Summary Investment and Borrowing Position at 31 March 2022

Investment Sub Committee Friday, 17 June 2022

Report of: Chief Finance Officer (Section 151)

Purpose: For information

Publication status: Unrestricted

Wards affected: All

Executive summary:

This report updates the Investment Sub Committee on the Council's investment and borrowing position at 31st March 2022 and sets out the scenario planning in relation to the future of the statutory override, as discussed at the Investment Sub Committee meeting on the 21st January 2022.

This report supports the Council's priority of: Building a better Council/ Supporting economic recovery in Tandridge.

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Recommendation to Committee:

That the Sub Committee notes:

A) the Council's Investment and Borrowing position at 31st March 2022 as set out in Appendix A and B; and

B) the scenario planning work underway to prepare for decisions expected from Government on the future of the statutory override.

Reason for recommendation:

This report will be reviewed by the Sub Committee, which provides an update on the Council's investment and borrowing position.

1. Introduction and background

1.1 The Capital, Investment and Treasury Management Strategy 2021/22 was reported to the Strategy and Resources Committee on 2nd February 2021. This covered the borrowing and investment plans for the Council. As detailed in this strategy, part of the Treasury Management function is to ensure that the cashflow is adequately planned and surpluses are invested while allowing for cash to be available when needed. Additionally, the treasury management function ensures that the Council can meet its capital spending plans. This requires the management of longer-term cash which will involve the use of long or short-term loans, or cash flow surpluses.

1.2 Tandridge District Council's contract for expert Treasury Management Advice with Link Group came to an end on the 30th April 2022. The new contract, with Arlingclose Ltd began on 1st May 2022 and their comments on the statutory override scenario planning is reflected in this report.

2. Summary Investment and Borrowing Position

2.1 A summary of the Council's investment and borrowing at 31st March 2022 is set out in Appendix A.

- Total long term financial investments (over 12 months) amount to £12.7 million.

- Short term investments (less than 12 months) amount to £15.3 million.

- The Council also has £21.2 million in non-financial investments which is made up of capital loans to specific service providers and limited companies.

- The total amount of Public Works Loan Board (PWLB) loans at 31st March 2022 is £102.3 million. This is made up of £43.4 million General Fund loans and £58.9 million Housing Revenue Account loans. The HRA balance has reduced by £2.4m since the Q3 update due to the repayment of a PWLB loan that the Council has not yet needed to refinance.

2.2 Appendix A shows the investments as short-term and long-term. The categorisation of this differs from how they are represented in the Statement of Accounts. A review of the differences in categorisation will be done as part of the production of the 2021/22 Statement of Accounts.

3. Statutory Override Scenario Planning

3.1 At its meeting on Friday 21st January 2022, Investment Sub Committee considered a report from officers and then-Treasury Management advisors, Link Group on the future of four long-term investments:

- CCLA Property Fund
- Schroeders Credit/Bond Fund
- UBS Multi Asset Fund
- CCLA Diversification Fund

3.2 The current regulatory environment means that the Council does not recognise annual gains and losses in the capital value of investments in the revenue budget, unless the investment is withdrawn. This is known as a statutory override, because it overrides usual accounting practice. The current override lasts until 31st March 2023.

3.3 Government has not yet made a decision on whether to extend, amend or remove the override from that point. Because of this override, the capital performance of funds has been less of an immediate concern in the past. We understand that DLUHC intends to consult shortly on this and hopes to issue a response in time for budget preparation. Ideally that would mean the Autumn, but it could slip into the Local Government Finance Settlement announcement (likely to be December).

3.4 The January report set out two key criteria for appraising the suitability of funds:

- The annual return is maintained without taking risks to the revenue budget from volatile capital values [funds cannot be assessed for this until the future of the override is known]; and
- In the medium-term, the investment portfolio is based around total overall return, from funds that offer a sustainable approach to maintaining investment values.

