



Audit & Governance Committee

Report Subject	Treasury Management Monitoring Outturn 2021/22 and update for Quarter 1 2022/23
Meeting date	28 July 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 March 2022.</p> <p>A surplus of £745k has been achieved through a reduced need to carry out temporary borrowing due to high cash balances generated from funding associated with the government's response to the pandemic as well as increasing interest rates earned on the Council's investments.</p> <p>The report also sets out the Quarter One performance for 2022/23 which forecasts an underspend of £840k due to the increase in interest rates.</p> <p>Further to the standard update the report seeks approval to increase our borrowing headroom in line with the proposal set out in the financial strategy supporting the proposed 2022/23 budget as endorsed by Cabinet.</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 2021/222) note the reported activity of the Treasury Management function for April to June 20223) note and endorse the update on borrowing set out from paragraph 25-354) approve and recommend to Council the revised prudential indicators set out in table 9.
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> <p>Council are required to approve any changes to the prudential indicators based on a recommendation from the Audit & Governance Committee.</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
Report author	Matthew Filmer, Assistant Chief Financial Officer ☎ 01202 128503 ✉ matthew.filmer@bcpcouncil.gov.uk

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 (2011).
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 15 June 2022 Monetary Policy Committee (MPC) meeting voted by a majority of 6-3 to increase rates from 1% to 1.25%, pushing them to the highest level in 13 years.
6. The MPC noted UK GDP growth was expected to slow sharply over the first half of the forecast period and, although the labour market was expected to tighten slightly further in the near term, the unemployment rate was projected to rise to 5½% in three years' time. CPI inflation was expected to average slightly over 10% at its peak in 2022 Q4. Conditioned on the rising market-implied path for Bank Rate at that time and the MPC's forecasting convention for future energy prices, CPI inflation was projected to fall to a little above the 2% target in two years' time, largely reflecting the waning influence of external factors, and to be well below the target in three years, mainly reflecting weaker domestic pressures. The risks to the inflation projection were judged to be skewed to the upside at these points.
7. The UK latest inflation rate hit 9.1% in the year to May, the highest rate for 40 years. The Bank of England has warned inflation might reach 11% within months, as the prices of fuel, energy and food put pressure on household budgets.

8. The rate is higher than the Bank of England's 2% inflation target mainly reflecting previous large increases in global energy and other tradable goods prices. The former has been greatly exacerbated by the war in Ukraine, which has also raised significantly the wholesale price of many agricultural commodities. The latter mainly reflects the impact of the pandemic, which shifted demand towards goods but also impaired and disrupted supply chains.

Interest Rates

9. Table 1 below which is produced by the authority's treasury consultants Link Asset Services sets out their current projection of interest rates over the medium term.

Table 1: Interest rate projection (Link Asset Services)

Interest Rate Forecasts								
Bank Rate	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24
Link	1.75%	2.25%	2.75%	2.75%	2.75%	2.75%	2.50%	2.50%
Cap Econ	1.75%	2.25%	2.50%	2.75%	3.00%	3.00%	3.00%	3.00%
5Y PWLB RATE								
Link	3.20%	3.30%	3.30%	3.30%	3.30%	3.20%	3.10%	3.00%
Cap Econ	3.40%	3.80%	3.70%	3.60%	3.50%	3.50%	3.30%	3.20%
10Y PWLB RATE								
Link	3.40%	3.50%	3.50%	3.50%	3.50%	3.40%	3.30%	3.20%
Cap Econ	3.60%	3.80%	3.80%	3.70%	3.60%	3.60%	3.50%	3.30%
25Y PWLB RATE								
Link	3.70%	3.70%	3.70%	3.70%	3.70%	3.70%	3.60%	3.50%
Cap Econ	3.70%	3.80%	3.80%	3.80%	3.80%	3.70%	3.60%	3.50%
50Y PWLB RATE								
Link	3.40%	3.40%	3.50%	3.50%	3.40%	3.40%	3.30%	3.20%
Cap Econ	3.60%	3.80%	3.80%	3.70%	3.70%	3.70%	3.60%	3.50%

Treasury Management Performance 2021/22

10. Table 2 below shows the final overall treasury management position for 2021/22. Investment income overachieved the budget set for 2021/22 by £260k. This was down to increasing interest rates being earned on the Council investments as well as having higher cash balances than forecasted.
11. The interest paid on borrowing was £485k under 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.

