**BARNSLEY METROPOLITAN BOROUGH COUNCIL**

**REPORT OF:** **Executive Director – Core Services & Director of Finance (Section 151 Officer)**

**TITLE:** **ANNUAL REPORT ON TREASURY MANAGEMENT ACTIVITIES 2022/23**

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|---|---|
| **REPORT TO:** | **Cabinet** |
| **Date of Meeting** | |
| **Cabinet Member Portfolio** | **Cllr Franklin – Core Services** |
| **Key Decision** | **Yes** |
| **Public or Private** | **Public** |

## Purpose of report

This report reviews the treasury management activities carried out by the Council during 2022/23, in accordance with statutory guidance. The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities on a quarterly basis. This report, therefore, ensures the Council is implementing best practice in accordance with the Code.

In broad terms this report covers:

- The overarching treasury management strategy for 2022/23;
- An economic summary for the year;
- An update on the Council's borrowing and investment activities; and
- The Council's Prudential and Treasury Indicators.

## Council Plan priority

All

## Recommendations

It is recommended that Cabinet:

**1.** Note the latest expectations for interest rates (as outlined at paragraph 2.6);
**2.** Note the activities undertaken during the year to support the Council's borrowing and investment strategies, and;
**3.** Note the Prudential and Treasury Indicators set out in Appendix 1.

## 1. INTRODUCTION

1.1 The Treasury Management Strategy Statement (TMSS) for 2022/23 was approved by full Council on 24 February 2022. It identifies the key risks associated with the Council's borrowing and investment activities and sets out how those risks will be managed.

1.2 The Council operates within a Treasury Framework which facilitates flexibility for treasury strategy. The need to adopt an agile approach to Treasury Management has never been as important following volatility within the economy during the latter part of 2022, namely the rapid increase in interest rates and the rise in the cost of borrowing.

1.3 The current borrowing strategy is to maintain a minimum proportion of fixed rate borrowing to limit the Council's exposure to interest rate risk, whilst managing an appropriate level of internal borrowing in order to reduce the Council's financing costs. As paragraph 2.6 refers, interest rate forecasts are closely monitored by treasury officers to achieve optimum value and manage risk exposure in the long-term in relation to the Authority's external borrowing requirement.

1.4 The current investment strategy seeks to minimise credit risk and maintain a suitable balance of liquid funds to ensure that sufficient cash is available when needed and as such the pursuit of higher investment returns is a secondary objective. Throughout the financial year, officers ensured that the Council's investments remained both secure and liquid.

