
NORTH AYRSHIRE COUNCIL

30 November 2021

Cabinet

Title:	Treasury Management and Investment Mid-Year Report 2021/22
Purpose:	To provide Cabinet with a Treasury Management update for the period 1 April to 30 September 2021.
Recommendation:	That Cabinet agrees to (a) endorse the contents of the Treasury Management and Investment Mid-Year Report for 2021/22 (Appendix 1); and (b) note the Prudential and Treasury Indicators contained therein.

1. Executive Summary

- 1.1 The Treasury Management and Investment Strategy and treasury management indicators provide a framework for the Council's treasury activities to ensure the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks.
- 1.2 This mid-year review report:
 - provides an update on performance to 30 September 2021;
 - updates the annual prudential indicators to reflect the latest information available to the Council; and
 - demonstrates that the treasury management activities carried out during the period 1 April to 30 September 2021 have been consistent with the Treasury Management and Investment Strategy 2021/22 and have complied with the treasury management indicators set out in the Strategy.

2. Background

- 2.1 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017) requires that Elected Members are provided with regular monitoring reports on treasury management activities. The Treasury Management Strategy for 2021/22 was approved by Council on 4 March 2021.

This report is the Mid-Year Report, providing Cabinet with an update on treasury management activities for the period 1 April to 30 September 2021.

An annual report on the treasury management activities for the year will be presented to Council following the end of the financial year.

These reports ensure that the Council is meeting best practice in accordance with CIPFA's Code of Practice.

2.2 The 2021/22 Mid-Year Report is attached at Appendix 1 and covers:

- Prudential and treasury indicators;
- Borrowing and associated rates; and
- Investments and associated rate of return.

2.3 This report provides an update on performance to 30 September 2021 and the annual prudential indicators to reflect the latest information. It is a statutory duty for the Council to determine and keep under review its approved borrowing limits and prudential indicators. Details within the report demonstrate that, during the period 1 April to 30 September 2021, the Council has operated within the authorised and operational limits and prudential indicators as set out in the Council's 2021/22 Annual Treasury Management Strategy Statement (TMSS).

2.4 The Executive Summary of the Mid-Year Report provides a high level overview of treasury management and performance, with more detail provided in the body of the report. Key points to note are:

- the re-profiling of capital expenditure into future years and continued use of internal resources have had an impact on all of the prudential indicators;
- during the year to date the Council has only undertaken temporary borrowing . The Council has also used internal short-term cash reserves to temporarily fund any capital borrowing requirement to 30 September 2021; and
- investment returns are marginally above the target and this is reflective of investments made at higher rates of return before the Bank of England base rate was reduced to 0.1% in March 2020.
- £5m investment with the London Borough of Croydon during 2020 was fully recovered , including interest payments , upon its maturity on the 20 August 2021.

3. Proposals

3.1 It is proposed that Cabinet (a) endorse the contents of the Treasury Management and Investment Mid-Year Report for 2021/22 (Appendix 1); and (b) note the Prudential and Treasury Indicators contained therein,

4. Implications/Socio-economic Duty

Financial

4.1 General Services

Capital Financing Costs - the Council budgeted £14.522m for financing costs and expenses on debt for 2021/22. It is currently estimated that actual costs will total £11.624m. This underspend will be transferred to the Loans Fund Reserve in line with the previously agreed policy to support delivery of the capital investment programme.

Housing Revenue Account

Capital Financing Costs - the Council budgeted £10.188m for financing costs and expenses for debt in 2021/22. It is currently estimated that actual costs will total £9.512m.

In both cases, the main reasons for the underspends are a) the re-profiling of capital expenditure into future years and b) the current strategy to utilise cash balances, resulting in savings on external interest costs.

Human Resources

4.2 None.

Legal

4.3 None.

Equality/Socio-economic

4.4 None.

Environmental and Sustainability

4.5 None.

Key Priorities

4.6 This report directly supports the Council Plan 2019 to 2024 by maximising resources and providing value for money to support financially sustainable delivery models.

Community Wealth Building

4.7 None.

5. Consultation

- 5.1 The Council's treasury advisors, Arlingclose Ltd, were consulted in the preparation of this report.

