Brighton & Hove City Council

Policy & Resources Committee — Agenda Item 9

Subject: **Treasury Management Strategy Statement 2021/22 – End of Year Review**

Date of meeting: **7 July 2022**

Report of: **Chief Finance Officer**

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Ward(s) affected: **All**

For general release

1. Purpose of the report and policy context

1.1 The 2021/22 Treasury Management Strategy Statement (TMSS), which includes the Annual Investment Strategy (AIS), was approved by Policy & Resources Committee on 11 February 2021 and by Full Council on 25 February 2021 as part of the 2021/22 Budget Report. The Treasury Management Strategy sets out the role of Treasury Management, the strategy for treasury Management activity in 2021/22, the key parameters and indicators for investing council cash balances and undertaking borrowing for the year.

1.2 A Mid-Year review was noted by Policy & Resources Committee on 2 December 2021 which reviewed the performance against the strategy and key indicators in the first half of the year.

1.3 This report reviews the performance against the strategy and the key prudential and treasury indicators for the last 6 months of the year.

1.4 Much of the detail within treasury management is described using technical language. To aid readers, a glossary of the main terms used in this report is included at Appendix 1.

2. Recommendations

2.1 That Policy & Resources Committee notes the key actions taken during the second half of 2021/22 to meet the Treasury Management Strategy Statement and practices (including the investment strategy) as set out in this report.

2.2 That Policy & Resources Committee notes the reported compliance with the Annual Investment Strategy for the 6 month period up to the end of March 2022.

2.3 That Policy & Resources Committee notes that the approved maximum indicator for investment risk of 0.05% has been adhered to and the authorised borrowing limit and operational boundary have not been exceeded.

3. Context and background information

3.1 The council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available (i.e. liquid) when it is needed. Effective cash flow planning enables surplus monies to be invested in counterparties or instruments commensurate with the council's risk appetite, providing adequate cash availability (liquidity) is maintained.

3.2 The second main function of the treasury management service is the funding of the council's capital plans. These capital plans provide a guide to the borrowing need of the council, essentially the longer-term cash flow planning, to ensure that the council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn on may be restructured to meet the council's risk or cost objectives.

3.3 The contribution the treasury management function makes to the authority is therefore critical, as the balance of debt and investment operations ensure liquidity and the ability to meet spending commitments as they fall due, either on day-to-day revenue spending or for larger capital projects. The treasury operations also therefore influence the interest costs of debt and the investment income arising from cash deposits which has implications for the council's budget.

3.4 Since cash balances generally result from holding earmarked and committed reserves and balances together with funding or financing held pending capital or revenue expenditure, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund.

3.5 Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities (arising usually from capital expenditure) and are separate from the day-to-day treasury management activities.

3.6 The Chartered Institute of Public Finance & Accountancy (CIPFA) defines treasury management as:

"The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions, the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks."

A key element of the Treasury Management Policy & Strategy concerns prudential indicators. These require the council to set limits on external debt and borrowing activity. These are set in the context of capital financing requirements but, more importantly, in the context of overall affordability. Anything borrowed must ultimately be repaid. All councils are required to set aside Minimum Revenue Provision (MRP) for debt but must also consider whether repayments will be affordable both now and in the longer term when resources may be predicted to reduce. Financing costs (principal and interest repayments) must also be budgeted for and any increase in repayments may therefore reduce the resources available for providing other essential services.

Economic Background

3.7 The council's treasury advisors, Link Asset Services, have provided their assessment of the UK and global economic landscapes over 2021/22 at **Appendix 2**.

3.8 The expectation for interest rates within the treasury management strategy for 2021/22 was that Bank Rate would remain at 0.10% over the term of the forecast period (until 2023/24). This forecast was on the basis that the damage to the economy as a result of the Covid-19 pandemic would take a number of years to recover, and the forecast was made at a time when the UK was in a third lockdown with significant uncertainty over the timing of economic recovery and the impact of the vaccination programme on mutations of the virus.

3.9 The economy began recovering in June and July of 2021 as a result of the easing of restrictions. This, combined with the emergence of global inflationary pressures (originally thought to be temporary) has resulted in the Bank of England increasing interest rates in December 2021, February 2022 and March 2022, with the year ending with the official interest rate at 0.75%. Further rate rises are anticipated in response to inflationary pressures.

