Brighton & Hove City Council

Strategy, Finance & City Regeneration Committee

Agenda Item 24

Subject: **Treasury Management Strategy Statement 2022/23 – End of Year Review**

Date of meeting: **13 July 2023**

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 This report provides a review of activity for the second half of 2022/23 as required by the Treasury Management Code. This follows on from the Mid-Year review of 2022/23 provided to Policy & Resources Committee on 1 December 2022.

1.2 The 2022/23 Treasury Management Strategy Statement (TMSS), which includes the Annual Investment Strategy (AIS), was approved by Policy & Resources Committee on 10 February 2022 and by Full Council on 24 February 2022 as part of the 2022/23 Budget Report. The Treasury Management Strategy sets out the role of Treasury Management, the strategy for Treasury Management activity in 2022/23, and the key parameters and indicators for investing council cash balances and undertaking borrowing for 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 the Strategy, Finance & City Regeneration 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 Strategy, Finance & City Regeneration 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 Strategy, Finance & City Regeneration 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 when it is needed. Effective cash flow planning enables surplus monies to be invested in counterparties (financial institutions) or financial 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 to ensure cash is available to support the council's capital plans. Capital plans provide a guide to the borrowing need of the council, which therefore informs longer-term cash flow planning requirements to ensure that the council can meet its capital spending obligations. This management of longer-term cash flow may involve arranging long or short-term loans or using longer-term cash flow surpluses. On occasion, any debt previously drawn on may be restructured when it is economically advantageous or prudent to do so, and provided that the council's risk and investment objectives can continue to be met.

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 have significant implications for the council's revenue funds.

3.4 Since cash balances generally result from holding earmarked and committed reserves and balances, together with funding or financing held or undertaken 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."

3.7 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.

3.8 All councils are therefore 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 remain flat or even 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 expectation for interest rates within the treasury management strategy for 2022/23, based on external treasury advice, was that the Bank Rate would rise very gradually, with just two rate rises during 2022/23 expected, taking the expected interest rate to 0.75% by March 2023. This was on the basis that at the time, the Monetary Policy Committee (MPC) expected inflation to peak at 6% in April 2022.

3.8 In the event, 2022/23 was an unprecedented year and inflation (CPI) has been much more persistent than the Bank of England were expecting, remaining at around 10% for much of the year and peaking at 11.1% in October 2022. This was impacted, amongst other things, by the Russian invasion of Ukraine. The MPC has responded by increasing interest rates much faster than originally expected. The official rate was at 0.75% by March 2022, with 8 further rises during 2022/23 taking the rate to 4.25% by March 2023.

3.9 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

3.10 A summary of the action taken in the 6 months to March 2023 is provided in **Appendix 3** to this report. The main points are:

- The council entered into no new borrowing in the last 6 months of 2022/23;
- The highest risk indicator during the period was 0.024% which is below the maximum benchmark of 0.050%;
- The return on investments has exceeded the budgeted rates but has lagged behind the target benchmark rates in the 6 months 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 2022 to 31 Mar 2023				
	Fixed deposits	Pooled Funds	Money market funds	Total	
Up to 1 week	-	-	£271.4m	£271.4m	86%
Between 1 week & 1 month	-	-	-	-	0%
Between 1 month & 3 months	£3.0m	-	-	£3.0m	1%
Over 3 months	£40.5m	-	-	£40.5m	13%
	£43.5m	**-**	**£271.4m**	**£314.9m**	**100%**

Summary of Treasury Activity October 2022 to March 2023

3.12 The following table summarises the treasury activity in the half year to March 2023 compared to the corresponding period in the previous year:

October to March	**2020/21**	**2021/22**	**2022/23**
Long-term borrowing raised (General Fund)	(£0.0m)	(£25.0m)	(£0.0m)
Long-term borrowing raised (HRA)	(£10.0m)	(£30.0m)	(£0.0m)
Long-term borrowing repaid (General Fund)	£0.8m	£1.0m	£5.3m
Long-term borrowing repaid (HRA)	£0.4m	£0.6m	£5.4m
Short-term borrowing (raised)/repaid	(£0.0m)	£4.5m	(£0.5m)
Investments made	£376.4m	£438.9m	£314.9m
Investments maturing	(£372.1m)	(£424.1m)	(£397.4m)

3.13 The Financing Costs budget variance in 2022/23 was a £2.495m underspend. The key variance (£2.055m) is due to an over-achievement of investment income. This is due to a combination of higher than budgeted investment rates arising from increases to the Bank of England base rate throughout the year, as well as higher than forecast cash balances available for investment.