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For further information please contact **David Forbes, Senior Manager (Strategic Business Partner)**, on **01294 324551**.

Background Papers

Treasury Management and Investment Strategy 2021/22 – Council 4 March 2021



North Ayrshire Council
Comhairle Siorrachd Àir a Tuath

Treasury Management and Investment Mid-Year Report

2021/22



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Treasury Management and Investment Mid-Year Review 2021/22

1. Purpose

The Council is required by regulations issued under the Local Government in Scotland Act 2003 and the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017) to produce a mid-year review of treasury management activities. The purpose of this mid-year review is to report the performance of the Council's treasury operation and how this measures up against the Council's Treasury Management and Investment Strategy. This is done through the publication of updated prudential and treasury indicators for 2021/22.

This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

During 2021/22, to meet the minimum reporting requirement, the following reports should be submitted to Elected Members:

- an annual treasury management and investment strategy (submitted to the Council on 4 March 2021)
- the capital strategy (submitted to the Council on 4 March 2021)
- a mid-year treasury update report (this report)
- an annual review following the end of the year describing the activity compared to the strategy (will be submitted to Council in June 2022)

Regulations place responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of treasury activities for the six months to 30 September 2021 and highlights performance against the Council's policies previously approved by members.

2. Executive Summary

During the six month period to 30 September 2021, the Council complied with its legislative and regulatory requirements.

The **key prudential and treasury indicators** for 2021/22 have been updated based on the latest available information and will be used to assess performance at the end of the year.

TABLE 1

Prudential and treasury indicators	2021/22 Original Estimate £m	2021/22 Revised Estimate £m
Capital expenditure (Indicator 1)		
· Non-HRA	77.762	59.653
· HRA	109.447	51.146
· Total	187.209	110.799
Capital Financing Requirement (CFR):		
· Non-HRA	233.228	208.717
· HRA	203.931	156.247
· Total	437.159	364.964
Gross borrowing (Indicator 4)	427.159	296.922
Operational Boundary (Indicator 5)	458.967	390.041
Authorised Limit (Indicator 6)	504.863	429.045
Investments (Indicator 8)		
· Longer than 1 year	-	-
· Under 1 year	20.000	30.282
· Total	20.000	30.282

A summary of performance is provided below with more detailed information provided in the body of the report.

Capital Expenditure for both the General Fund and HRA vary from original estimates due to changes in the profile of projects. Full details of all movements in the capital expenditure budgets are included in the capital programme performance reports submitted to Cabinet throughout the year.

The **Capital Financing Requirement (CFR)** is the underlying borrowing requirements of the Council. The reduction to the requirement during 2021/22 reflects the change in profile of the capital programme.

Gross Borrowing reflects the actual borrowing which has been undertaken. This is projected to be lower than anticipated due to the revised profile of capital projects and the use of internal funds, the latter being a key element of the Treasury Management Strategy to minimise costs.

The **Operational Boundary** is the maximum we would anticipate borrowing to fund the current year capital programme building in flexibility for the timing of the different funding streams and principal repayments. The in-year variance is linked to the use of internal funds and the re-profiling of the capital programme.

The **Authorised Limit** is set at 10% above the Operational Boundary to give some flexibility to raise funds for future year capital investment.

The Council has a strategy of taking a combination of temporary and permanent borrowing in recognition of the Council's longer term borrowing requirements and the market rates available at that time. This balances short term financial savings with longer term security of costs. During the period 1 April to 30 September 2021 the Council undertook £5m of temporary borrowing which was repaid on the 22 October 21.

Affordability of borrowing is measured by a number of indicators, including the impact of:

- Percentage of financial costs relative to the net revenue stream of the General fund and Housing Revenue Account.

As at 30 September 2021 the above indicator shows estimated ratios of 3% and 18.6% for General Fund and HRA respectively. Capital expenditure impacts on the revenue budget through financing charges so it is essential the Council ensures the financing costs remain affordable and do not constitute an excessive proportion of the revenue resources available. From a General Fund perspective, the latest Scottish Local Authority average was 6.94%, therefore demonstrating a prudent borrowing policy. For the HRA, the latest Scottish average was 22.68%. The level of loan charges is deemed prudent and affordable within the framework of the 30 year Housing business plan.

