BARNSLEY METROPOLITAN BOROUGH COUNCIL

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

TITLE: **ANNUAL REPORT ON TREASURY MANAGEMENT ACTIVITIES 2021/22**

REPORT TO:	**Cabinet**
Date of Meeting	**1 June 2022**
Cabinet Member Portfolio	**Core Services**
Key Decision	**No**
Public or Private	**Public**

Purpose of report

This report reviews the treasury management activities carried out by the Council during 2021/22, in accordance with statutory guidance. In broad terms it covers:

- The overarching treasury management strategy for 2021/22;
- 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

That Cabinet:-

1. Note the latest expectations for interest rates;
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 of the report.

1. INTRODUCTION

1.1 The Treasury Management Strategy for 2021/22 was approved by full Council on 25 February 2021. 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 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, in the interests of budget certainty, the fixed rate borrowing target for 2022/23 was met earlier than planned during 2021/22 due to a combination of falling PWLB borrowing rates and forecast interest rate rises.

1.3 The current investment strategy seeks to 2crutini 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. The focus in 2021/22 has been managing elevated cash levels from continuing disbursement of COVID-19 funds from the Government and also increased cash levels from the loans taken out in line with the borrowing strategy. Throughout the year officers ensured that the Council's short-term investments remained both secure and liquid.

2. PROPOSAL

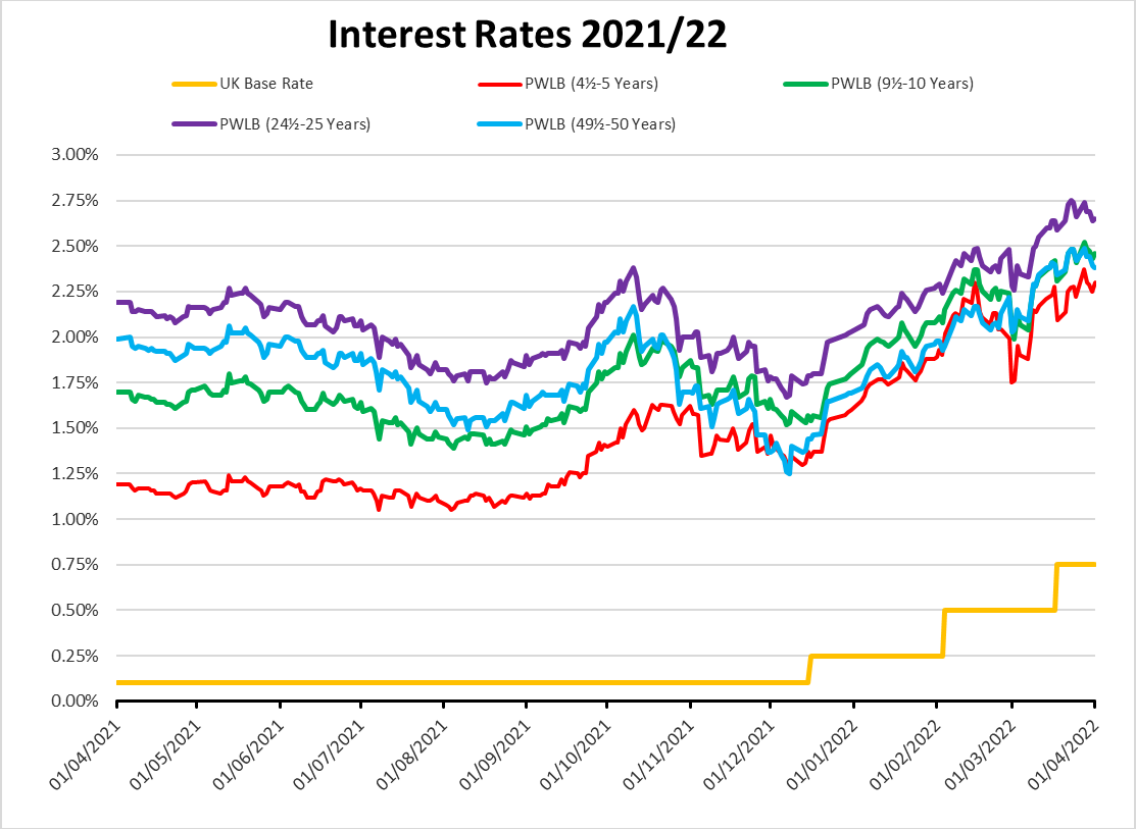
Economic Summary

Highlights:

- *The UK Bank rate increased from 0.10% to 0.75% during the year;*
- *Volatility in PWLB borrowing rates over the financial year, with levels falling to historically low levels in December before rising sharply towards the end of March;*
- *The annual inflation rate in the UK rose to a new 30-year high of 7.0% in March 2022 (up from 6.2% in February 2022) and is expected to rise further in the near term.*

2.1 Interest rates are a key driver of the Council's treasury management activities and as such are closely monitored by officers.

2.2 As illustrated in the graph below, there was a high level of volatility in PWLB rates over the course of the financial year, with rates falling to historically low levels in early December 2021. The latest forecasts are predicting a steady rise in rates to 2024/25 (see 2.3 below).



2.3 After the Bank of England became the first major western central bank to increase interest rates in December, it has quickly followed up its first 0.15% rise by a further two 0.25% rises to 0.75%, in what is very likely to be a series of increases during 2022. The Council's treasury advisors, Link Group, are currently forecasting the following movement in UK Base Rate and the 50 Year PWLB Certainty Rate over the next three years. It is worth noting that other leading economists (Capital Economics) have rates increasing at a faster rate than Link currently predict. The forecasts for the UK Base Rate and PWLB 50 Year Certainty Rate are shown below:

Latest Interest Rate Projections (provided by Link Group & Capital Economics as at 31.03.22)

	Latest	**Sep-22**	**Mar-23**	**Sep-23**	**Mar-24**	**Sep-24**	**Mar-25**
UK Base Rate ~ Link Group	*0.75%*	1.00%	1.25%	1.25%	1.25%	1.25%	1.25%
UK Base Rate ~ Capital Economics	*0.75%*	1.25%	1.50%	2.00%	-	-	-
PWLB Certainty 50 Years ~ Link Group	*2.44%*	2.30%	2.40%	2.40%	2.40%	2.40%	2.40%
PWLB Certainty 50 Years ~ Capital Economics	*2.44%*	2.60%	2.80%	3.00%	-	-	-

2.4 Despite the end of the COVID 19 restrictions from late January, the immediate outlook for the UK economy remains uncertain. With constantly fluctuating prices, inflation running at a 30-year high and the Russian invasion of Ukraine, economies worldwide are finding it difficult to maintain stability. The Bank of

England's strategy has been to increase the UK Base Rate to manage inflation, a trend that is likely to continue for the foreseeable future. Officers will continue to closely monitor interest rate forecasts in order to mitigate the risk of movements which could adversely impact on Council finances.

Borrowing Activity

Highlights:

- *£57.7M new fixed rate PWLB borrowing undertaken during the year;*
- *A closing Capital Financing Requirement (CFR) of £844.7 Million (down £3.6 Million from the original estimate);*
- *An external borrowing requirement of up to £185.1 Million by the end of 2023/24; of which £78.0 Million would need to be addressed through fixed rate borrowing in order to meet the Council's agreed exposure targets;*
- *Next year's fixed rate borrowing target has been increased to 70% in line with the Treasury Management Strategy Statement (TMSS) and performance against the target will be reported throughout the year.*

2.5 As outlined previously (see paragraph 1.2) the Council's borrowing strategy is to actively 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 as at 31st March 2022 and how this compares to the original estimate.