Table 2: Treasury Management Performance 2021/22

	Actuals 2021/22 £'000	Budget 2021/22 £'000	Variance 2021/22 £'000
<u>Expenditure</u>			
Interest Paid on Borrowings	2,696	3,181	(485)
<u>Income</u>			
Investment Interest Received	(305)	(45)	(260)
Total	2,391	3,136	(745)

Borrowing

12. The Council has adopted a two-pool approach to debt management, separating the debts of the General Fund (Pool 1) and the Housing Revenue Account (HRA) (Pool 2). The HRA pool is a combination of both the Poole and Bournemouth Neighbourhood HRA accounts.
13. Table 3 below shows the closing level of borrowing for the Council's two loans pool.

Table 3: Council Borrowings as at 31 March 2022

Initial Loan Value £'000	Interest Rate	Balance as at 31 Mar 2022 £'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%	625	22-Aug-2023	-	625	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		189,521		62,000	127,521	
49,000	2.83%	48,747	24-May-2068	48,747	-	Phoenix Life Limited
22,625	2.26% + RPI Annually	16,289	17-Oct-2039	16,289	-	Prudential Assurance Co
3,673	0.00%	255	01-Apr-2023	255	-	Salix
271,194		256,812		127,291	129,521	

14. Table 4 below shows the closing level of the Council Capital Financing Requirement and how that is made up of actual external borrowing and what the level of under borrowing.

Table 4: Council Capital Financing Requirement 31 March 2022

	General Fund £000	HRA £000	Total £000
External Borrowing	127,291	129,521	256,812
Internal Borrowing (under borrowing)	216,107	3,710	219,817
Capital Financing Requirement	343,398	133,231	476,629

Investments

15. During the year, cash surpluses are invested by the Treasury Management team through direct dealing or money brokers with approved counterparties. The Council's counterparty list i.e. the list of organisations that it has been agreed that the Council can invest with has become increasingly restricted in recent years due to the economic climate and the criteria used to select appropriate organisations.
16. A full list of investments held by the authority as of 31 March 2022 is shown in Table 5 below.

Table 5: Investment Summary as at 31 March 2022

Investments	Maturity Date	Principal Amount £	Interest %
<u>Fixed Term Deposits</u>			
Landesbank Hessen Thuringen	19-Apr-2022	25,150,000	0.73%
Cornwall Council	25-Apr-2022	10,000,000	0.60%
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%
Goldman Sachs International Bank	16-Aug-2022	13,000,000	1.20%
Close Brothers	29-Sep-2022	10,000,000	1.20%
Sub Total		97,150,000	
<u>Call Account</u>			
Santander UK	120 day notice	22,825,000	0.50%
HSBC Sterling Liquidity Fund	instant access	29,975,000	0.56%
Total		149,950,000	

17. The Treasury Management function has continued to achieve higher average returns of 0.20% for the period 1 April 2021 to 31 March 2022 for its combined investment compared to the SONIA overnight rate of (0.15%).

Treasury Management Performance 2022/23

18. Table 6 below shows the overall treasury management position for 2022/23. The current forecast is an underspend of £840k on interest receivable budgets reflecting the increase in interest rates and still being in receipt of a number of significant grants from central government.