## 2. PROPOSAL

<u>Economic Summary</u>

**Highlights:**

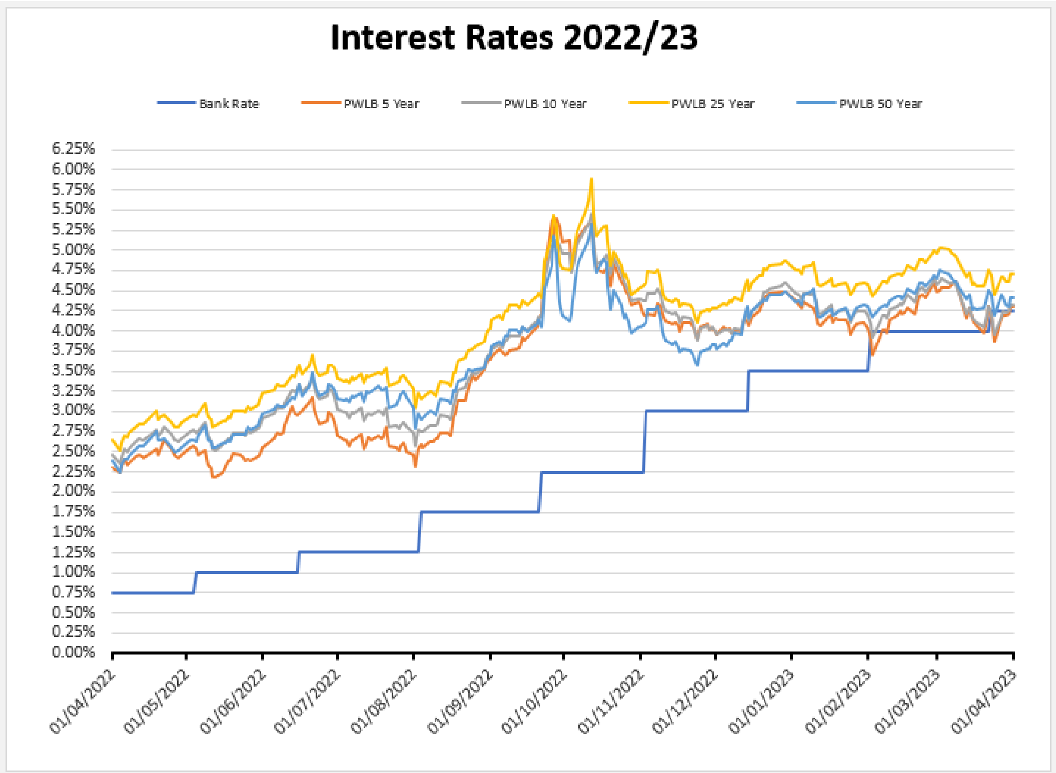
- *The UK Bank rate increased from 0.75% to 4.25% during the year, with consecutive rises throughout the year taking rates to their highest level since autumn 2008;*
- *PWLB borrowing rates during the 2022/23 financial year were volatile, particularly during September 2022 under the Truss/Kwarteng government;*
- *The annual inflation rate in the UK rose to a new 40-year high of 11.1% in October 2022, with the latest forecasts expecting this to fall back to around 4.0% by the end of 2023 (still above the Bank of England's 2.0% target).*

2.1 Starting April 2022 at 0.75%, the UK Bank Rate moved up in stepped increases of either 0.25% or 0.5%, reaching 4.25% by the end of the 2022/23 financial year, with the potential for a further one or two increases forecast in 2023/24.

2.2 The annual inflation rate rose to a high of 11.1% during 2022/23 and while the outlook for inflation has improved significantly, many forecasters remain cautious. The concern is that the bout in inflation, (as a result of the reopening of economies after Covid-19 restrictions followed by commodity issues due to the invasion of Ukraine), has been embedded in inflation expectations and therefore pricing behaviors of firms and wage expectations of employees. The worry is that inflation could remain stubbornly high, due to core inflation (which excludes items such as food and energy) and price rises remaining widespread across the economy due to a relatively tight economic environment. This means that a degree of caution must be used in terms of interest rate forecasts and long-term decision making.

2.3 The economy narrowly avoided contracting in the final quarter of 2022 and entering into a technical recession. However, gas prices remain more than twice their pre-pandemic level which, when added to the stagnation in business investment since 2016, the recent rise in labour market inactivity, and the slowdown in productivity growth since the financial crisis, according to the OBR means that there "remains weak underlying momentum" in the UK economy.

2.4 As illustrated in the graph below, PWLB rates experienced a period of high volatility at the end of September 2022 under the Truss/Kwarteng government. Since then, as a result of confidence returning to financial markets following the appointment of the Sunak/Hunt government, PWLB rates have stabilised during the remainder of the financial year.




2.5 The Council has appointed Link Group as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. The latest view (as at 27th March 2023) is that the Bank of England will increase the Bank Rate to a peak of 4.50%, before falling back to lower levels by 2024/25. As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts.

2.6 Interest rates are a key driver of the Council's treasury management activities and are closely monitored by officers. For comparison purposes, the Council reviews forecasts published by other leading economists (Capital Economics) in addition to those provided by Link Group. The UK Base Rate and PWLB 50 Year Certainty Rate forecasts are shown below and these are closely monitored in order to mitigate the risk of movements which could adversely impact on Council finances.