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 two years. The large cashflow deficits in the second half of 2021/22 and 2022/23 are in part as a result of the repayment of £34m and £27m (in 2021/22 and 2022/23 respectively) to central Government of additional Section 31 retail relief grant provided to cover cashflow implications over the period of the pandemic. In 2022/23 there has also been a cash out-flow of funds held for the Coast to Capital LEP of £20m, and the net impact of the capital investment programme.

October to March	2020/21	2021/22	2022/23
Net cash flow (shortage)/surplus	**(£4.0m)**	**(£34.0m)**	**(£72.1m)**
Represented by:			
Increase/(reduction) in long-term borrowing	£8.8m	£53.4m	(£10.7m)

Increase/(reduction) in short-term borrowing*	£0.0m	(£4.5m)	£0.5m
Reduction/(increase) in investments	(£4.3m)	(£14.8m)	£82.5m
Reduction/(increase) in bank balance	(£0.5m)	(£0.1m)	(£0.2m)

**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 2023 is set out in the table below and shows that investments continue to be held in good quality, short-term instruments in line with the approved strategy.

'AAA' rated money market funds	£20.60m	11%
'AA' rated institutions*	£74.00m	43%
'A' rated institutions	£67.50m	40%
'BBB' rated institutions	£0.00m	0%
Unrated Funds	£8.89m	5%
Total	**£170.99m**	**100%**
Period – less than one week	£29.49m	17%
Period – between one week and one month	£30.00m	18%
Period – between one month and three months	£26.00m	15%
Period – between three months and 1 year	£75.50m	44%
Period – more than 1 year**	£10.00m	6%
Total	**£170.99m**	**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 2022/23 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 0.013% and 0.024% between October 2022 and March 2023, reflecting the high proportion of investments held 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 'substantial' level of assurance was provided during the most recent audit (October 2022). No recommendations were made in the course of the audit.

Investment Rates

3.18 The official Bank Rate increased sharply through the year, starting at 0.75% and finishing the year at 4.25%. This change has been reflected by financial institutions which resulted in more attractive investment rates, allowing the council to re-invest maturing deals into more attractive investment rates.

Investment Performance

3.19 The council's investment portfolio achieved an average rate of 2.65% over the last six months of the year against a benchmark rate of 3.26% for the same period.

3.20 The investment performance has underperformed the benchmark by 0.61%. This is not unexpected as investment performance will normally lag behind the benchmark in a rising interest rate environment as it takes time for existing investments to mature and to be re-invested at higher rates, whereas the benchmark reacts instantly to changes in the Base Rate. However, this has been exacerbated in the last 6 months of 2022/23 due to the investment portfolio needing to reduce in size to fund large cash outflows which has reduced the availability of cash to invest in longer term and higher yielding investments.

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

	Average Balance	Average rate
Budget 2022/23	£143.7m	0.75%
Actual 2022/23	£263.4m	1.80%
Benchmark Rate*		2.24%

* *SONIA rate is used as a benchmark. SONIA is defined in Appendix 1.*

3.22 Investments under-performed the benchmark rate by 0.44% across the year in total. The majority of this under-performance was incurred during the last 6 months of the year as outlined in paragraph 3.20.

3.23 A number of new investments, totaling £43.5m at an average investment rate of 4.51%, were entered into during October to March.