3.5 The recommendations included in the report were therefore contingent on a decision being made by Government on the future of the override. Officers confirmed that responses to the scenarios would be developed whilst the future of the override was clarified by Government.

3.6 This section sets out the latest position, developed in consultation with Arlingclose; the Council's Treasury Management Advisors.

3.7 Back in 2018, Government stated that it did not believe it was appropriate for local authorities to set revenue budgets and council tax based on their forecasts for the financial markets at the end of the following financial year. It also committed to review the situation before the override expires. Arlingclose understands that a consultation will be forthcoming during 2022 in advance of budget setting for 2023/24.

3.8 The impact of Covid-19 on the value of investments has demonstrated the application of the override – Tandridge's funds showed a loss of £947,000 against the purchase cost in March 2020, mostly recovering to a £200,000 loss in March 2021 and more than fully recovering to a £349,000 gain in March 2022 (set out in Appendix B). It would have been illogical for the Council to require savings from services or increase council tax as a result of these temporary losses during the pandemic. Many other local authorities are in a similar position and there is therefore a good argument for the override to continue to cover the next economic downturn.

3.9 Nevertheless, the Council's options in the two scenarios are as follows:

Scenario	**Override continued**	**Override removed**
Outline	General Fund continues to be insulated from gains and losses in fair value. The gain / loss on the asset would have a General Fund impact if the investment was withdrawn at greater than or lower than the initial investment.	General Fund is no longer insulated from gains and losses in fair value. The change in value at 31st March each year would be part of the Council's General Fund outturn against budget.
Potential responses	• Maintain the current portfolio of investments if they still demonstrate strong in-year yield; or • Disinvest in current funds and then re-invest in funds that offer the strongest in-year yield but set aside surpluses into a reserve to manage volatility in funds that would be felt if the Council needed to disinvest from the asset; or • Reduce the investment portfolio in overall size.	• Maintain investment in the funds, and manage the year-to-year volatility through reserves; or • Disinvest in current funds and reinvest in funds that offer the best combination of asset value security and in-year yield; i.e. total return; or • Sell the investments and move into lower yielding deposits, causing a budget pressure; or • Sell the investments and move into higher risk alternatives where the override is not required; or • Reduce the investment portfolio in overall size

<table>
<tr><th>Scenario</th><th>Override continued</th><th>Override removed</th></tr>
<tr><td>Preferred response</td><td>The portfolio of funds should be kept under review to maximise in-year yield whilst providing adequate long-term security of Council investments;
An element of in-year yield could be credited to a reserve to guard against falls in value upon disinvestment – a target level of reserve for this purpose would be developed in consultation with Arlingclose
The appropriate overall value of investments will continued to be gauged against cash requirements and the differential in interest rates on new borrowing and investment return</td><td>When a decision is made by Government, funds currently below their market value should be withdrawn when their capital value recovers to at least the amount invested, or if it becomes clear that their value will not be recovered further;
Losses in these funds would currently be covered by the gain in CCLA Property;
Cash should then be reinvested in funds that offer the best total return (i.e. the combination of in-year yield and capital value)
An element of in-year surpluses should be held in reserves to cover future volatility of funds – a target level of reserve for this purpose would be developed in consultation with Arlingclose
The appropriate overall value of investments will continued to be gauged against cash requirements and the differential in interest rates on new borrowing and investment return</td></tr>
</table>

<table>
<tr><th>Scenario</th><th>Override continued</th><th>Override removed</th></tr>
<tr><td>Risks</td><td>The continuation of the override may be time-limited, or the prevailing financial position of the Council may require disinvestment from funds, potentially at a loss. The statutory override does not protect the General Fund in the event of disinvestment.</td><td>In-year volatility in the market value of investments may impact the delivery of the General Fund Budget.</td></tr>
<tr><td>Mitigations</td><td colspan="2">Although the risks differ in timing, ultimately the General Fund would bear the risk of falls in the value of investments. The potential mitigations are the same in both scenarios.