Treasury Management Strategy

3.10 A summary of the action taken in the 6 months to March 2022 is provided in **Appendix 3** to this report. The main points are:

- The council entered into £30.0m of new borrowing in November and December 2021 to fund the HRA Capital Programme;
- The council entered into £25.0m of new borrowing in November and December 2021 to fund the General Fund Capital Programme;
- The highest risk indicator during the period was 0.016% which is below the maximum benchmark of 0.050%;
- The return on investments has exceeded the target benchmark rates in 4 of the 6 months. The benchmark was not achieved in February & March as a result of the portfolio's longer-term investments not being able to keep pace with the change in interest rates;
- The two borrowing limits approved by full Council have not been exceeded;
- The Annual Investment strategy parameters have been met throughout the 6 month period.

3.11 Investment activity for the half-year has focused on a short-term horizon as summarised in the table below:

	Amount invested 1 Oct 2021 to 31 Mar 2022			
	Fixed	Pooled	Money	Total

	deposits	Funds	market funds		
Up to 1 week	-	-	£356.9m	£356.9m	81%
Between 1 week & 1 month	-	-	-	-	0%
Between 1 month & 3 months	£10.0m	-	-	£10.0m	2%
Over 3 months	£72.0m	-	-	£72.0m	17%
	£82.0m	**-**	**£356.9m**	**£438.9m**	**100%**

Summary of Treasury Activity October 2021 to March 2022

3.12 The following table summarises the treasury activity in the half year to March 2022 compared to the corresponding period in the previous year:

October to March	**2019/20**	**2020/21**	**2021/22**
Long-term borrowing raised (General Fund)	(£0.0m)	(£0.0m)	(£25.0m)
Long-term borrowing raised (HRA)	(£7.5m)	(£10.0m)	(£30.0m)
Long-term borrowing repaid (General Fund)	£0.8m	£0.8m	£1.0m
Long-term borrowing repaid (HRA)	£0.4m	£0.4m	£0.6m
Short-term borrowing (raised)/repaid	(£2.0m)	(£0.0m)	£4.5m
Investments made	£369.4m	£376.4m	£438.9m
Investments maturing	(£367.1m)	(£372.1m)	(£424.1m)

3.13 The Financing Costs budget variance in 2021/22 was a £2.521m underspend. The key variance (£1.749m) is a large reduction in interest costs and minimum revenue provision (MRP) as a result of delays to capital programme expenditure. The other key variance (£0.772m) is due to an over achievement of investment income as a result of a combination of higher balances and higher than budgeted investment rates. The higher investment balances were due to a combination of factors including:

- continuing to carry balances in relation to significant cashflow support provided by the government to support the authority's pandemic response;
- delays to elements of the capital programme for a variety of reasons including the impact of the pandemic (i.e. cash balances have not been drawn down as quickly as expected);
- undertaking borrowing to meet the council's Capital Financing Requirement but in advance of it being drawn down to support the capital programme.

3.14 The table below summarises how the day-to-day cash flows in the second half-year have been funded compared to the same period in the previous year. The large cashflow deficit in the second half of 2021/22 is a result of the repayment of £34m to central Government of additional Section 31 retail relief grant provided in 2020/21 to cover the cashflow implications of reduced business rates income from new covid reliefs being introduced.

October to March	2019/20	2020/21	2021/22
Net cash flow (shortage)/surplus	**(£6.9m)**	**(£4.0m)**	**(£34.0m)**
Represented by:			
Increase/(reduction) in long-term borrowing	(£6.3m)	£8.8m	£53.4m
Increase/(reduction) in short-term borrowing*	£2.0m	£0.0m	(£4.5m)
Reduction/(increase) in investments	£2.3m	(£4.3m)	(£14.8m)
Reduction/(increase) in bank balance	(£0.9m)	(£0.5m)	(£0.1m)

**South Downs National Park external investments plus temporary borrowing*

Investment Strategy

3.15 A summary of investments made by the in-house team and outstanding as at 31 March 2022 is set out in the table below shows that investments continue to be held in good quality, short-term instruments.

