APPENDIX B

TREASURY MANAGEMENT STRATEGY STATEMENT 2022-23

Introduction

1. Treasury management is the management of the authority's cash flows, borrowings and investments. The council is exposed to financial risks from treasury management activities, including possible losses associated with the council's investments and potential for increased borrowing costs arising from market movements. The identification, monitoring and control of financial risks are a crucial part of the financial management and governance arrangements of the council.

2. Treasury risk management is carried out within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services Code of Practice (the CIPFA Code) which requires the council to approve a treasury management strategy before the start of each financial year. This report fulfils the council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

3. Investments held for service purposes or for commercial profit are considered in the Capital Strategy.

4. Under financial delegation, the strategic director of finance and governance is responsible for all executive and operational decisions on treasury management. This treasury management strategy, together with supporting prudential indicators and policies will ensure that these responsibilities are, carried out effectively.

Economic Context

5. The ongoing impact of coronavirus on the UK, combined with higher inflation, higher interest rates, and the country's trade position post-Brexit, will remain major influences on the council's treasury management strategy for 2022-23.

6. The Bank of England (BoE) increased Bank Rate from 0.1% to 0.25% in December 2021. With the increased uncertainty and risk that the new covid variant presents, the BoE revised down its estimates for December quarter GDP growth to 0.6% from 1.0%. Inflation was projected to be higher than previously forecast, with CPI likely to remain above 5% throughout the winter and peak at 6% in April 2022. UK CPI for November 2021 was 5.1% year on year, up from 4.2% in the previous month, the 6th successive month of inflation.

7. The 5-year UK benchmark gilt yield began the quarter at 0.62% before rising to 0.82%. Over the same period, the 10-year gilt yield fell from 1% to 0.97% and the 20-year yield declined from 1.35% to 1.20%.

The Sterling Overnight Rate (SONIA), which has replaced LIBOR averaged 0.07% over the quarter to December 2021.

Net Borrowing Position

8. As at 31 December 2021, the council held £874m of borrowing and £197m of investments.

9. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, known as internal borrowing.

10. The Council has an increasing CFR due to its ambitious capital programme. Based on current forecasts there is an estimated need to borrow up to £1bn by 31 March 2025.

Balance Sheet Summary

	2020-21 Actual £m	2021-22 Forecast £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m
General Fund CFR	699	728	835	872	875
HRA CFR	521	621	964	1,138	1,242
Total CFR	**1,220**	**1,349**	**1,799**	**2,010**	**2,117**
Less: Other debt liabilities*	-91	-86	-101	-96	-91
Borrowing CFR	**1,129**	**1,263**	**1,698**	**1,914**	**2,026**
Less: External Borrowing**	-891	-831	-708	-688	-667
Internal Borrowing / (Over Borrowing)	**238**	**432**	**990**	**1,226**	**1,359**
Less: Usable reserves	-343	-293	-263	-243	-223
Less: Working capital	-47	-47	-47	-47	-47
(Investments)/New Borrowing	**-152**	**92**	**680**	**936**	**1,089**
Net Borrowing Requirement	**-739**	**-923**	**-1,388**	**-1,624**	**-1,756**

**Leases and PFI liabilities that form part of the Authority's total debt*

***Shows only loans to which the Authority is committed*

Borrowing strategy and debt management activity and position

11. The council's debt management strategy since 2011-12 has been to pursue a policy of internal borrowing, which is the use of existing reserves and balances to temporarily fund capital expenditure rather than the use of external borrowing.

12. The use of internal borrowing allows the council to minimise unnecessary external borrowing costs, by only borrowing when needed for liquidity, or to benefit from advantageous borrowing rates. Borrowing in advance of need from a cash flow perspective creates a 'cost of carry' which is the difference between the short term investment income earned through holding cash balances compared against longer term external debt financing costs

13. Efficient use of existing council resources to fund capital expenditure through internal borrowing also reduces the council's counterparty risk inherent in the investment of cash balances.

14. **Liability Benchmark**

To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as the forecast balance sheet table above, but that cash and investment balances are kept to a minimum level of £140m at each year-end. This amount includes the Council's strategic investment portfolio of £100m, and a liquidity balance of £40m, to maintain sufficient liquidity.

	2020-21 Actual £m	2021-22 Forecast £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m
Borrowing CFR	**1,129**	**1,263**	**1,698**	**1,914**	**2,026**
Less: Usable reserves	-343	-293	-263	-243	-223
Less: Working capital	-47	-47	-47	-47	-47
Minimum Investment Balance	140	140	140	140	140
Liability Benchmark	**879**	**1,063**	**1,528**	**1,764**	**1,896**

The liability benchmark suggests the Council will require a minimum level of borrowing in 2022-23 of £465m (£1,528m less £1,063m). The actual level of borrowing at year-end depends on whether the Council's spending plans proceed as planned and on the actual timing of borrowing.

15. The extent of internal borrowing and the need to refinance scheduled debt repayments, together with potential for interest rate rises in the current financial year, indicated the need for long-term borrowing. The council therefore borrowed £50m from the Public Works Loans Board (PWLB) in December 2021, with maturity terms ranging from 39 to 41 years at approximately 1.6%.

