



Audit & Governance Committee

Report Subject	Treasury Management Monitoring report for the period April to December 2021 and Treasury Management Strategy 2022/23
Meeting date	13 January 2022
Status	Public
Executive summary	<p>This report sets out the monitoring of the Council's Treasury Management function for the period 1 April 2021 to 31 December 2021. A surplus of £619k will be achieved through lower borrowing costs due to historically low interest rates and higher interest earned on investments.</p> <p>The Treasury Management Strategy 2022/23 is included as an appendix to this report. Key changes to the strategy have been set out in paragraphs 18-20 as well as inclusion of analysis of the approach to finance more of the capital programme through borrowing.</p> <p>The report also sets out in paragraph 29-31 to modify the council's accounting policy surrounding capitalisation of interest during the construction of major capital projects.</p>
Recommendations	<p>It is recommended that Audit & Governance Committee:</p> <ol style="list-style-type: none">1) note the reported activity of the Treasury Management function for the period ending 31 December 20212) Approve the Treasury Management Strategy 2022/23 & Treasury Management Policy, Practices and Schedules included in Appendix 1 and 23) Note the current position on debt levels of the council set out in Appendix 34) Approve the change in accounting policy surrounding capitalisation of interest set out in paragraph 29-31
Reasons for recommendations	<p>It is a requirement under the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice that regular monitoring of the Treasury Management function is reported to Members.</p>
Portfolio Holder	Councillor Drew Mellor, Leader, Finance & Transformation
Corporate Director	Graham Farrant, Chief Executive
Service Director	Adam Richens - Chief Financial Officer
Classification	For information and recommendation

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Background Detail

1. Treasury Management is defined as the management of the Council's cash flows, its borrowings and investments, the management of the associated risks and the pursuit of the optimum performance or return consistent with those risks.
2. The Treasury Management function operates in accordance with The Chartered Institute of Public Finance and Accountancy (CIPFA) 'Treasury Management in the Public Services' Code of Practice (2021).
3. The Treasury Management function manages the Council's cash flow by exercising effective cash management and ensuring that the bank balance is as close to nil as possible. The objective is to ensure that bank charges are kept to a minimum whilst maximising interest earned. A sound understanding of the Council's business and cash flow cycles enables funds to be managed efficiently.
4. This report considers the treasury management activities in relation to the Treasury Management Strategy. Also included is a summary of the current economic climate, an overview of the estimated performance of the treasury function, an update on the borrowing strategy, investments and compliance with prudential indicators.

Economic Background

5. The Bank of England (BoE) on 16 December 2021 raised interest rates for the first time in more than three years. The Bank's Monetary Policy Committee (MPC) voted 8-1 in favour of the increase to 0.25%, up from the record low of 0.1% and unanimously decided to make no changes to its programme of quantitative easing purchases due to finish in December 2021 at a total of £895bn.
6. The BoE cited that inflation was the main driver for the increase. The CPI measure of inflation showed the cost of living surged by 5.1% (up from 4.2%) in the 12 months to November 2021, the highest annual rise since September 2011. Inflation will remain the biggest concern for the UK and global economies, with more recent increases in prices, particularly the increases in gas and electricity prices in October 2021 and due again in April 2022, are, indeed, likely to lead to faster and higher inflation expectations and underlying wage growth, which would in turn increase the risk that price pressures would prove more persistent.
7. The BoE have suggested that inflation could peak to around 6% in the first quarter of 2022. The rate is clearly higher than the Bank of England's 2% inflation target so this comment is fuelling debate about whether interest rates will need to go up further during 2022.
8. The ongoing Covid pandemic will also be cause of further concern in the UK economy with the latest Omicron variant likely to cause further disruption.

Interest Rates

9. Table 1 below which is produced by the authority's treasury consultants Link Asset Services illustrates that there is an expectation that the bank rate will increase again as soon as June 2022.