'AAA' rated money market funds	£49.01m	19%
'AA' rated institutions*	£118.00m	46%
'A' rated institutions	£79.90m	31%
'BBB' rated institutions	£0.00m	0%
Unrated Funds	£9.51m	4%
Total	**£256.42m**	**100%**
Period – less than one week	£58.52m	23%
Period – between one week and one month	£19.00m	7%
Period – between one month and three months	£27.50m	11%
Period – between three months and 1 year	£131.40m	51%
Period – more than 1 year**	£20.00m	8%
Total	**£256.42m**	**100%**

* *For the purposes of this analysis, other Local Authorities are assumed to have the same credit rating as the UK government (AA).*

** *All investments that are over one year either have a legal offset against debt with the same counterparty, or are with other Local Authorities.*

Risk

3.16 As part of the investment strategy for 2021/22 the council agreed a maximum risk benchmark of 0.05% i.e. there is a 99.95% probability that the council will get its investments back. The benchmark is a simple target that measures risk based on the financial standing of counterparties and length of each investment based on historic default rates. The actual risk indicator has varied between 0.009% and 0.015% between October 2021 and March 2022, reflecting the high proportion of investments in high security and/or very liquid investments. It should be remembered however that the benchmark is an 'average risk of default' measure and does not constitute an expectation of loss for any particular investment.

3.17 The treasury management service is subject to a detailed audit on a regular basis. This includes the testing of the control environment and the management of risk. A 'reasonable' level of assurance was provided during the most recent audit (October 2019). One medium and two low priority recommendations were made which have all been implemented.

Investment Rates

3.18 Whilst the official Bank Rate remained unchanged at 0.10% for much of the year, the Bank of England's MPC increased the Bank Rate to 0.25% in December 2021, to 0.50% in February 2022 and again to 0.75% in March 2022. This change was reflected by financial institutions which resulted in more attractive investment rates became available to the council in the last three months of the financial year.

3.19 Additionally, the yield earned by Money Market Funds (MMFs) significantly improved as a result of this change. In the first six months of the year, many of the MMFs that the council used were not producing a yield, and fund managers were reducing their fees in order that negative yields were not passed onto investors.

Investment Performance

3.20 The council's investment portfolio achieved an average rate of 0.32% over the last six months of the year against a benchmark rate of 0.22% for the same period.

3.21 Historically, the Authority has used the 7-day London Inter-Bank Bid Rate (LIBID) +0.10% to benchmark its investment yield performance. The Financial Conduct Agency (FCA) announced that LIBOR & LIBID will cease to exist after 31 December 2021, and instead markets would transition to the Sterling Overnight Index Average (SONIA). Therefore, the benchmark that is used for performance of investments has transitioned to SONIA, which is a backward-looking overnight rate that is calculated daily by the Bank of England based on large volumes of actual transactions that have been undertaken. On transition, SONIA was approximately 0.10% higher than the 7 Day LIBID, which makes the benchmark for investments approximately similar to the council's existing benchmark. However, LIBID was a forward-looking benchmark whilst SONIA is a historical benchmark, so there will be some differences. The use of SONIA as a benchmark will be monitored during 2022/23 to ensure it remains the appropriate rate to use.

3.22 The following table summarises the performance achieved on investments compared to the budgeted position and approved benchmark for the whole year.

	In-house Investments	
	Average Balance	Average rate
Budget 2021/22	£65.6m	0.15%
Actual 2021/22	£267.7m	0.32%
Benchmark Rate*		0.12%

** benchmark rate was set at 7 Day LIBID +0.10% until 31 December 2021 and moved to SONIA from 1 January 2022. See paragraph 3.21 for more detail on this change.*

3.23 A number of new investments totaling £52.0m, at an average investment rate of 0.93%, were entered into during January to March to take advantage of the improved investment rates. These deals were for a range of periods between 3 and 12 months so that maturing deals can be re-invested at higher rates expected in the rising interest rate environment, effectively “laddering” the investments to gradually increase the rates earned in the portfolio. Additionally, funds from the council’s two notice accounts were called for return in order to take advantage of improving interest rates.

3.24 The total yield in the two Royal London short dated bond funds has been negative over the period. The funds have been paying dividend income of 2.43% across the year (calculated as the income received as a proportion of the capital value as at 1 April 2021), but the capital value of the council’s holding has fallen, in part due to the timing of our investment against a rising interest rate environment. It is expected that the fall in capital value is temporary and does not represent an actual loss to the council, as there is no intention to withdraw the holding from these funds until the capital value has recovered to at least the original investment value.