Table 6: Treasury Management performance 2022/23

	Forecast 2022/23 £'000	Budget 2022/23 £'000	Variance 2022/23 £'000
<u>Expenditure</u>			
Interest Paid on Borrowings	3,199	3,199	0
<u>Income</u>			
Investment Interest Received	(885)	(45)	(840)
Total	2,314	3,154	(840)

Borrowing

19. Table 7 below shows the closing level of borrowing for the Council's two loans pool.

Table 7: Council Borrowings as at 30 June 2022

Initial Loan Value £'000	Interest Rate	Balance as at 30 June 2022 £'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
3,673	0.00%	128	01-Apr-2023	128	-	Salix
5,673		2,128		128	2,000	
Long Term Borrowing						
5,000	2.66%	625	22-Aug-2023	-	625	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		189,521		62,000	127,521	
49,000	2.83%	48,491	24-May-2068	48,491	-	Phoenix Life Limited
22,625	2.26% + RPI Annually	16,097	17-Oct-2039	16,097	-	Prudential Assurance Co
271,194		256,237		126,716	129,521	

Investments

20. A full list of investments held by the authority as at 30 June 2022 is shown in Table 8 below.

Table 8: Investment Summary as at 30 June 2022

Investments	Maturity Date	Principal Amount £	Interest %
<u>Fixed Term Deposits</u>			
Landesbank Hessen Thuringen	18-Jul-2022	25,150,000	1.00%
Goldman Sachs International Bank	16-Aug-2022	13,000,000	1.20%
Santander UK	24-Aug-2022	22,825,000	0.74%
Close Brothers	29-Sep-2022	10,000,000	1.20%
National Bank of Canada	11-Nov-2022	10,000,000	1.57%
Sub Total		80,975,000	
<u>Call Account</u>			
HSBC Sterling Liquidity Fund	instant access	27,595,000	1.14%
Total		108,570,000	

21. The Treasury Management function has continued to achieve higher average returns of 0.81% for the period 1 April 2022 to 30 June 2022 for its combined investment compared to the SONIA overnight rate of (0.86%).

Prudential Indicators

22. The Treasury Management Prudential Code Indicators were set as part of the 2021/22 & 2022/23 Treasury Management Strategy. It can be confirmed that all indicators have been complied with during all of 2021/22 and the period 1 April 2022 to 31 June 2022.

Compliance with Policy

23. 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 January 2022 rated the Treasury Management function as "Reasonable" assurance which means that there is a sound control framework which is designed to achieve the service objectives, with key controls being consistently applied.
24. 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 all of 2021/22 and the period 1 April 2022 to 30 June 2022.

Update on changing regulations associated with debt

25. DLUHC have made it clear that local authorities taking on excessive risk and any non-compliance with the framework will see increased interventions from government potentially leading to caps on borrowing. DLUHC also made it clear that they planned to better constrain the risks associated with complex capital transactions. This included credit arrangements, such as PFI deals or income strips, and financial derivatives. These types of arrangement can carry more risk than traditional forms of financing and require the right expertise to support effective decisions and risk management.
26. As part of this tightening DLUHC on the 12 May 2022 announced as part of its Levelling Up and Regeneration Bill, the proposal to address excessive risk arising from local authority investment and borrowing, while supporting local freedoms for investment. They propose a set metrics for local authorities including the following:
 - proportionality of debt compared to the financial resources at the disposal of the authority.
 - proportion of capital assets which are investments taken out to generate net financial return or profit.
 - Whether the authority is meeting its statutory duty to make sufficient provision for debt repayment.
 - proportion of debt held where the counterparty is not local or central government including credit arrangements and loans.
 - Any other metric specified by regulations made by the secretary of state
27. The proposals set out above also coincide with a further update to Public Works Loan Board (PWLB) guidance to address lending to authorities where there is a more than negligible risk of non-repayment. HM Treasury will be reviewing authorities that raise concerns and could mean limiting the loan term length generally offered or restricting lending altogether.
28. The Levelling Up and Regeneration Bill published on the 11 May 2022 proposes to amend the LG Act 2002 to give the Secretary of State powers to issue a “risk mitigation direction”. This could be issued if a council receives a section 114 notice, receives a capitalisation direction, or breaches one of the five capital risk thresholds set out above. Such directions could direct asset sales and limit council borrowing levels.