The **average investment** rate to 30 September 2021 was 0.15%, compared to a target of 0.10% and actual in 2020/21 of 0.25%. The return secured this year to date reflects the Bank of England base rate which has remained at 0.10% since March 2020. Interest rates are extremely low for investments with counterparties with high creditworthiness. Rates for deposits with the Debt Management Account Deposit Facility (DMADF) and other local authorities are both largely around zero. Net returns on Money Market Funds are also close to zero.

Other prudential and treasury indicators and supporting information can be found in the main body of this report.

Conclusion

The Head of Finance confirms that long-term borrowing is only undertaken for a capital purpose and the statutory borrowing limit (the authorised limit) has not been breached.

3. Prudential and Treasury Indicators for 2021/22

The Prudential Code establishes a framework to ensure Councils demonstrate effective control over levels of, and decisions relating to, capital investment activity including borrowing. The Treasury indicators are used to ensure that risk is managed and controlled effectively. Together the Prudential and Treasury Indicators consider the affordability and impact of capital expenditure decisions and set out the Council's overall capital framework.

These indicators help the Council to demonstrate public accountability in relation to borrowing and investments. As part of this accountability this report will summarise the following: -

- Capital activity during the year (section a);
- Impact of this activity on the Council's underlying debt (the Capital Financing Requirement) (section b);
- The actual prudential and treasury indicators (section a – e);
- Overall treasury position identifying how the Council has borrowed in relation to this debt, and the impact on investment balances (section e);
- Detailed debt activity (section e); and
- Summary of interest rate movements in the year (section 4);
- Detailed investment activity (section 5).

(a) The Council's Capital Expenditure and Financing 2021/22 (Prudential Indicator 1)

The Council incurs capital expenditure when it invests in its long term assets. Capital Expenditure can be funded in two main ways:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply other resources, the capital expenditure will give rise to borrowing, which is approved as part of the Council's investment plans.

The tables below show the planned capital expenditure for 2021/22 and the latest forecast alongside the amount estimated to be financed in year and the amount which will give rise to borrowing.

TABLE 2

General Fund	2021/22	2021/22
	Original Estimate £m	Revised Estimate £m
Capital expenditure (Indicator 1)	77.762	59.653
Financed in year from external funding and reserves	21.319	31.294
Unfinanced capital expenditure	56.443	28.359
HRA	2021/22	2021/22
	Original Estimate £m	Revised Estimate £m
Capital expenditure (Indicator 1)	109.447	51.146
Financed in year from external funding and reserves	33.548	26.178
Unfinanced capital expenditure	75.899	24.968

(b) The Council's Overall Borrowing Need (the Capital Financing Requirement) (Prudential Indicators 2 and 3)

This indicator outlines the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not been paid from either a capital or revenue resource and therefore needs to be funded from borrowing. It is essentially a measure of the Council's underlying borrowing need.

Part of the Council's treasury activity is to meet the funding requirements for this borrowing need. The treasury management section organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government through the Public Works Loan Board [PWLB], or the money markets), by utilising temporary cash resources within the Council or through temporary borrowing from other local authorities.

The Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. The Council is required to make an annual revenue charge, called the Loan Fund Principal Repayment. This is effectively a repayment of the borrowing need and it is charged to revenue over the life of the asset. This charge reduces the CFR each year. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- increasing the annual revenue charge

The Council's CFR for the year is shown in the following table and is a key prudential indicator. The opening balance excludes the PPP / NPD schemes because no borrowing is actually required against these schemes as a borrowing facility is included in the contract.

Table 3 shows that, based on historic capital expenditure and this year's capital expenditure, the Council has a cumulative underlying borrowing need of £364.964 forecast at 31 March 2022. This is lower than the original estimate largely as a result of changes in the profile of capital projects.

TABLE 3

CFR	2021/22 Original Estimate £m	2021/22 Revised Estimate £m
Opening Balance	312.654	319.548
Add unfinanced capital expenditure (General Fund and HRA per Table 2)	132.342	53.327
Less Loans Fund Principal Repayments	(7.837)	(7.911)
Closing balance (Indicator 2)	437.159	364.964
Annual Change (Indicator 3)	124.505	45.416

c) Limits to Borrowing Activity (Prudential Indicators 4 - 6)

Borrowing activity is constrained by the prudential indicators for CFR, gross borrowing and by the authorised limit to ensure the Council operates its activities within well-defined limits.