Compliance with the Annual Investment Strategy

3.25 All parameters in the Annual Investment Strategy have been complied with in full.

Borrowing Strategy

3.26 During the year, the General Fund (GF) has maintained an internal borrowing position, which it has been carrying since 2008. An internal borrowing position means that the borrowing need in the capital programme has not been fully funded with loan debt, and instead cash balances have been used as an interim measure. This strategy was prudent as investment returns have been very low, and this strategy also reduces cash balances and therefore reduces counterparty risk on placing investments.

3.27 The policy of avoiding new borrowing by running down cash balances has served the authority well over the last few years. However, with interest rates rising, this strategy was kept under review during the year to avoid incurring higher borrowing costs in the future when the authority may not be able to avoid new borrowing to finance capital expenditure. Against this backdrop, and the risks within the economic forecast, a decision was made to undertake £25.0m of new borrowing in the second half of the year to reduce the GF internal borrowing position and fund new capital expenditure. This borrowing was undertaken at an average rate of 1.51%. Similarly, further GF borrowing has been undertaken in the first half of 2022/23 which will be reported in the 2022/23 Mid-Year review.

3.28 The Housing Revenue Account (HRA) carries a fully-funded borrowing position (i.e. the HRA does not borrow from its own reserves, but instead undertakes borrowing for its entire borrowing requirement). In the last three years, the HRA has undertaken a mixture of external borrowing from the PWLB and a total of £8.0m borrowed from the General Fund.

3.29 A total of £30m of new borrowing was undertaken for the HRA in the second half of the year at an average rate of 1.50%. A total of £55.0m has therefore been borrowed for the HRA during 2021/22 of which £8m was used to replace the borrowing from the General Fund, and £21.3m was used to fund the 2021/22 capital programme. The remaining £25.7m has been “borrowed in advance of need”. That is, borrowing was undertaken early to take advantage of attractive interest rates. This borrowing is expected to be applied to the HRA capital programme in 2022/23.

Treasury Advisors

3.30 Officers recognise that responsibility for decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. It also recognises that there is value in employing external providers of treasury management services in order to access specialist skills and resources.

Member Training

3.31 It is a requirement of CIPFA’s Treasury Management code to ensure that the members responsible for decision making and scrutiny of the authority’s TMSS are adequately trained to undertake their roles in this area.

3.32 Treasury Management training was last provided in October 2021.

4. Analysis and consideration of alternative options

4.1 Alternative treasury management policies and practices, and investment strategies, are considered annually by Policy & Resources Committee and full Council. This report sets out action taken in the 6 months to March 2021. Treasury management actions have been carried out within the parameters of the approved AIS, TMSS, and Prudential Indicators and therefore no alternative options have been exercised.

5. Community engagement and consultation

5.1 The council’s external treasury advisors have been consulted over the content of this report. No other consultation has been undertaken.

6. Conclusion

6.1 Treasury management is governed by a code that is recognised as “best and proper practice” under the Local Government Act 2003. The Code requires a minimum of two reports per year, one of which is required to review the previous year’s performance. This report fulfils this requirement.

7. Financial implications

7.1 The financial implications of treasury management activity are reflected in the financing costs budget set out in paragraph 3.13.
Finance officer consulted: James Hengeveld   Date consulted: 24/06/22

8. Legal implications

8.1 The TMSS is approved and associated actions carried out under the powers given to the Council by Part 1 of the Local Government Act 2003 to invest for the purposes of the prudent management of its financial affairs (section 12).

8.2 Local authorities are required to have regard to statutory guidance in the form of the Prudential Code for Capital Finance in Local Authorities (2017 ed), issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) when carrying out functions under Part 1 of the Act.

8.3 The council's approach is consistent with the requirements of the Act and the aforementioned Code.

Lawyer consulted: Victoria Simpson Date consulted: 09/06/22

9. Equalities, Sustainability and other significant implications

9.1 There are no direct implications arising from this report.

Supporting Documentation

Appendices

1. Glossary of terms
2. The Economy & Interest Rates – Link Asset Services
3. A summary of the action taken in the period October 2020 to March 2021

Background documents

1. Part I of the Local Government Act 2003 and associated regulations
2. The Treasury Management Policy Statement, including the Annual Investment Strategy 2021/22 approved by Policy &Resources Committee on 11 February 2021.
3. Treasury Management Strategy Statement 2021/22 – Mid Year Review approved by Policy & Resources Committee on 2 December 2021.
4. The Prudential Code for Capital Finance in Local Authorities published by CIPFA 2017