Table 1: Interest rate projection (Link Asset Services)

Bank Rate	Interest Rate Forecasts							
	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23
Link	0.25%	0.25%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%
Cap Econ	0.25%	0.25%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%
5Y PWLB RATE								
Link	1.40%	1.50%	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%
Cap Econ	1.40%	1.50%	1.50%	1.60%	1.60%	1.70%	1.80%	1.90%
10Y PWLB RATE								
Link	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
Cap Econ	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%
25Y PWLB RATE								
Link	1.80%	1.90%	2.00%	2.10%	2.10%	2.20%	2.20%	2.20%
Cap Econ	1.80%	1.80%	1.80%	2.00%	2.00%	2.10%	2.10%	2.20%
50Y PWLB RATE								
Link	1.50%	1.70%	1.80%	1.90%	1.90%	2.00%	2.00%	2.00%
Cap Econ	1.50%	1.60%	1.70%	1.70%	1.80%	2.00%	2.10%	2.20%

Treasury Management Performance 2021/22

10. Table 2 below shows the overall treasury management position for 2021/22. The current forecast is an underspend of £619k which will be mostly achieved from savings on the interest payable budget. Despite the Council taking out new PWLB borrowing of £25m in August 2021, this was at a historically low rate, far lower than assumed in the budget. An additional £17m was borrowed in November 2021 following a switch of loans held by both loans' pools between the Housing Revenue Account and General Fund.
11. Investment income is also forecasted to provide additional £122k interest received beyond the budget. This is due to higher cash balances than assumed coming into this financial year. The Government provided funding to the Council in relation to the Covid-19 pandemic such as financial support to businesses which the Council has distributed during 2020/21. Most of these schemes have now finished and there are some unspent monies that need to be returned to the Government later in the year.

Table 2: Treasury Management Performance 2021/22

	Forecast 2021/22 £'000	Budget 2021/22 £'000	Variance 2021/22 £'000
<u>Expenditure</u>			
Interest Paid on Borrowings	2,684	3,181	(497)
<u>Income</u>			
Investment Interest Received	(167)	(45)	(122)
Total	2,517	3,136	(619)

Borrowing

12. Table 3 below shows the closing level of borrowing for the Council's two loans pools.

Table 3: Council Borrowings as at 31 December 2021

Initial Loan Value £'000	Interest Rate	Balance as at 31 Dec 2021 £'000	Maturity Date	General Fund Pool £'000	HRA Pool £'000	Source
Short Term Borrowing						
2,000	8.00%	2,000	25-Nov-2022	-	2,000	PWLB
2,000		2,000		-	2,000	
Long Term Borrowing						
5,000	2.66%	833	22-Aug-2023	-	833	PWLB
5,000	4.45%	5,000	24-Sep-2030	-	5,000	PWLB
5,000	4.45%	5,000	24-Nov-2031	-	5,000	PWLB
5,000	4.75%	5,000	24-Sep-2032	-	5,000	PWLB
5,000	4.45%	5,000	24-Nov-2032	-	5,000	PWLB
5,000	4.75%	5,000	24-Sep-2033	-	5,000	PWLB
5,000	4.60%	5,000	23-Feb-2035	-	5,000	PWLB
5,000	4.72%	5,000	22-Aug-2036	-	5,000	PWLB
5,000	2.80%	5,000	20-Jun-2041	5,000	-	PWLB
5,000	2.80%	5,000	20-Jun-2041	5,000	-	PWLB
10,000	1.83%	10,000	22-Jul-2046	10,000	-	PWLB
2,500	6.75%	2,500	06-Mar-2056	-	2,500	PWLB
1,500	6.75%	1,500	13-Mar-2057	-	1,500	PWLB
1,500	5.88%	1,500	07-Mar-2058	-	1,500	PWLB
42,488	3.48%	42,488	28-Mar-2062	-	42,488	PWLB
43,908	3.48%	43,908	28-Mar-2062	-	43,908	PWLB
17,000	1.54%	17,000	17-May-2068	17,000	-	PWLB
12,500	1.56%	12,500	16-Aug-2068	12,500	-	PWLB
12,500	1.55%	12,500	16-Aug-2069	12,500	-	PWLB
193,896		189,729		62,000	127,729	
49,000	2.83%	48,747	24-May-2068	48,747	-	Phoenix Life Limited
22,625	2.26% + RPI Annually	16,480	17-Oct-2039	16,480	-	Prudential Assurance Co
3,673	0.00%	255	01-Apr-2023	255	-	Salix
271,194		257,211		127,482	129,729	

