Treasury Management Activity 2021/22: April to November 2021

The council's treasury management activity is underpinned by the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management ("the Code"). The Code recommends that members are informed of treasury management activities. This report provides a review of the treasury management activity between 1 April and 30 November 2021.

Economic context

The year has seen global economies recovering from the impact of the pandemic and some increasing inflation. The Monetary Policy Committee (MPC) of the Bank of England noted that the pace of the global recovery was broadly in line with its November Monetary Policy Report and that the UK economy was evolving in line with expectations. However, the new Omicron coronavirus variant is adding significant uncertainty with expectations of growth for the rest of the year now being lower than initially anticipated.

Inflation has been increasing during the year with the UK Consumer Price Index (CPI) for November 2021 registered 5.1% year on year, up from 4.2% in the previous month. Inflation is now forecast by the MPC to remain above 5% throughout the winter and peak at 6% in April 2022.

As a result of the inflationary pressure there was an expectation that the Bank Rate would be increased. Although this did not happen in November, the Bank of England did increase the Bank Rate to 0.25% in December 2021.

Arlingclose, the council's treasury management advisors, expect the Bank Rate to rise to 0.5% in quarter one of 2022 and then stay at that level for the foreseeable future.

Investment activity

Investments at 30 November 2021 totalled £637m and consisted of £201m in bank and local authority deposits and £436m in corporate and government bonds. The following table shows the investment activity between 1 April and 30 November 2021.

Bank and Local Authority Deposits	**Call £m**	**Fixed £m**	**Total £m**
Balance 1 April 2021	**60.5**	**67.0**	**127.5**
Maturities	-266.7	-57.0	-323.7
New Investments	386.9	10.0	396.9
Balance 30 November 2021	**180.7**	**20.0**	**200.7**

Bonds	LA Bonds £m	Gilts £m	Others £m	Total £m
Balance 1 April 2021	**15.2**	**390.0**	**229.3**	**634.5**
Maturities/Sales	-7.0	-2,831.4	-1,215.3	-4,053.7
New Investments	0.0	2,575.0	1,280.0	3,855.0
Balance 30 November 2021	**8.2**	**133.6**	**294.0**	**435.8**

The period saw some significant volatility in the price of the Gilts and also general volatility in the markets overall. This resulted in the opportunity being taken to sell some of our holdings to enhance the overall return on the investments and is reflected in the level of sales and new investments during the period.

The current rate of return on the investment portfolio measured by Arlingclose is 0.85% which compares favourably with the Sterling Overnight Rate (SONIA) which averaged 0.05% over the same period.

Borrowing activity

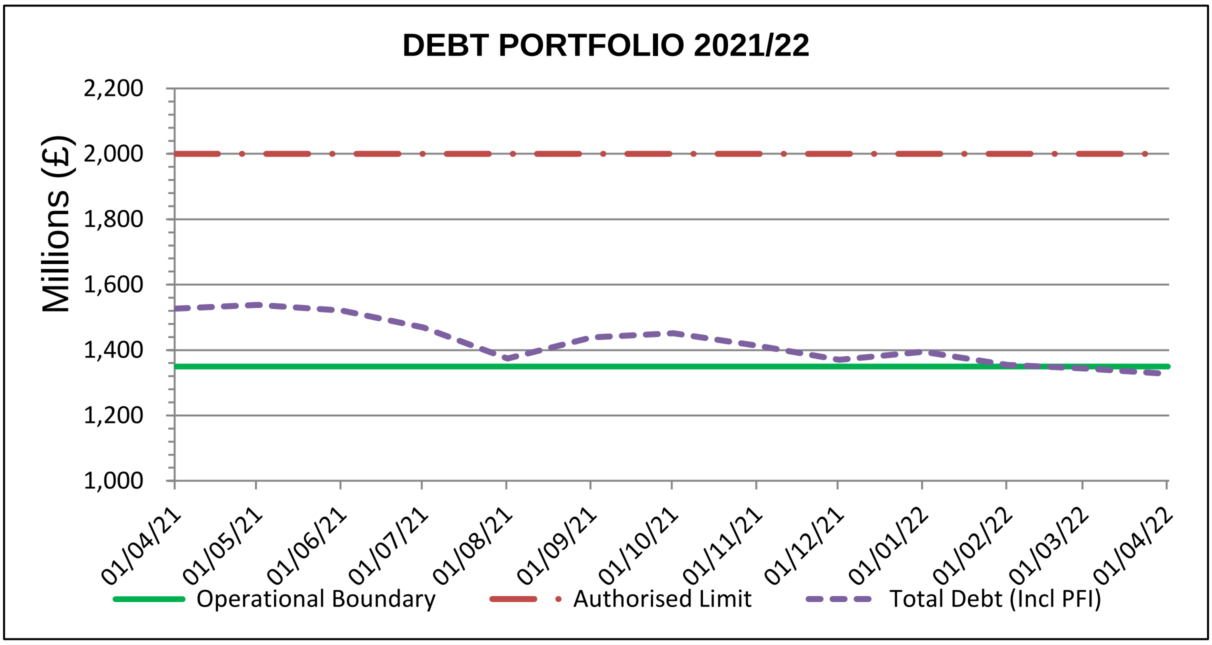
The council's capital programme includes a requirement to borrow to fund new capital investment. The table below summarises the borrowing activity which has taken place between 1 April and 30 November 2021.