*Latest Interest Rate Projections (provided by Link Group & Capital Economics as at 27.03.23)*

| | ***Latest*** | **Sep-23** | **Mar-24** | **Sep-24** | **Mar-25** | **Sep-25** | **-26** |
|---|---|---|---|---|---|---|---|
| **UK Base Rate ~ Link Group** | *4.25%* | 4.50% | 4.00% | 3.25% | 2.75% | 2.50% | 2.50% |
| **UK Base Rate ~ Capital Economics** | *4.25%* | 4.50% | 4.25% | 3.50% | - | - | - |
| **PWLB Certainty 50 Years ~ Link Group** | *4.44%* | 4.20% | 3.90% | 3.70% | 3.50% | 3.20% | 3.10% |
| **PWLB Certainty 50 Years ~ Capital Economics** | *4.44%* | 4.00% | 3.70% | 3.60% | - | - | - |

Borrowing Activity

**Highlights:**

- *No new long-term borrowing undertaken during the year;*
- *A closing Capital Financing Requirement (CFR) of £846.0 Million (down £5.7 Million from the original estimate);*
- *An external borrowing requirement of up to £144.8 Million by the end of 2024/25; of which £71.1 Million to be addressed through fixed rate borrowing in order to meet the Council's agreed exposure targets;*
- *Fixed rate borrowing targets to be reviewed throughout the new financial year in line with interest rate forecasts and monitoring of capital expenditure over the planning period.*

2.7 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for capital spend. It represents the 2022/23 unfinanced capital expenditure, and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

2.8 Part of the Council's treasury management activities is to address the funding requirements for this borrowing need. The treasury management service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and daily cash flow requirements. This may be sourced through borrowing from external bodies, or by utilising temporary cash resources within the Council.

2.9 The Council's CFR for the year is shown in the following table and represents a key prudential indicator (refer to Appendix 1 for further details). The Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the

CFR, which is effectively a repayment of the non-HRA borrowing need, and is represented in the table as the 'Amounts set aside to repay debt'. The Council's 2022/23 MRP Policy, (as required by DLUHC Guidance), was approved as part of the TMSS 2022/23 on 24th February 2022.

2.10 In accordance with the approved TMSS 2022/23, the Council's borrowing strategy is to reduce its exposure to interest rate risk, whilst maintaining an under-borrowed* position to keep its financing costs to a minimum. The table below shows the Council's under-borrowed position of £194.5M as at 31st March 2023, and how this compares to the original estimate.

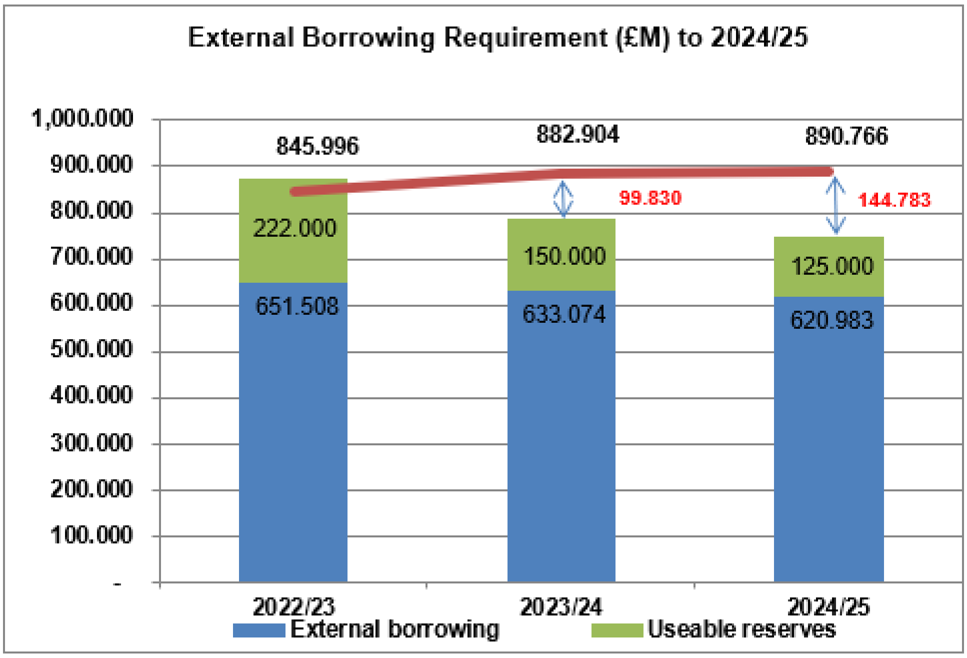
| | 2022/23 Estimate (£M) | 2022/23 Actual (£M) | Variance (£M) |
|---|---|---|---|
| **Opening CFR (exc. PFI Schemes / finance leases**)** | **841.872** | **841.872** | **0.000** |
| Increase from in-year capital investment | 14.606 | 9.335 | (5.271) |
| Amounts set aside to repay debt | (4.832) | (5.211) | (0.379) |
| **Closing CFR (exc. PFI Schemes / finance leases**)** | **851.646** | **845.996** | **(5.650)** |
| External borrowing | (651.508) | (651.508) | 0.000 |
| **Under-borrowed position** | **200.138** | **194.488** | **(5.650)** |