Gross borrowing and the CFR

There is a need to ensure that gross debt does not, except in the medium term, exceed the total CFR (i.e. the Council does not borrow more than it needs to fund its capital programme). In exceptional circumstances Councils are allowed to borrow to cover the current financial year plus the next two financial years (i.e. to 2023/24). This provides some flexibility to borrow in advance where this is appropriate.

Table 4 highlights the Council's forecast gross borrowing position against the CFR and confirms that at 30 September 2021 the Council has complied with this prudential indicator as gross borrowing is currently within its CFR. The Council is currently under-borrowed by £117.563m due to the continuing strategy to delay long-term external borrowing by utilising internal cash balances.

TABLE 4

	2021/22 Original Estimate £m	2021/22 Revised Estimate £m	30 September 2021 Actual £m
Gross borrowing position (Indicator 4)	427.159	296.922	247.401
CFR	437.159	364.964	364.964
(Under)/Over Borrowed Position	(10.000)	(68.042)	(117.563)

As part of its annual Treasury Management and Investment Strategy the Council sets limits for external borrowing which it is not normally expected to exceed. These limits are explained below.

The Operational Boundary

The operational boundary is the expected maximum borrowing position of the Council during the year, taking account of the timing of various funding streams and the recharge of principal repayments from the revenue account. Periods where the actual position varies from the boundary is acceptable subject to the authorised limit not being breached.

The Authorised Limit

The authorised limit represents a limit beyond which external debt is prohibited. Performance against the approved strategy is monitored throughout the year and reported to Cabinet as appropriate. However, ultimate responsibility for setting or adjusting this limit lies with full Council. The current limit is set at 10% of the Operational Boundary.

Table 5 demonstrates that between 1 April and 30 September 2021 the Council's gross borrowing was within both the operational boundary and its authorised limit, by a significant margin due to the continuing strategy to delay new external borrowing by utilising internal cash balances and changes in the capital programme that have resulted in a reduced borrowing requirement.

TABLE 5

	Estimated £m	Revised £m
Average gross borrowing position 1 April to 30 September 2021		255.542
Maximum gross borrowing position 1 April to 30 September 2021		260.366
Operational boundary per Treasury Strategy 2021/22 (Indicator 5)	458.967	390.041
Authorised limit per Treasury Strategy 2021/22 (Indicator 6)	504.863	429.045

(d) Treasury Position at 30 September 2021 (Prudential Indicators 7 - 11)

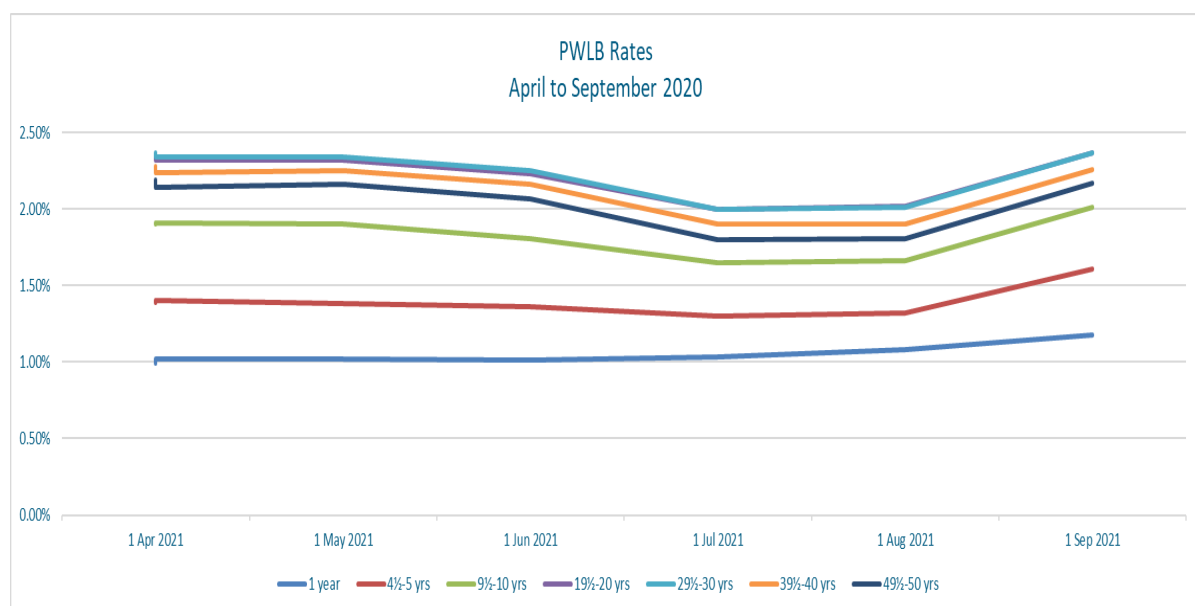
The Council's debt and investment position is organised by the treasury management service to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within agreed parameters. Procedures and controls to achieve these objectives are well established through both Member reporting and the Council's Treasury Management Practices.