16. Drawing of long-term borrowing has been supplemented by a continuation of short-term borrowing from other local authorities, to reduce the overall debt interest expense for the council. The level of short-term borrowing from other local authorities as at 31 March 2021 was £197m.

17. This approach to short-term borrowing has continued during 2021-22, with the balance of short-term borrowing from local authorities as at 31 December 2021 being £140m. The weighted average rate of interest on existing short-term borrowing is 0.1%, which is significantly less than long-term rates of borrowing.

18. Officers regularly monitor current and forecast interest rates to determine the appropriateness of the internal and short term borrowing approach, so that the reduction in current borrowing costs from use of internal balances is not offset by higher borrowing costs in the future.

19. The Covid-19 pandemic has had a significant impact on capital programme delivery in 2021-22, deferring spend to future periods. The re-profiling of capital expenditure into future years has allowed the council to defer external borrowing, reducing the interest cost associated with debt financing.

20. With the exception of £7m of long-term debt from the Mayor of London's Energy Efficiency Fund (MEEF), all historical long-term debt for the council has been drawn from the PWLB. Future borrowing could come from a variety of different sources including banks, other financial institutions and local authorities but the PWLB remains the council's preferred lender.

21. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield. The council intends to avoid this activity in order to retain its access to PWLB loans.

22. All borrowing decisions will be made taking into consideration capital and cash flow forecasts, market conditions, interest rate expectations and the associated risks. The council will also utilise the advice of its external treasury advisor - Arlingclose.

23. The council's outstanding debt portfolio, used to fund historical capital expenditure, stood at £688m as at 31 March 2021 with £496m attributable to the HRA and £192m to the general fund.

24. The weighted average rate of interest for the council's debt portfolio is 3.4% as at 31 December 2021, 0.1% less than the rate at 31 March 2021.

Investment Position and Activity

25. The council holds sizable investment balances, representing income received in advance of expenditure plus balances and reserves held. Investments as at 31 December 2021 were £197m (£151m at 31 December 2020).

26. Council resources that are not immediately required for current expenditure are invested in money market instruments in accordance with the MHCLG (now rebranded DLUHC – Department for Levelling Up, Housing & Communities) Guidance on Local Authority Investments and the approved investment strategy. The MHCLG guidance gives priority to security and liquidity and the council's aim is to achieve a yield commensurate with these principles.

27. Council investments are managed both in-house and delegated to two external fund managers: Alliance Bernstein and Aberdeen Standard (formerly Aberdeen Asset Management).

28. The focus for in-house investment is to meet variable near-term cash liquidity requirements, principally using money market funds and other highly secure, liquid financial instruments.

29. Any surplus cash resources not required in the short term to fund council activities is placed with the council's two external fund managers. The fund managers invest for a longer term in UK government gilts, supranational bank bonds, certificates of deposits issued by major banks/ building societies and other financial instruments.

30. The use of fund managers has the advantage of diversification of investment risk, coupled with the services of professional fund managers, which over the longer-term, provides enhanced returns within the council's risk appetite. Although investments can be redeemed from the fund managers at short notice, the intention is to hold them for the medium term. Their performance and suitability in meeting the council's investment objectives are regularly monitored.

31. The distribution of council investments across counterparties by rating and maturity as at 31 December 2021 is set out in the table below:

	AAA		**AA**		**A**		**BBB**		**Total**	
Investment Maturity Profile	**£m**	%	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**
Up to 1 Year	24.8	23.6	17.1	16.3	26.9	25.7	5.8	5.6	74.6	71.2
1 - 2 Years	11.3	10.7	8.4	8.0	3.4	3.2	0.0	0.0	23.1	21.9
2 - 5 Years	3.6	3.4	3.7	3.5	0.0	0.0	0.0	0.0	7.3	6.9
Total	**39.7**	**37.7**	**29.2**	**27.8**	**30.3**	**28.9**	**5.8**	**5.6**	**105.0**	**100.0**

32. The annualised rate of return for council treasury management assets for the first nine months of the financial year was 0.03%. To analyse the treasury management portfolio, the council measures the return against SONIA and one to three year gilt index. For the equivalent period the benchmark index annualised return was -0.23% indicating an outperformance of 0.26%.

33. The rate of investment return generated by the treasury management portfolio is a consequence of the council's prudent, low risk approach to treasury management investing. This is in line with the requirements of the statutory guidance for local government treasury investment issued by MHCLG.

34. The priorities for treasury management investment are, in order of priority, security, liquidity and yield. The objective therefore is to ensure that funds are available to meet council liabilities as they fall due.

35. Our advisors expects Bank Rate to rise to 0.50% in Q1 2022 and then remain there. Risks are initially weighted to the upside, but becoming more balanced over time.

36. It is important that the treasury management strategy is suitably flexible such that the council can take advantage of market opportunities and maintain appropriate asset diversification within the portfolio to best support the council's revenue budget, whilst retaining the overriding objectives of security and liquidity.

37. The 2021-22 investment strategy, agreed by Council Assembly in February 2021 allowed for enhanced flexibility in the implementation of the investment strategy for the council such that there is no requirement to change it further at this time.