Investments

13. A full list of investments held by the authority as at 31 December 2021 is shown in Table 4 overleaf.

Table 4: Investment Summary as at 31 December 2021

Investments	Maturity Date	Principal Amount £	Interest %
<u>Fixed Term Deposits</u>			
Landesbank Hessen Thuringen	07-Jan-2022	18,200,000	0.06%
Landesbank Hessen Thuringen	07-Jan-2022	16,000,000	0.15%
Goldman Sachs International Bank	16-Feb-2022	7,850,000	0.17%
Close Brothers	29-Mar-2022	10,000,000	0.25%
Close Brothers	24-May-2022	15,000,000	0.40%
Goldman Sachs International Bank	17-Jun-2022	15,000,000	0.47%
Goldman Sachs International Bank	30-Jun-2022	9,000,000	0.52%
Sub Total		91,050,000	
<u>Call Account</u>			
Santander UK	120 day notice	22,825,000	0.25%
Aberdeen Standard Liquidity Fund	instant access	19,585,000	0.05%
HSBC Sterling Liquidity ESG Fund	instant access	34,650,000	0.09%
Total		168,110,000	

14. The Treasury Management function has continued to achieve higher average returns of 0.13% for the period 1 April 2021 to 31 December 2021 for its combined investment compared to the average 7-day benchmark rate of (0.07%).

Prudential Indicators

15. The Treasury Management Prudential Code Indicators were set as part of the 2021/22 Treasury Management Strategy as agreed with Council in February 2021. It can be confirmed that all indicators have been complied with during the period 1 April 2021 to 31 December 2021.

Compliance with Policy

16. The Treasury Management activities of the Council are regularly audited both internally and externally to ensure compliance with the Council's Financial Regulations. The recent internal audit in December 2021 rated the Treasury Management function as "Reasonable" assurance which means that there is basically a sound control framework there are some weaknesses identified.
17. The Treasury Management Strategy requires that surplus funds are placed with major financial institutions but that no more than 25% (AA- Rated Institutions) or 20% (A to A- Rated) of the investment holding is placed with any one major financial institution at the time the investment takes place. It can be confirmed

that the Treasury Management Strategy has been complied with during the period 1 April 2021 to 31 December 2021.

Treasury Management Strategy 2022/23

18. The Treasury Management Strategy is produced each year in accordance with the CIPFA Code of Practice on Treasury Management. It sets out how the Council's Treasury service will support capital investment decisions, and how the treasury management operates day to day. Its sets out the limitations on treasury management activity through prudential indicators, within which the council's treasury function must operate. The strategy is included as Appendix 1 to the report.
19. CIPFA published updated Treasury Management and Prudential Codes on 20th December 2021. CIPFA has stated that there will be a soft introduction of the codes with local authorities not being expected to have to change their current strategy reports for 2022/23 but full implementation would be required for 2023/24.
20. It should also be noted that the Department of Levelling Up, Housing and Communities (DLUHC) is proposing to tighten up regulations around local authorities financing capital expenditure on investments in commercial projects for yield and has already closed access to all PWLB borrowing if such schemes are included in an authority's capital programme. The new CIPFA codes have also adopted a similar set of restrictions to discourage further capital expenditure on commercial investments for yield which have to be abided to straight away before full implementation in 2022/23.

Capital investment programme – Debt Headroom

21. On 29 July 2021, the Audit and Governance Committee was provided with an analysis of the Council debt plans which considered the Council's ambition to invest in its local community and regenerate areas of the conurbation as expressed through its "Big Plan". The large-scale projects which underpin such ambition will, by and large, need to be funded through increased borrowing if the Council is to retain ownership of the assets created.
22. Through the financial strategy Cabinet endorsed the intention to move the self-imposed debt levels to the mid-point of all upper tier authorities as a percentage of net revenue expenditure. Such an approach enabled the Council to determine that it had debt headroom of £212 million compared to its 31 March 2024 forecast position. The headroom was additional to the £184m already set aside to support service delivery, housing, and regeneration schemes over the next three years such as those the being delivered to increase our housing stock and the schemes being delivered by the Bournemouth Development Company (BDC).
23. Subsequently Audit and Governance Committee and then Council approved the necessary adjustments to our treasury management prudential indicators to enable this change in approach to be implemented.
24. A key element of the Treasury Strategy is to ensure planned Capital spend remains affordable and within this the self-imposed debt headroom of £212m.

25. Appendix 3 of this report sets out the schedule that itemises by scheme how the Councils total borrowings (HRA and GF) will change based on the planned capital expenditure for 2022/23 onwards. This change has been reflected in the prudential indicators of the Treasury Management strategy ultimately increasing the level of future borrowing required.