3.24 The total yield in two Royal London short-dated bond funds has been negative over the period. The funds have been paying dividend income of 3.23% across the year (calculated as the income received as a proportion of the capital value as at 31 March 2023), but the capital value of the council's holding has fallen, in part due to the timing of the 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 The General Fund (GF) has been carrying an internal borrowing position since 2008, partly in response to the financial crisis. This is where the General Fund borrows cash from its own reserves rather than externally. However, the reserves and balances are reviewed regularly to ensure that cash will remain available (liquid) to continue to support the internal borrowing and other day-to-day spending.

3.27 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 both reduce the GF internal borrowing position and fund new capital expenditure. This borrowing was undertaken at an average rate of 1.51%, and a further £25m was undertaken in the first half of 2022/23 at an average rate of 2.65%.

3.28 Interest rates have increased to a point which currently makes long-term borrowing a relatively expensive option (although not historically so), particularly where our advisors are forecasting that interest rates will peak in 2023, and then start reducing during 2024/25. Therefore, no further long-term borrowing was undertaken during 2023, and further borrowing need was met by using existing cash balances.

3.29 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.

3.30 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 to take advantage of attractive interest rates to meet the HRA's identified capital financing requirements. This borrowing is expected to be applied to the HRA capital programme in 2022/23. In addition, a further £25m was undertaken in the first half of 2022/23 at an average rate of 2.65%. This results in the HRA Capital Programme being fully funded, with £9.8m that is profiled to fund the 2023/24 HRA capital programme.

3.31 HM Treasury have reduced the margin at which the HRA can undertake PWLB borrowing from 0.80% above gilt rates to 0.40% above gilt rates. This change has been implemented for one year from 15 June 2023. However, even though this reduces the rate at which the HRA can borrow at, it is unlikely that long term borrowing will be undertaken at these rates on the basis that interest rates are expected to be at their peak for this period. However, opportunities to borrow will continue to be monitored by officers.

3.32 A summary of the council's debt portfolio is included in **Appendix 3**.

Treasury Advisors

3.33 Officers recognise that responsibility for decisions remains with the organisation at all times and ensure that undue reliance is not placed upon external service providers and advisers. However, it is recognised that there is value in employing external providers of treasury management services in order to access specialist skills and resources.

Member Training

3.34 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.

3.35 Treasury Management training was last provided in October 2021. Further training will be provided to the members of the Strategy, Finance & City Regeneration Committee, and the Audit & Standards Committee in autumn 2023.

4. Analysis and consideration of alternative options

4.1 Alternative treasury management policies and practices, and investment strategies, are considered annually by Strategy, Finance & City Regeneration Committee and full Council. This report sets out action taken in the 6 months to March 2023. Treasury management actions have been carried out within the parameters of the approved AIS, TMSS, and Prudential Indicators and therefore no breaches have occurred and 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, together with the earlier mid-year review, fulfil 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: 16/06/23

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 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 considered to be consistent with the requirements of the Act and the aforementioned Code.

Lawyer consulted: Victoria Simpson Date consulted: 14/06/23

9. Equalities, Sustainability and other significant implications

9.1 There are no direct implications arising from this report. The council undertakes investments in accordance with its own ethical standards and monitors markets and providers through advisers and the financial press to ensure that counterparties are not involved in unethical or other activities that may have reputational implications for the council. However, this is an imperfect science and a new initiative to promote and secure providers that offer ethical Environmental, Sustainable & Governance (ESG) investments is being developed. This promotes the concept of sustainable and 'socially responsible' investment. Monitoring processes are being developed across the financial markets to help investors select appropriate counterparties by reflecting ESG credentials within the industry-standard credit ratings. As noted in the approved Treasury Strategy for 2023/24, the council will follow the development of ESG monitoring and consider how this can be incorporated in future Treasury Strategies.

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 2022 to March 2023

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 2022/23 approved by Policy & Resources Committee on 10 February 2022.
3. Treasury Management Strategy Statement 2022/23 – Mid Year Review approved by Policy & Resources Committee on 1 December 2022.
4. The Prudential Code for Capital Finance in Local Authorities published by CIPFA 2017.