of a 1% rise or fall in interest upon variable rate investments and loans were:

Interest rate risk indicator	31.3.22 Actual	2021/22 Limit	Complied
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	£20,177	£50,000	Yes
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	£20,177	£50,000	Yes

6.39 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates, and that the business cases for commercial properties (costs and income) are stand alone.

6.40 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:

	31.3.22 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	44.32%	100%	0%	Yes
12 months and within 24 months	9.42%	100%	0%	Yes
24 months and within 5 years	16.07%	100%	0%	Yes
5 years and within 10 years	9.70%	100%	0%	Yes
10 years and above	20.50%	100%	0%	Yes

6.41 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.

6.42 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	2022/23	2023/24
Actual principal invested beyond year end	£nil	£nil	£nil
Limit on principal invested beyond year end	£30m	£25m	£25m
Complied	Yes	Yes	Yes

#### **Other Matters – Revised CIPFA Codes, Updated PWLB Lending Facility Guidance**

6.43 In August 2021 HM Treasury significantly revised guidance for the PWLB lending facility with more detail and 12 examples of permitted and prohibited use of PWLB loans.

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.

- 6.44 CIPFA published its revised Prudential Code for Capital Finance and Treasury Management Code on 20th December 2021. The key changes in the two codes are around permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments.
- 6.45 The principles of the Prudential Code took immediate effect although local authorities could defer introducing the revised reporting requirements until the 2023/24 financial year if they wish. SWT Council has adopted this deferral because the joining of Somerset councils into the new Somerset Unitary Council means that reporting will not be continuous. The new reporting requirements are, naturally, anticipated to commence from 2023/24.
- 6.46 To comply with the Prudential Code, authorities must not borrow to invest primarily for financial return. This Code also states that it is not prudent for local authorities to make investment or spending decision that will increase the CFR unless directly and primarily related to the functions of the authority. Existing commercial investments are not required to be sold; however, authorities with existing commercial investments who expect to need to borrow should review the options for exiting these investments.
- 6.47 Borrowing is permitted for cashflow management, interest rate risk management, to refinance current borrowing and to adjust levels of internal borrowing. Borrowing to refinance capital expenditure primarily related to the delivery of a local authority's function but where a financial return is also expected is allowed, provided that financial return is not the primary reason for the expenditure. The changes align the CIPFA Prudential Code with the PWLB lending rules.
- 6.48 Unlike the Prudential Code, there is no mention of the date of initial application in the Treasury Management Code. The TM Code now includes extensive additional requirements for service and commercial investments, far beyond those in the 2017 version.
- 6.49 The Council will follow the same process as the Prudential Code, i.e. delaying changes in reporting requirements to the 2023/24 financial year.

## **IFRS16**

- 6.50 The implementation of the new IFRS 16 Leases accounting standard was due to come into force for local authorities from 1st April 2022. Following a consultation CIPFA/LASAAC announced an optional two-year delay to the implementation of this standard, a decision which was confirmed by the Financial Reporting Advisory Board in early April 2022. Councils can now choose to adopt the new standard on 1st April 2022, 1st April 2023 or 1st April 2024. It is not yet known at which date the new Council, Somerset Council, intends to adopt the new standard, although this will undoubtedly form a part of the Local Government Review work being undertaken by staff across the

five Somerset authorities.

## **7 Links to Corporate Aims / Priorities**

7.1 The Capital, Investment and Treasury Management Strategies support the delivery of the Corporate Aims.

## **8 Finance / Resource Implications**

8.1 The Treasury Management function has been well-managed during the year in compliance with the Treasury Management Strategy. As interest rates remain historically low, the opportunities to generate significant income through short-term investments has been limited.

8.2 This report provides full details of the Treasury Management activity during the year. A summary of the key points follows:

- As at 31 March 2022, Somerset West and Taunton Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was indicatively £248.527m, while usable reserves and working capital which were the underlying resources available for investment were £87.653m and £59.404m respectively.
- As at 31 March 2022, Somerset West and Taunton Council had external borrowing of £180.50m, with £105.50m attributable to the Housing Revenue Account and £75.00m attributable to the General Fund.
- Somerset West and Taunton Council also had £39.761m of investments as at 31 March 2022.
- The Council's current strategy was to maintain borrowing and investments below their underlying levels, referred to as internal borrowing.