	PWLB Fixed £m	PWLB Variable £m	Long Term Bond £m	Other Local Authorities £m	Police, Fire & Lancashire District Councils £m	Total £m
Balance 1 April 2021	**313.9**	**125.8**	**600.0**	**273.0**	**68.8**	**1,381.5**
New Borrowing	0.0	0.0	0.0	421.0	366.9	787.9
Maturities	-29.3	-125.8	0.0	-439.0	-343.7	-937.8
Balance 30 November 2021	**284.6**	**0.0**	**600.0**	**255.0**	**92.0**	**1,231.6**
Private Finance Initiative (PFI) Liability	-	-		-	-	139.5
Total Borrowing & PFI						**1,371.1**

Total borrowing at the end of November was £1,371m including the financing of £139.5m of assets through remaining Private Finance Initiative schemes. The outstanding borrowing has decreased by £150m in the period.

The council uses both long and short-term borrowing to meet its total requirements. In the last couple of years, the aim has been to have a higher proportion of the borrowing as long term to reduce re-financing risk while taking advantage of low long term interest rates. This has principally been achieved by the issuance of two bonds for a total of £600m. As a consequence, the borrowing was temporarily higher than required until some debt matured. Some of this debt is now maturing hence the fall in the overall level of borrowing in the year.

The borrowing is undertaken within the framework set by the Authorised and Operational Limits. The following graph shows the level of debt for the current financial year compared with the prudential indicator operational and authorised boundaries. It is expected that the debt may exceed the operational limit on occasion, but it should not exceed the Authorised Limit. The debt shown from 30 November represents the debt position if no maturing debt was replaced, rather than an estimate of the expected position.



Total debt during the year has remained below the authorised but has exceeded the operational limits. The operational limit has been exceeded partly as the opportunity was taken to take long-term borrowing at low rates in 2020/21and it was taken before existing debt matured. It is anticipated that the debt will be below the operational limits by financial year end.

The current interest rate payable on debt, as measured by Arlingclose, is 1.49%.

Non-treasury investment strategy

A non-treasury investment strategy was approved by the Full Council in February 2021. This enabled the investment in bonds for commercial purposes where cash-flow permits. In accordance with this a number of local authority loans were purchased from a bank and bonds in EDF acquired along with other commercial bonds. Hedge transactions were undertaken to mitigate the interest rate risk inherent in these investments.

In October 2021, all these local authority loans apart from one were sold, and some of the related hedge transactions settled. In total it is estimated that the net value remaining of these activities at 30 November is £121m summarised in the following table:

	£m
LOBO Bond	26.15
Other Commercial Bonds	174.86
Hedge transaction	(80.00)
Total	**121.01**

Under accounting regulations any change in the market value of some of these assets will be charged or credited to the revenue account.

Budget monitoring position

It was reported to Cabinet in September 2021 that there is a forecast underspend against the treasury management budget, including the non-treasury management investments, of £13.5m, as summarised in the following table.