Increase the Councils Debt Threshold (Capital Financing Requirement)

29. As part of the financial strategy supporting the development of the 2022/23 budget the council in September 2021 approved a revision to its self-imposed debt threshold. This change recognised that our borrowing of £457m as of 31 March 2021, represented 160% of our Net Revenue Expenditure (NRE), and was towards the lower end of the third quarter when compared to upper tier authorities including metropolitan boroughs. The decision was to move our debt threshold to 257% of our NRE which would move the council to the mid-point average and

support a debt level of £855m. There were two main drivers for extending the Council's debt threshold.

1) To enable service-based capital expenditure to be financed from debt with the cost spread over the time-period that will benefit from the expenditure.

2) To support the big plan objective including the delivery of regeneration and housing business cases which will provide an ongoing resource base for the authority, as a minimum, once the borrowing is repaid.

30. As at the 31 March 2022 the Council has increased its current actual borrowing position to £487m and has now committed over the five-year period to 31 March 2027 to using all the current £855m threshold including those decisions outlined in May 2022 Cabinet and Council reports. This includes decisions in respect of the Futures Fund £50m, Carters Quay £46m, Green Futures Fund £20m, SEND Capital £10m, the multi-year investments in the Council New Build and Housing Acquisition Strategy, and the capitalisation of neighbourhood highway maintenance up to and including 2025/26.
31. The proposal now is to increase the Council debt threshold to £1.334bn which will represent 387% of our NRE and position us at the top of the 3rd quarter when compared to upper tier authorities including metropolitan boroughs (see Appendix 1). This headroom will provide the Council with a further £479m to support delivery of its Big Plan. It will be allocated based on prudent business cases that take account of risk, support the levelling up agenda, and will be particularly focused on the delivery of housing or extra care housing related schemes, be that via the councils housing revenue account, or any BCP FuturePlaces Ltd or Bournemouth Development Company LLP led projects. It will not be invested in any commercial for yield activity.
32. Self-imposed debt levels are set against the Councils Capital Financing Requirement (CFR). Such levels are a requirement of the CIPFA Prudential Code and link into the prudential indicators agreed by Council based on recommendations of the Audit and Governance Committee who are responsible for the Treasury Management Strategy.
33. The recommended new indicators are as follows:

Table 9: Revised Treasury Indicators: limits to borrowing activity

	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Operational boundary	797	855	1,334	1,334
Authorised limit	847	905	1,384	1,384

34. Recognising the acute financial challenges in the Councils current and future year budgets and demonstrating fiscal discipline it is recommend that no further borrowing is undertaken which is not supported by a self-funding business case. Therefore, it is recommended that no further commitments to debt be taken on which would require the general fund budget of the council to finance the revenue implications of taking on that additional debt.

35. The Chief Financial Officer supports utilising the opportunity afforded by borrowing on the basis that as a principle it ensures the cost of various capital projects are spread over the time periods that are anticipated to benefit from the investment. But all estimates for capital expenditure must prove to be affordable, prudent, and sustainable. In addition, schemes such as those to reduce homelessness or create extra care housing schemes should significantly reduce the annual operating expenditure of the authority. Schemes such as the Poole Bay beach master plan meet a key principle of the council's capital strategy by leveraging in high levels of inward investment via government grant funding. Over and above this any schemes should ensure they adhere to the ever-tightening regulatory framework set down by government and be supported by strong, robust financial business cases. To emphasise the point already made in the report the CFO would not support any further debt being undertaken which would require the general fund budget of the council to finance the revenue implications of taking on that additional debt. Councillors also need to be cognisant of the perception created if Council was to choose to have debt levels above those of similar local authorities.

Summary of Financial/Resource Implications

36. Financial implications are as outlined within the report.

Summary of Legal Implications

37. There are no known legal implications.

Summary of Equalities and Diversity Impact

38. 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

39. 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

40. 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

41. 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

42. 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

43. 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

44. 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

45. Treasury Management report to Full Council on 22 February 2022
<https://democracy.bcpccouncil.gov.uk/documents/g4812/Public%20reports%20pack%2022nd-Feb-2022%2019.00%20Council.pdf?T=10>

Appendices

Appendix 1 - BCP Council Debt Benchmarking

Appendix 2 – Details of capital commitment against the debt ceiling