## **9 Legal Implications**

9.1 The S151 Officer has a statutory responsibility to ensure appropriate arrangements are in place to adequately control the Council's resources. The Council is required to have regard to the Prudential Code, Treasury Management Code and relevant statutory guidance.

## **10 Climate and Sustainability, Safeguarding and/or Community Safety, Equality and Diversity, Social Value, Partnership, Health and Wellbeing, Asset Management, Data Protection and Consultation Implications**

10.1 None in respect of this report.

### **Democratic Path:**

- **Audit, Governance and Standards Committee – Yes**
- **Full Council – Yes**

**Reporting Frequency: Annually**

**List of Appendices**

Appendix A	External Context – Analysis by Arlingclose
Appendix B	List of Investments as at 31 March 2022

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### External Context – Analysis by Arlingclose

#### External Context

**Economic background:** The continuing economic recovery from coronavirus pandemic, together with the war in Ukraine, higher inflation, and higher interest rates were major issues over the period.

Bank Rate was 0.1% at the beginning of the reporting period. April and May saw the economy gathering momentum as the shackles of the pandemic restrictions were eased. Despite the improving outlook, market expectations were that the Bank of England would delay rate rises until 2022. Rising, persistent inflation changed that.

UK CPI was 0.7% in March 2021 but thereafter began to steadily increase. Initially driven by energy price effects and by inflation in sectors such as retail and hospitality which were re-opening after the pandemic lockdowns, inflation then was believed to be temporary. Thereafter price rises slowly became more widespread, as a combination of rising global costs and strong demand was exacerbated by supply shortages and transport dislocations. The surge in wholesale gas and electricity prices led to elevated inflation expectations. CPI for February 2022 registered 6.2% year on year, up from 5.5% in the previous month and the highest reading in the National Statistic series. Core inflation, which excludes the more volatile components, rose to 5.2% y/y from 4.4%.

The government's jobs furlough scheme insulated the labour market from the worst effects of the pandemic. The labour market began to tighten and demand for workers grew strongly as employers found it increasingly difficult to find workers to fill vacant jobs. Having peaked at 5.2% in December 2020, unemployment continued to fall and the most recent labour market data for the three months to January 2022 showed the unemployment rate at 3.9% while the employment rate rose to 75.6%. Headline 3-month average annual growth rate for wages were 4.8% for total pay and 3.8% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 0.1% while regular pay fell by 1.0%.

With the fading of lockdown – and, briefly, the 'pingdemic' – restraints, activity in consumer-facing sectors improved substantially as did sectors such as oil and mining with the reopening of oil rigs but materials shortages and the reduction in the real spending power of households and businesses dampened some of the growth momentum. Gross domestic product (GDP) grew by an upwardly revised 1.3% in the fourth calendar quarter of 2021 according to the final estimate (initial estimate 1.0%) and took UK GDP to just 0.1% below where it was before the pandemic. The annual growth rate was revised down slightly to 7.4% (from 7.5%) following a revised 9.3% fall in 2020.

Having increased Bank Rate from 0.10% to 0.25% in December, the Bank of England hiked it further to 0.50% in February and 0.75% in March. At the meeting in February, the Monetary Policy Committee (MPC) voted unanimously to start reducing the stock of its asset purchase

scheme by ceasing to reinvest the proceeds from maturing bonds as well as starting a programme of selling its corporate bonds.

In its March interest rate announcement, the MPC noted that the invasion of Ukraine had caused further large increases in energy and other commodity prices, with the expectation that the conflict will worsen supply chain disruptions around the world and push CPI inflation to around 8% later in 2022, even higher than forecast only a month before in the February Monetary Policy Report. The Committee also noted that although GDP in January was stronger than expected with business confidence holding up and the labour market remaining robust, consumer confidence had fallen due to the squeeze in real household incomes.