** Refers to the temporary use of internal cash resources (e.g. earmarked reserves or grants received in advance of expenditure) to support its borrowing requirement.*

*** Excluded on the basis that each arrangement contains its own borrowing facility and therefore the Council is not required to borrow separately.*

2.11 There was a £32.7M decrease in total external debt during the year, with the final balance as at 31st March 2023 being £651.5M (£684.2M as at 31/03/22). A breakdown of the net movement in borrowing is provided at Appendix 2. During 2022/23, the Council has followed advice from our Treasury Management Advisors, Link Group, and focused on a policy of internal and temporary borrowing, utilising cash balances and reserves in lieu of long-term external borrowing. This borrowing strategy is being continually reviewed to avoid incurring higher costs in the future when the Authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

2.12 The Council's total borrowing requirement by the end of 2024/25 is in the region of £144.8M, based on capital expenditure and useable reserves estimates as at 31st March 2023. A breakdown of this borrowing requirement has been provided in the table below:




| Projected external borrowing requirement 2023/24 - 2024/25 | £M |
|---|---|
| Planned capital investment | 55.138 |
| Maturing loans / reduced support from useable reserves | 105.418 |
| Amounts set aside to repay debt | (15.773) |
| **Total** | **144.783** |

2.13 In line with the approved TMSS 2022/23, the Council is committed to maintaining its interest rate risk exposure within the current limits set out below. The Director of Finance confirms that the fixed rate exposure target for 2022/23 has been achieved earlier than planned during 2021/22 and this has created significant savings for the Council by taking advantage of low interest rates at that time.

| Interest Rate Risk Exposure | 2022/23 | 2023/24 | 2024/25 |
|---|---|---|---|
| Limit on Variable Rate Borrowing / Unfinanced CFR | 30% | 30% | 30% |

2.14 To deliver against these risk exposure targets, it is anticipated that the Council will need to fix out in the region of £71.1M by the end of 2024/25. The remainder could be funded through temporary borrowing or utilising internal cash resources. This borrowing strategy creates cost certainty for the Council in terms of the Medium-Term Financial Strategy, whilst also allowing flexibility to use the under borrowed position to minimise costs.

2.15 Members are asked to note that the reported position does not currently account for the proposed South Yorkshire Mayoral Combined Authority Gainshare policy which is expected to add significantly to the Council's overall level of borrowing in future, increasing all aspects of our Treasury Management risk. In view of this and the Council's existing debt levels, the advice of the Director of Finance is to undertake prudent and modest additional borrowing to effectively manage the Council's risk exposure, which is essential in the current economic climate of rising interest rates. Updates in relation to the Council's

TM policy and the impact on the capital financing requirement will be provided to Members throughout 2023/24.

2.16 In light of the above requirement, officers continue to monitor rates and assess borrowing options and opportunities as set out in the Council's borrowing strategy:

- **Deferred loans** - the Council may be able to access long-term, fixed rate funding from financial institutions such as banks, insurance companies and pension funds on a deferred drawdown basis. Whilst there is a small premium above PWLB rates, deferred loans help to protect the Council from interest rate risk without the additional cost of carry and credit risk. The Council has already secured £40M of deferred loans and will work with its advisors in order to identify any further potential lenders.
- **Municipal Bonds Agency (MBA)** - the MBA was established in 2014 with the intention of providing an alternative source of funding to the PWLB. The MBA has made two bond issues for Lancashire CC and are aiming to launch a pooled bond issue. Barnsley has been a leading authority in promoting the MBA and has already committed to the next bond issue subject to 'due diligence' tests. The MBA also offer a flexible range of short and long-term loans, and forward loans. Officers are monitoring the situation and any updates on the MBA bond launch will be reported.
- **PWLB borrowing** - The latest forecasts (at paragraph 2.6) show a gradual decline in PWLB rates during the forecast period to March 2025. There is however likely to be unpredictable volatility during this period as detailed in the economic summary section of the report and officers will continue to closely monitor long-term PWLB rates.
- **Local authority loans** - the Council may be able to borrow from other local authorities for periods of up to 5 years, which would provide additional budget certainty over the medium-term whilst providing a saving against current long-term PWLB rates. Opportunities for inter-authority lending have been assessed by treasury officers on an ongoing basis throughout the year.
- **Market loans** - as with deferred loans the Council may be able to access long-term, fixed rate funding from financial institutions on a spot basis (i.e. immediate drawdown). However, this is currently a more expensive option than borrowing from the PWLB, and therefore has not been utilised during 2022/23.

Investment Activity

**Highlights:**

- *Total investment balance of £154.0M as at 31 March 2023;*
- *A net decrease in investment balances of £35.1 Million during the year, primarily due to the repayment of short-term temporary loans;*
- *Investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties;*
- *Security and liquidity remained the key priorities, with the majority of new investments placed in secure Money Market Funds and instant access accounts;*
- *Returns on the Council's investments have improved throughout the financial year, in-line with Bank Rate increases.*

2.17 The TMSS for 2022/23, which includes the Annual Investment Strategy, was approved by the Council in February 2022. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

2.18 The Council aims to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. In the current economic climate, it is considered appropriate to keep investments short-term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach.

2.19 The majority of transactions during the financial year related to short term deposits. However, to maintain sufficient liquidity, an appropriate balance of cash was deposited in the Council's Money Market Funds and instant access accounts (see Appendix 3 for further details). In addition, officers continued to take advantage of the competitive rates offered on short-term local authority deposits.

2.20 The key investment issues managed by the Council during 2022/23 have included:

- **Changing Investment Landscape** - Investment returns picked up throughout the course of 2022/23 as central banks, including the Bank of England, realised that inflationary pressures were ongoing, and that tighter monetary policy was necessary. Improved investment rates required the pro-active investment of the Authority's surplus cash and a detailed working knowledge of cashflow projections in order to maintain an appropriate balance between maintaining cash for liquidity purposes and locking into investment rates to achieve the best value on returns.

- **Economic Climate and Market Volatility** – Following the Government's fiscal event on 23rd September 2022, the rating agencies Standard and Poor's (S&P) and Fitch both placed the UK sovereign rating on Negative Outlook. Whilst this is not necessarily a precursor to a rating downgrade for the country (just a watching brief on the overall Outlook) it does indicate expectations of weaker finances. Financial markets can quickly change in volatile economic times, and it remained critical for treasury officers to undertake continual monitoring of all aspects of risk and return throughout the financial year.

- **Creditworthiness and Investment Security** –The Council continues to take a cautious approach to investing, whilst also recognizing that there have been changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that were introduced following the Financial Crisis in 2008/09. During 2022/23, the Bank of England maintained various monetary policy easing measures to ensure specific markets, the banking system and the economy had appropriate levels of liquidity at times of stress. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions. The Director of Finance confirms that all investments as at 31st March 2023 are placed with low-risk, high credit rated counterparties in accordance with the approved TMSS 2022/23.

- **Local Authority Creditworthiness / Reputation Management** – This remained an ongoing issue for local authorities during 2022/23, particularly in light of the economic climate. Whilst there are no issues foreseen from a credit perspective (there are regulations in place to avoid local authorities going bankrupt), officers recognise the reputational risk associated with such investments and take this into consideration when deciding where to invest the Council's surplus cash. The Council does not invest in Local Authorities with a Section 114 Notice in place.