Borrowing Strategy for 2021/22

The Borrowing Strategy for 2021/22 anticipated bank interest rates remaining low during 2021/22 and small increases in medium and longer term fixed borrowing rates. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period. Continued economic uncertainty has promoted a cautious approach, whereby investments continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

The economic recovery from coronavirus pandemic continued to dominate the first half of the financial year. By the end of the period over 48 million people in the UK had received their first dose of a COVID-19 vaccine and almost 45 million their second dose. The Bank of England Bank Rate has been maintained at 0.10% during the year.

The following graph demonstrates that PWLB rates have remained relatively steady during the period April to September 2021.



Local authorities can borrow from the PWLB provided they can confirm they are not planning to purchase 'investment assets primarily for yield' in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 95 Officer. 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.

The Authority is not planning to purchase any investment assets primarily for yield within the next three years and so is able fully access the PWLB.

Borrowing Position for 2021/22

To date in 2021/22, the Council has only undertaken temporary borrowing. The Council has also used internal short-term cash reserves to temporarily fund its capital borrowing requirement to 30 September 2021.

In terms of outlook for the remainder of the year, based on current capital plans and replacement borrowing requirements, it is estimated that the Council will borrow £60.513m this financial year, with a forecasted planned under borrowed position of £68m at the end of March 2022.

Rescheduling

No rescheduling has taken place between 1 April 2021 and 30 September 2021 as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

The Council's treasury position (excluding borrowing by PPP/NPD and finance leases) at the 31 March 2021 and 30 September 2021 was as follows:

TABLE 6

	31 March 2021		30 September	
	Principal £m	Rate/ Return %	Principal £m	Rate/ Return %
Fixed rate funding:				
-PWLB	183.943	4.95%	182.499	4.68%
-Other Local Authorities	15.000	0.76%	12.388	0.35%
-Market	1.614	0.00%	1.564	8.18%
Variable rate funding:				
-Market	50.950	5.33%	50.950	5.10%
Total debt (Indicator 7)	251.507	4.61%	247.401	4.57%
CFR	319.548		364.964	
Over / (under) borrowing	(68.041)		(117.563)	
Investments:				
- internally managed	42.258	0.80%	30.282	0.15%
Total investments (Indicator 8)	42.258		30.282	

All investments at 30 September 2021 mature within one year in line with the Treasury Management and Investment Strategy (**Indicator 9**).

The maturity structure of the debt portfolio (**Indicator 10**) at 30 September 2021 is shown below and shows the period when the Council is required to repay and/or refinance debt. It is important to ensure a reasonable spread of debt to mitigate against high exposure levels in respect of refinancing. The current profile ensures this:

TABLE 7

Maturity Profile of Borrowing (Indicator 10)	31-Mar-21 Actual £m	30 September 2021 Actual £m
Under 12 months	43.931	41.310
12 months and within 24 months	2.961	2.950
24 months and within 5 years	8.931	8.931
5 years and within 10 years	25.620	25.589
10 years and within 20 years	31.152	35.109
20 years and within 30 years	7.025	1.625
30 years and within 40 years	106.887	106.887
40 years and within 50 years	15.000	15.000
50 years and above	10.000	10.000
Total Borrowing	251.507	247.401

The next indicator is used to manage risk and reduce the impact of adverse movement in interest rates. This sets a limit on the Council's exposure to fixed and variable interest rates (**Indicator 11**). The Council approved a limit on variable borrowing of £60.000m in the Treasury Management Strategy 2021/22.