An element of surpluses should be credited to a specific reserve in order to manage the risk that losses in investment values will ultimately be a General Fund impact (either each year if the override is discontinued or on disinvestment if it is not).

The reserve may require a level of up-front funding. It is proposed that this is achieved through either a) from in-year surpluses in investment income (if achievable) or;
b) a contribution from the General Fund at a level to be determined through the 2023/24 budget process and in consultation with Arlingclose.

Any losses could also be mitigated by recognising the gain from a stronger-performing investment.</td></tr>
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3.10 In January, the Committee queried whether there was likely to be any difficulty in disinvesting from funds if the statutory override is not continued, factoring in the extent to which funds are reliant on local authorities as their major source of investment. Arlingclose advise that sale of all except one fund should not present a problem. They are invested in liquid securities listed on the stock exchange and will be able to handle redemption requests from multiple local authorities easily without affecting the valuation. Up to one week’s notice is required to sell these funds.

3.11 The one exception is the Local Authorities Property Fund operated by CCLA. Only local authorities may invest in the fund and it owns commercial property, which will take time to sell. There is a three-month notice period for redemptions, but the fund can suspend redemptions if this is in investors best interests (and it has done so three times since 2008). If multiple redemption requests led to the fund being a forced seller, or even to liquidating, it may not achieve the valuer's estimated price for the properties, which would cause the fund price to fall. Depending on market conditions, and the speed of sale, this could be a price fall of 10-20%, and it might take a year to receive all the proceeds.

3.12 As context, 56% of the District Councils who share Arlingclose as their advisors invest in CCLA Property. The average DC investment size in CCLA is £4m and the largest is £10m; only eight districts have £2m or less invested. There does not appear to be any appetite to disinvest amongst other authorities since CCLA Property is currently showing a gain which would offset losses elsewhere.

3.13 Redeeming the CCLA investment now would only be the correct choice if:

- the override is not extended
- the fund suspends redemptions
- the fund price falls during the suspension period, with the fall large enough to cause a problem managing the volatility through reserves

3.14 The current advice from Arlingclose is that these are an unlikely combination of events and therefore to maintain the investment. CCLA and its part-owner the LGA are likely to lobby Government in order to stop this foreseeable and avoidable situation from occurring.

Key implications

4. Comments of the Chief Finance Officer

4.1 The outturn position is for investment income of £26k more than budgeted. This is mainly due to a one-off receipt from Funding Circle in June for sale of non-performing loans previously charged as bad debt against net earnings. General Fund loan interest payable is in accordance with budget. HRA loan interest payable is £31k under budget due to the Council's cash position allowing us to avoid the immediate re-financing of maturing loans.

4.2 All investments carry a degree of risks as outlined in section 3. The Council manages these risks by holding diversified investments and through seeking expert advice from its Treasury Management Advisors and through the Finance Joint Working Agreement with the Orbis Centre of Expertise. The Council will continue to monitor the value of its investments in context of the regulatory environment.

5. Comments of the Head of Legal Services

5.1 The Council's Treasury Management Strategy Statement follows the latest codes of practice and the MHCLG and CIPFA guidance.

5.2 The Council has borrowed and invested 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 financial risk are therefore central to the Council's prudent financial management.

6. Equality

6.1 The proposals within this report do not have the potential to disadvantage or discriminate against different groups with protected characteristics in the community.

7. Climate change

7.1 There are no significant environmental/sustainability implications associated with the report. It is however recognised that some Council investments may be in companies that are considered to have a detrimental impact on the climate, for example oil companies. The Climate Change Action Plan that is currently being draw up will have an action included to consider our current investment approach and determine if changes can or should be made.

Appendices

Appendix A – Summary of Investments and Borrowing

Appendix B – Market Value of Long Term Investments

Background papers

Investment Sub-Committee Papers 21st January 2022

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