CIPFA Financial Resilience and Benchmarking

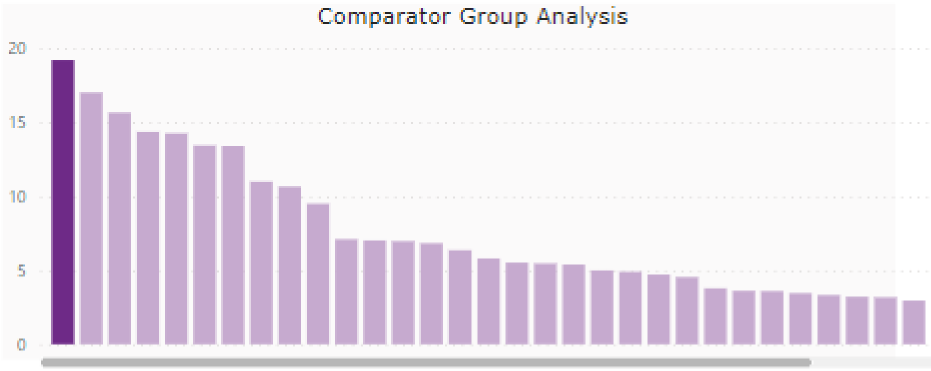
2.21 The Financial Resilience Index has been designed by CIPFA to identify councils displaying consistent and comparable features that highlight good practice, but crucially, also highlight areas that are associated with financial difficulties. The tool allows comparison with other councils with similar characteristics and will support councils in identifying areas of weakness, enabling them to take action to mitigate the risk of financial failure.

2.22 The Council has continued to assess itself against the CIPFA Financial Resilience Index. Whilst there are indices currently indicating high risk (relating to borrowing levels and reserves), the Director of Finance is confident that this risk is manageable via the Council's ongoing reserves, capital investment and treasury management strategies and the Council continues to demonstrate a strong financial grip, holding a robust and stable reserves position with a sound strategy in place to meet the immediate challenges faced by the Council.

2.23 The results below are based on 2021/22 accounts and compare the Council with other Metropolitan Authorities. In comparison to other Metropolitan Authorities, the Council has the highest ratio of interest costs to net revenue expenditure, and this is largely due to a combination of additional capital expenditure on the town centre redevelopment and the interest payable on PFI schemes. Gross debt in 2021/22 was £877.755M and the Council's position is shown in the second graph below.

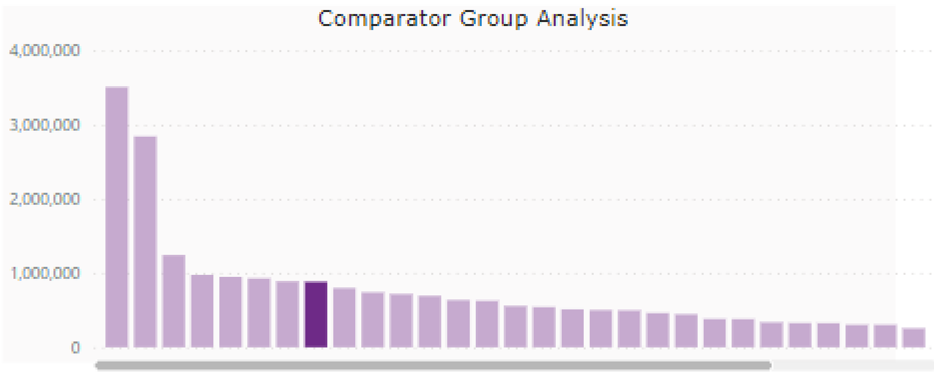
**Interest Payable / Net Revenue Expenditure indicator**

This indicator is the ratio of interest payable and net revenue expenditure; 19.21% in 2021/22.




**Gross External Debt indicator**

This indicator compares the gross external debt held by the Council; £877.755M in 2021/22.




2.24 The Council continues to assess its position in terms of its financial resilience and ability to continue to meet future financial challenges. The Director of Finance recommends that this position be kept under close scrutiny so that the Council's future policy choices are not overly constrained and to ensure that it's long-term financial sustainability is maintained.