Recommended changes to the Treasury Management Strategy 2022/23

26. Following a discussion with the Chair and Vice Chair of Audit and Governance Committee it is planned that a Treasury Management training session will take place in the summer of 2022 conducted by the councils Treasury Management Advisors Link Asset Group.
27. For approved investment bodies it is proposed to extend the options to include Police and Fire authorities. Although local bodies are rarely used as investments options occasionally deals have been forthcoming which have been competitive.
28. The 2022/23 Accounting code of practice will require all leases to be added to the balance sheet, which will in effect increase the Councils liabilities and therefore its overall Capital Financing Requirement. It is prudent to ensure that we have estimated the impact of this accounting change in the Treasury Management strategy to ensure sufficient headroom has been allowed for in the Councils prudential indicators.

Accounting Policy - Capitalisation of Interest – borrowing costs for Investment and Acquisition Strategy Developments

29. In preparing the Statement of Accounts, the Section 151 Officer is responsible for selecting suitable accounting policies and ensuring that they are applied consistently. Accounting policies are the specific principles, conventions, rules and practices applied in preparing and presenting the financial statements and set out how transactions are recognised, presented and measured in the accounts.
30. In general accounting policies do not change significantly between years however one change is recommended to be approved for the 2022/23 financial year set out below:
- The council may borrow to meet capital costs for a qualifying asset as part of approved capital programme. It is the council's policy to capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset, with capitalisation of interest against the qualifying asset.
 - The capitalisation rate shall be the weighted average of the borrowing costs that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.
 - A qualifying asset will be that which takes more than two years to get ready for intended use and where the forecast expenditure is in excess of £10m.
 - Interest will be capitalised on a quarterly basis and will be based on the weighted average of the borrowing costs that are outstanding during the period. Cessation of capitalisation will occur when substantially all the

activities necessary to prepare the qualifying asset for its intended use are complete.

31. The proposed change in the accounting policy is fully compliant with CIPFA accounting code of practice and will be included in the Statement of Accounts Accounting Policies. Materiality will be key in determining whether a separate disclosure is needed.

Summary of Financial/Resource Implications

32. Financial implications are as outlined within the report.

Summary of Legal Implications

33. There are no known legal implications.

Summary of Equalities and Diversity Impact

34. The Treasury Management activity does not directly impact on any of the services provided by the Council or how those services are structured. The success of the function will have an impact on the extent to which sufficient financial resources are available to fund services to all members of the community.

Summary of Risk Assessment

35. The Treasury Management Policy seeks to consider and minimise various risks encountered when investing surplus cash through the money markets. The aim in accordance with the CIPFA Code of Practice for Treasury Management is to place a greater emphasis on the security and liquidity of funds rather than the return gained on investments. The main perceived risks associated with treasury management are discussed below.

Credit Risks

36. Risk that a counterparty will default, fully or partially, on an investment placed with them. There were no counterparty defaults during the year to date, the Council's position is that it will invest the majority of its cash in the main UK Banks which are considered to be relatively risk adverse and have been heavily protected by the UK Government over the last few years. The strategy is being constantly monitored and may change if UK Bank Long Term ratings fall below acceptable levels.

Liquidity Risks

37. Aims to ensure that the Council has sufficient cash available when it is needed. This was actively managed throughout the year and there are no liquidity issues to report.

Re-financing Risks

38. Managing the exposure to replacing financial instruments (borrowings) as and when they mature. The Council continues to monitor premiums and discounts in relation to redeeming debt early. Only if interest rates result in a discount that will benefit the Council would early redemption be considered.

Interest Rate Risks

39. Exposure to interest rate movements on its borrowings and investments. The Council is protected from rate movements once a loan or investment is agreed as the vast majority of transactions are secured at a fixed rate.

Price Risk

40. Relates to changes in the value of an investment due to variation in price. The Council does not invest in Gilts or any other investments that would lead to a reduction in the principal value repaid on maturity.

Background papers

41. Treasury Management report to Full Council on 23 February 2021
<https://democracy.bcpccouncil.gov.uk/documents/g4287/Public%20reports%20pack%2023rd-Feb-2021%2019.00%20Council.pdf?T=10>

Appendices

Appendix 1 - Treasury Management Strategy 2022/23

Appendix 2 – Treasury Management Policy, Practices and Schedules

Appendix 3 – Itemised Borrowing for BCP Council – *subject to minor amendments*