TABLE 8

	2021/22 Original Limits £m	30 September 2021 Actual £m
Limits on fixed interest rates based on net debt (Indicator 11)	504.863	429.045
Limits on variable interest rates based on net debt (Indicator 11)	60.000	50.950

(e) Affordability Prudential Indicators (Prudential Indicator 12 - 14)

These Prudential Indicators assess the affordability of capital investment plans and provide an indication of the impact of capital investment plans on the Council's overall finances. The cost impact of borrowing decisions are reflected in the Council's budget as loan charges.

The actual and estimates of the ratio of financing costs to net revenue stream indicator identifies the trend in the cost of capital (borrowing and other long-term liabilities net of investment income) against the net revenue stream.

TABLE 9

Estimate of ratio of financing costs to net revenue stream (Indicator 14)	2021/22 Original Estimate £m	2021/22 Revised Estimate £m
General Services	3.4%	3.0%
HRA	21.2%	18.6%

Capital expenditure impacts on the revenue budget through financing charges so it is essential the Council ensures the financing costs remain affordable and do not constitute an excessive proportion of the revenue resources available.

From a General Fund perspective, the latest Scottish Local Authority average was 6.94%, thereby demonstrating a prudent borrowing policy.

For the HRA, the latest Scottish average was 22.68%. The level of loan charges is deemed prudent and affordable within the framework of the 30 year Housing business plan.

4. Investment Rates in 2021/22

The Bank Rate has remained at 0.10% during the period April to September. The Council's treasury advisers, Arlingclose, project that the bank rate will rise to 0.25% in Quarter 2 2022 with a further 0.25% increase in the first quarter Of 2023. The global economy continues to recover from the pandemic but has entered a more challenging phase. The resurgence of demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. This is particularly apparent in the UK due to the impact of the country's exit from the European Union.

5. Investment Position for 2021/22

Investment Policy

The Council's investment policy is governed by Scottish Government investment regulations, which have been implemented in the annual treasury management and investment strategy, approved by Council on 4 March 2021. This policy sets out the approach for choosing investment counterparties, based on credit ratings provided by the three main credit rating agencies and supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

All investments during 2021/22 have complied with our investment policy.

Resources

The Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's cash resources at 30 September 2021 were as follows:

TABLE 10

Cash Balances	2021/22 Actual £m
1 April 2021	42.258
30 September 2021	30.282
Change within 6 months	(11.976)

The Investment balance at 1 April included a £5m investment with the London Borough of Croydon made during 2020 and maturing on 20 August 2021. As noted in the Treasury Management Strategy 2021-22, the Council was aware that the London Borough of Croydon was issued with a Section 114 notice on 11 November 2020 which prevented the Council from entering into new expenditure arrangements. However, contractual expenditure, including loan repayments remained necessary and allowable. It has been confirmed that the full amount of this loan, including interest payments, was recovered upon maturity on 20 August 2021.

Investments held by the Council

The Council has maintained an average balance of £38.101m of invested funds and utilised cash balances during the year in support of the under-borrowed position.

The Council's treasury management advisors, Arlingclose Limited, have five Scottish unitary authorities in their client group and provide regular investment benchmarking information to the Council. In terms of investment performance, North Ayrshire Council's average weighted rate of return on investments during the period 1 April 2021 to 30 September 2021 was 0.15% (0.25% for the period to 30 September 2020). The actual rate of return on investments as at 30 September for North Ayrshire Council was 0.08% compared to the group average rate of 0.07%.

The target investment rate for 2021/22 was 0.10% and the slightly higher weighted average return in the first half of the year reflects returns on investments made at higher rates before the Bank of England base rate was reduced to 0.10% in March 2020.

It should be noted that interest rates are extremely low for investments with counterparties with high creditworthiness. Rates for deposits with the Debt Management Account Deposit Facility (DMADF) and other local authorities are both largely around zero. Net returns on Money Market Funds are also close to zero.

We will continue to invest with approved counterparties in accordance with the approved strategy.
