Brighton & Hove City Council

Policy & Resources Committee

Agenda Item 77

Subject: **Treasury Management Strategy Statement 2022/23 - Mid Year Review**

Date of meeting: **1 December 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 2022/23 Treasury Management Strategy Statement (TMSS) was approved by Policy & Resources Committee on 10 February 2022 and full Council on 24 February 2022.

1.2 The TMSS sets out the role of Treasury Management and includes the Annual Investment Strategy (AIS) which sets out the key parameters for investing council cash funds.

1.3 It is recommended good and proper practice that Members receive half yearly reports and review and endorse treasury management actions during the year. The purpose of this report is to advise of the action taken in the first half of 2022/23.

2. Recommendations

2.1 That Policy & Resources Committee notes the key actions taken during the first half of 2022/23 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 September 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 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."

Economic Background

3.4 The council's treasury advisors, Link Asset Services, have provided their assessment of the UK and global economic landscapes over 2022/23 at **Appendix 2**.

Treasury Management Strategy

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

- The council has entered into £50.0m of new borrowing during the period to support the HRA and General Fund capital programme;
- The highest risk indicator during the period was 0.018% which is well below the maximum benchmark of 0.050%;
- The return on investments has exceeded the target benchmark rate;
- The two borrowing limits approved by full Council have not been exceeded.

3.6 Treasury management activity for the half-year has focused on a short-term horizon as summarised in the table below:

	Amount invested 1 Apr 2022 to 30 Sep 2022			
	Fixed deposits	Money market funds & Notice Accounts	Total	
Up to 1 week	-	£382.5m	£382.5m	77.5%
Between 1 week & 1 month	-	-	-	0%
Between 1 month & 3 months	£5.0m	£10.0m	£15.0m	3.0%
Over 3 months	£96.0m	-	£96.0m	19.5%
	£101.0m	**£392.5m**	**£493.5m**	**100.0%**

Summary of Treasury Activity April 2022 to September 2022

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

April to September	**2021/22**	**2022/23**
Long-term borrowing raised (General Fund)	(£0.0m)	(£25.0m)
Long-term borrowing raised (HRA)	(£25.0m)	(£25.0m)
Long-term borrowing repaid (i360)	£0.5m	£0.5m
Long-term borrowing repaid (General Fund)	£0.0m	£0.5m
Long-term borrowing repaid (HRA)	£0.0m	£0.6m
Short-term borrowing (raised)/repaid	£2.0m	£1.5m
Investments made	£493.5m	£418.1m
Investments maturing	(£396.4m)	(£420.6m)

3.8 As at TBM month 6 (September), an underspend of £1.538m had been reported within the Financing Costs Budget for the year. This underspend is largely as a result of increased investment income earned as a result of the increase in interest rates.

3.9 The following table summarises how the day-to-day cash flows in the half-year have been funded compared to the same period in the previous year:

April to September	2021/22	2022/23
Net cash flow (shortage)/surplus	**£70.4m**	**(£49.7m)**
Represented by:		
Increase/(reduction) in long-term borrowing	£24.5m	£48.5m
Increase/(reduction) in short-term borrowing*	£2.0m	(£1.5m)
Reduction/(increase) in investments	(£97.1m)	£2.5m
Reduction/(increase) in bank balance	£0.2m	£0.2m

*including South Downs National Park external investments

3.10 The large reduction in the cashflow compared to the previous year is largely as a result of repayment of covid advances back to central government.

Investment Strategy

3.11 A summary of investments made by the in-house team and outstanding as at 30 September 2022 in the table below shows that investments continue to be held in highly rated, short term instruments:

'AAA' rated money market funds	£56.14m	22%
'AA' rated institutions*	£89.00m	35%
'A' rated institutions	£99.41m	39%
'BBB' rated institutions	£0.00m	0%
Unrated Funds	£10.00m	4%
Total	**£254.55m**	**100%**
Period – less than one week	£76.14m	30%
Period – between one week and one month	£10.00m	4%
Period – between one month and three months	£26.41m	10%
Period – between three months and 1 year	£127.00m	50%
Period – more than 1 year**	£15.00m	6%
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

3.12 As part of the investment strategy for 2022/23 the Council agreed a maximum risk benchmark of 0.050% i.e. there is a 99.95% probability that the council will receive its investments back. The benchmark is a simple target that measures the 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 0.018% and 0.011% between April 2022 and September 2022. It should be remembered however that the benchmark is an 'average risk of default' measure and does not constitute an expectation of loss against a particular investment.