GDP growth in the euro zone increased by 0.3% in calendar Q4 2021 following a gain of 2.3% in the third quarter and 2.2% in the second. Headline inflation remains high, with CPI registering a record 7.5% year-on-year in March, the ninth successive month of rising inflation. Core CPI inflation was 3.0% y/y in March, was well above the European Central Bank's target of 'below, but close to 2%', putting further pressure on its long-term stance of holding its main interest rate of 0%.

The US economy expanded at a downwardly revised annualised rate of 6.9% in Q4 2021, a sharp increase from a gain of 2.3% in the previous quarter. In its March 2022 interest rate announcement, the Federal Reserve raised the Fed Funds rate to between 0.25% and 0.50% and outlined further increases should be expected in the coming months. The Fed also repeated its plan to reduce its asset purchase programme which could start by May 2022.

**Financial markets:** The conflict in Ukraine added further volatility to the already uncertain inflation and interest rate outlook over the period. The Dow Jones started to decline in January but remained above its pre-pandemic level by the end of the period while the FTSE 250 and FTSE 100 also fell and ended the quarter below their pre-March 2020 levels.

Bond yields were similarly volatile as the tension between higher inflation and flight to quality from the war pushed and pulled yields, but with a general upward trend from higher interest rates dominating as yields generally climbed.

The 5-year UK benchmark gilt yield began the quarter at 0.82% before rising to 1.41%. Over the same period the 10-year gilt yield rose from 0.97% to 1.61% and the 20-year yield from 1.20% to 1.82%.

The Sterling Overnight Rate (SONIA) averaged 0.39% over the quarter.

**Credit review:** In the first half of FY 2021-22 credit default swap (CDS) spreads were flat over most of period and are broadly in line with their pre-pandemic levels. In September spreads rose by a few basis points due to concerns around Chinese property developer Evergrande defaulting but then fell back. Fitch and Moody's revised upward the outlook on a number of UK banks and building societies on the Authority's counterparty to 'stable', recognising their improved capital positions compared to 2020 and better economic growth prospects in the UK.



Fitch also revised the outlook for Nordea, Svenska Handelsbanken and Handelsbanken plc to stable. The agency considered the improved economic prospects in the Nordic region to have reduced the baseline downside risks it previously assigned to the lenders.

The successful vaccine rollout programme was credit positive for the financial services sector in general and the improved economic outlook meant some institutions were able to reduce provisions for bad loans. However, in 2022, the uncertainty engendered by Russia's invasion of Ukraine pushed CDS prices modestly higher over the first calendar quarter, but only to levels slightly above their 2021 averages, illustrating the general resilience of the banking sector.

Having completed its full review of its credit advice on unsecured deposits, in September Arlingclose extended the maximum duration limit for UK bank entities on its recommended lending list from 35 days to 100 days; a similar extension was advised in December for the non-UK banks on this list. As ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remains under constant review.

## Investments as at 31 March 2022

Borrower	Amount £	Rate of Interest %	Date of Investment	Date of Maturity
National Westminster Bank	1,630,092	0.01	N/A	On Demand
Debt Management Office	2,898,000	0.14	17/01/2022	18/04/2022
Federated Money Market Fund	5,200,000	Variable	N/A	On Demand
Aberdeen Standard Liquidity	5,500,000	Variable	N/A	On Demand
Aviva	3,200,000	Variable	N/A	On Demand
CCLA Public Sector Deposit Fund	4,000,000	Variable	N/A	On Demand
CCLA Local Authority Property Fund	5,697,030	Variable	N/A	On Demand
Ninety-One (Formerly Investec)	2,752,351	Variable	N/A	On Demand
Columbia Threadneedle	1,980,392	Variable	N/A	On Demand
Royal London Enhanced Cash Fund	983,176	Variable	N/A	On Demand
Payden Sterling Reserve Fund	1,984,727	Variable	N/A	On Demand
AEGON Diversified Income Fund (Formerly Kames)	1,889,091	Variable	N/A	On Demand
Schroder Income Maximiser Fund	2,046,194	Variable	N/A	On Demand
<b>TOTAL</b>	<b>39,761,053</b>			