<u>Performance Measurement / Compliance with Prudential and Treasury Limits</u>

2.25 The Council's capital financing budget underspent during the year by £2M. The underspend is primarily due to maintaining an appropriate level of internal borrowing and delaying the decision to undertake further external borrowing when interest rates were running at high levels. This underspend is expected to reduce in future years as reserves are utilised and the Council considers further external borrowing when economic conditions are more favourable.

2.26 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the year to 31 March 2023, the Council has operated within the prudential and treasury indicators set out in the agreed TMSS 2022/23. The Director of Finance reports that no difficulties are envisaged for the current or future years in complying with these indicators (see Appendix 1 for more details). All treasury management operations have been conducted in full compliance with the Council's Treasury Management Practices.

Regulatory Framework & Risk Assessment

2.27 The Council has adopted the statutory guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Department for Levelling Up, Housing and Communities (DLUHC), which seeks to ensure that its capital expenditure and borrowing are prudent, affordable and sustainable, and its treasury practices demonstrate a low-risk approach.

2.28 The Council is aware of the risks of passive management of the treasury portfolio and, with the support of its Treasury Management advisers, Link Group, has proactively managed the debt and investments over the past year.

2.29 Treasury Management is subject to annual inspection from the Council's Internal Audit function, and Treasury Management risks are identified and monitored as part of the Council's overall approach to managing risk. The purpose of the audit is to provide assurance that the systems, processes and procedures in respect of Treasury management are robust and operating effectively and efficiently. The latest audit assessment of Treasury Management systems focused on the governance, controls and risk management arrangements in line with the Core Financial Systems Strategy for 2022/23, and a 'substantial' assurance opinion has been provided in relation to the internal control framework.

2.30 Treasury Management activities are also scrutinised as part of the Council's External Auditors annual accounts and VfM opinion process with any recommendations to be included as part of their 2022/23 Annual Reports. As a result, the Council will continue to closely monitor treasury management activities and the associated risks.

2.31 As part of the Council's overall commitment to transformation, the treasury management section has implemented a new and improved IT system during 2022/23, Treasury Live, to make improvements and advancements in how the Council's cash position is organized to ensure that sufficient cash is available to meet capital plans and daily cash flow requirements. Treasury Live has been specifically designed to fully reflect CIPFA's recommended best practice. In the current financial climate, the Treasury Live system enhances the ability to manage financial risks and allows the Council to prudently monitor future cash flows to service and repay current and future borrowings.

## 3. IMPLICATIONS OF THE DECISION

### 3.1 Financial and Risk

The financial and risk implications arising from the treasury management activities for the year are reported to Cabinet separately as part of the Council's revenue outturn report for 2022/23.

### 3.2 Legal

Not applicable.

### 3.3 Equality

Not applicable – Equality Impact Assessments are undertaken for key Treasury Management decisions where appropriate.

### 3.4 Sustainability

Decision-making wheel not completed – where appropriate individual decision-making wheels would be completed for key Treasury Management decisions.

### 3.5 Employee

None arising from this report.

### 3.6 Communications

No specific requirements.

## 4. CONSULTATION

4.1 This report has been prepared in consultation with Link Asset Services and approved by the Treasury Management Panel.

## 5. ALTERNATIVE OPTIONS CONSIDERED

5.1 Not applicable as reporting year-end position.

## 6. REASONS FOR RECOMMENDATIONS

6.1 Recommendations made in-line with the approved Treasury Management Strategy.

## 7. GLOSSARY

Not applicable.

## 8. LIST OF APPENDICES

Appendix 1: Actual Prudential Indicators and Treasury Indicators for 2022/23
Appendix 2: BMBC Borrowing 2022/23
Appendix 3: BMBC Investments 2022/23

## 9. BACKGROUND PAPERS

Various Financial Services working papers.

If you would like to inspect background papers for this report, please email governance@barnsley.gov.uk so that appropriate arrangements can be made.

## 10. REPORT SIGN OFF

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| **Financial consultation & sign off** | Report prepared by Director of Finance |
| **Legal consultation & sign off** | Legal Services officer consulted and date |

**Report Author: Neil Copley**
**Post: Director of Finance**
**Date: 24/04/2023**