3.13 In July 2022, Internal Audit undertook an audit of the treasury management function. The audit concluded that "substantial assurance" is provided on the effectiveness of the control framework operating and mitigating risks for treasury management. There were no recommendations or actions were required in response to the audit.

Compliance with the Annual Investment Strategy

3.14 For the reporting period, the information in this report provides assurance that the Annual Investment Strategy has been complied with in full.

Investment Performance

3.15 The council's investment portfolio achieved an average rate of 1.11% over the first six months of the year. This is against a benchmark rate of 1.22% for the same period. The benchmark that is used for performance of investments since 31 December 2021 is 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.

3.16 The investment performance has underperformed the benchmark rate by 0.11% in the first six months of the year. This is to be expected in a rising interest rate environment as it takes time for investments to mature and to be re-invested at higher rates, whilst the benchmark instantly responds to the changes in Base Rate.

3.17 The current forecast estimates that the average investment rate earned over the full year will increase to 1.65% (which approximately reflects the average bank rate expected for the year). As set out in Appendix 2, Link Asset Services are expecting interest rates to increase to a peak of 4.50% by June 2023, and gradually start reducing from March 2024. Therefore investments are currently being invested at staggered maturities to take advantage of increasing interest rates.

Borrowing Strategy

3.18 The council operates separate debt portfolios for the General Fund and the HRA following the introduction of the HRA Self-Financing regime in 2012.

3.19 The General Fund (GF) has been carrying an internal borrowing position (i.e. where the General Fund borrows cash from its own reserves) since 2008 as a response to the financial crisis. The reserves and balances are reviewed regularly to ensure that the cash will remain available to continue to support the internal borrowing.

3.20 In response to rising interest rates during 2021/22 a decision was made to undertake £25.0m of new borrowing in the second half of 2021/22 to reduce the GF internal borrowing position and fund new capital expenditure. This borrowing was undertaken at an average rate of 1.51%.

3.21 A total of £50m of new borrowing was undertaken in May 2022 at an average rate of 2.65%. The General Fund has been allocated £25m of this new borrowing to further reduce the internal borrowing position and fund the 2022/23 capital programme (this allocation between the HRA & GF will be kept under review). Based on capital programme projections as at TBM5, further general fund borrowing is required during the year. However, interest rates have increased to a point which currently makes long term borrowing an expensive option, particularly where our advisors are forecasting that interest rates will peak in 2023, and then start reducing during 2025. Therefore it is expected that any further GF borrowing need during the year will be met by using existing cash balances and/or short term borrowing from other local authorities.

3.22 The Housing Revenue Account (HRA) adopts 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). The HRA has undertaken a number of new loans over the last 5 years to support its capital programme, including borrowing a total of £8m from the general fund on a short-term basis.

3.23 A total of £55.0m of borrowing for the HRA was undertaken in 2021/22 at an average rate of 1.55%, of which £8.0m 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 was “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.

3.24 A further £25.0m of new borrowing has been allocated to the HRA in the first half of 2022/23 at an average rate of 2.65%. This results in the borrowing within the 2022/23 HRA capital programme being fully funded, with the expectation of a balance to be carried over to fund the 2023/24 HRA Capital programme. Whilst this results in a revenue pressure for interest payable in 2022/23, it will result in long term savings due to the borrowing been undertaken at low interest rates.

3.25 A summary of the council’s debt portfolio is summarised in **Appendix 3**.

Treasury Advisors

3.26 The council has a 4-year contract for treasury advisory services with Link Asset Services (LAS) which started 1 April 2020.

3.27 The council recognises 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.

4. Analysis and consideration of alternative options

4.1 This report sets out action taken in the 6 months to September 2021. Treasury management actions have been carried out within the parameters of the AIS, TMSS and Prudential Indicators. Therefore, no alternative options have been considered.

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 3.8.

Finance officer consulted: James Hengeveld Date consulted: 21/11/22

8. Legal implications

8.1 The TMSS is approved and associated actions are 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 (most recently updated in December 2021), 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: 21/11/22

9. Equalities, Sustainability and other significant implications

9.1 There are no direct implications arising from this report.

Supporting Documentation

1. Appendices

1. Glossary of terms
2. Economic Overview & Interest Rates – Link Asset Services
3. A summary of the action taken in the period April 2022 to September 2022

2. Background documents

1. Part I of the Local Government Act 2003 and associated regulations.
2. The Treasury Management Policy Statement 2022/23 (including the Annual Investment Strategy) approved by Policy & Resources Committee on 10 February 2022 and by full Council on 24 February 2022.
3. The Prudential Code for Capital Finance in Local Authorities 2017 published by CIPFA.
4. The Code for Treasury Management in Local Authorities 2017 published by CIPFA