	Budget 21/22 £m	**Outturn 21/22 £m**	**(Under) /Overspend £m**
MRP	20.331	21.490	1.159
Interest Paid	27.245	26.400	(0.845)
Interest Received	(15.889)	(29.703)	(13.814)
Grants	(0.040)	(0.040)	0.000
Total	**31.647**	**18.147**	**(13.500)**

This is primarily a result of extra income received through the continuing volatility in the price of Gilts and other bonds enabling sales to be made which have generated a surplus. However, the final outturn may be significantly different from the current forecast, due to recent and expected continued market volatility.

The position is kept under regular review and discussed with the Director of Finance on a monthly basis.

Prudential Indicators

The Treasury Management Strategy included some prudential indicators which provide a framework for the operation and risk management of Treasury Management. These are shown below for 2021/22 with the latest available actual position.

Authorised Limits for debt

The 'authorised limit' is a prudent estimate of external debt but allows sufficient headroom for unusual cash flow movements. During the year the Director of Finance approved the re-allocation of the Authorised Limit between the borrowing and other long-term liabilities to provide some additional flexibility to take long term borrowing. This approval is in accordance with the Prudential Code.

	Limit	Actual
	£m	£m
Borrowing	1,600	1,232
Other long-term liabilities (PFI schemes)	400	139
TOTAL	**2,000**	**1,371**

Operational Limits for debt

The 'operational limit' for external debt is based on the same estimates as the authorised limit. Although it reflects a prudent estimate of debt, there is no provision for unusual cash flow movements. In effect, it represents the estimated maximum external debt arising as a consequence of the council's current plans. As required under the Code, this limit has been monitored during the year.

	Limit	Actual
	£m	£m
Borrowing	1,200	1,232
Other long-term liabilities (PFI schemes)	150	139
TOTAL	**1,350**	**1,371**

As explained in the report, the timing of taking long term loans has resulted in the level of borrowing being above the operational limit. It is anticipated that this will continue to be the case throughout 2021/22 as some of the borrowing was taken in advance of need as permitted by the Prudential Code. It is expected that with debt maturing the debt level will fall below the operational limit by 31 March 2022.

Gross debt and the capital financing requirement

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the authority's total debt should be lower than its highest forecast capital financing requirement over the next three years. The county council's borrowing is in excess of the capital financing requirement however, in making this comparison certain borrowing is included in the total borrowing but does not count against the capital financing requirement. These include the shared investment scheme, premiums paid and the transferred debt. The current level of debt also includes an element of borrowing in advance. Therefore, the Director of Finance confirms that the level of borrowing over the three years is within the capital financing requirement conditions.

Interest rate exposure

In order to control interest rate risk, the council measures its exposure to interest rate movements. These indicators place limits on the overall amount of risk the council is exposed to. The one-year impact indicator calculates the theoretical impact on the revenue account of an immediate 1% rise in all interest rates over the course of one financial year.

	Upper Limit	Actual
Upper limit on one-year revenue impact of a 1% rise in interest rates	£50m	£44m

The indicator excludes the fair value impact of the non-treasury management portfolio of a rise in interest rates, this is very difficult to quantify but is estimated to be in the region of £70m.

Maturity structure of debt

Limits on the maturity structure of debt help control refinancing risk.

	Upper Limit	Actual
Under 12 months	75%	15%
12 months and within 2 years	75%	22%
2 years and within 5 years	75%	4%
5 years and within 10 years	75%	5%
10 years and above	75%	54%

Investments over 1 year

Limit on the level of long-term investments helps to control liquidity, although the majority of these investments are currently held in securities which are readily saleable. The limit is largely determined by the forecast of reserves and balances held at the year-end. It is anticipated that the level of reserves will fall gradually during the year and there will be positive cash-flows in year which will require a higher level of investments to be held including bonds held specifically for liquidity purposes.

	Upper limit	Actual
Total invested over 1 year	£800m	£639m
Operational or forecast limit at 31 March 2022	£550m	£639m

The indicator excludes investments undertaken as part of the non-treasury management portfolio as they are not part of the in-year liquidity requirements. The level of investments is not anticipated to fall to the £550m by the year end due to reserves and balances remaining higher than initially anticipated.

Minimum Average Credit Rating

To control credit risk the council requires a very high credit rating from its treasury counterparties.

	Benchmark	Actual
Average counterparty credit rating	A	AA