	2021/22 Estimate (£M)	**2021/22 Actual (£M)**	**Variance (£M)**
Opening CFR (exc. PFI Schemes / finance leases)**	**828.377**	**828.377**	**0.000**
Increase from in-year capital investment	24.596	20.916	(3.680)
Amounts set aside to repay debt	(4.647)	(4.548)	0.099
Closing CFR (exc. PFI Schemes / finance leases)**	**848.326**	**844.745**	**(3.581)**
External borrowing	(626.545)	(684.245)	(57.700)
Under-borrowed position	**221.781**	**160.500**	**(61.281)**

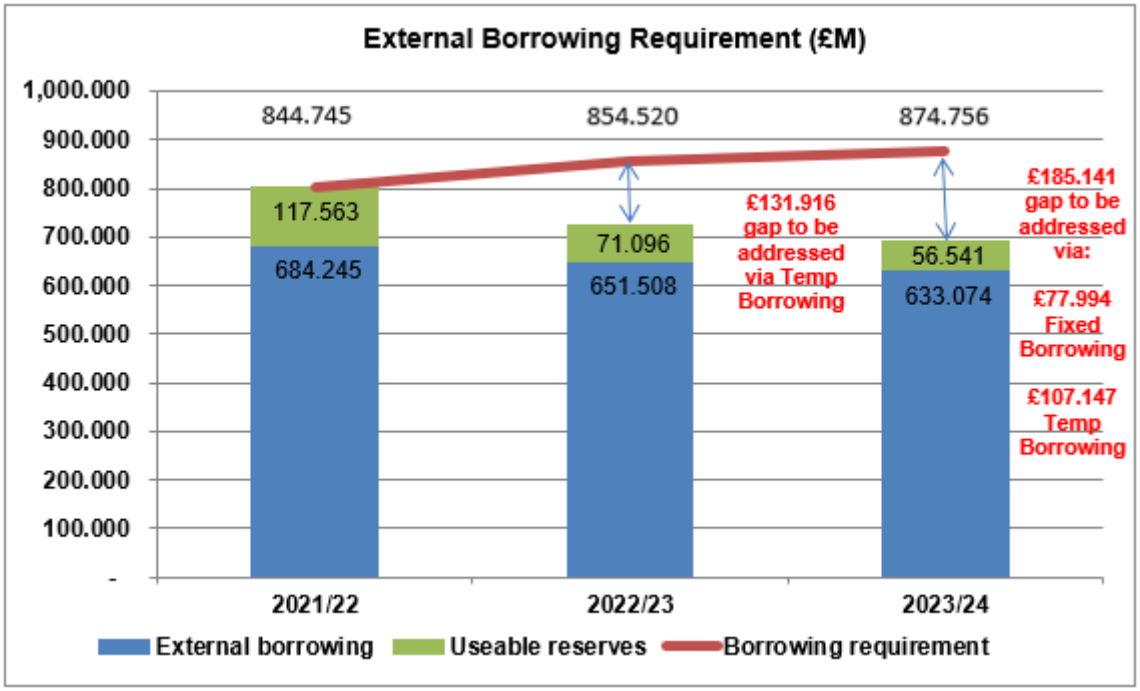
** Refers to the temporary use of internal cash resources (e.g. earmarked reserves or grants received in advance of expenditure) to support its borrowing requirement.*

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

2.6 Although the fixed rate borrowing target for 2021/22 had already been met, due to a combination of falling PWLB borrowing rates and forecast interest rate rises it was decided to fix out the borrowing requirement for 2022/23 early.

2.7 The Council had previously made a successful bid for a discounted 'local infrastructure rate' which secured a 0.2% discount from the existing rate on a loan of £25.3M. An additional £32.4M was borrowed at the PWLB 'certainty rate' and a combination of these loans has enabled the Council to lock into historically low rates and create future budget certainty. The total of these loans (£57.7M) is represented in the table above as the movement in external borrowing. The under-borrowed position (£160.5M) will keep financing costs to a minimum by temporarily using internal cash resources to support the Council's borrowing requirement.

2.8 Having met the fixed rate borrowing targets for 2021/22 and 2022/23 early, based on current capital spend plans it is anticipated that the Council's remaining borrowing requirement will be £185.1M by the end of 2023/24. This is shown in the graph below and consists of £78.0M to be secured through fixed rate borrowing and £107.1M in temporary or variable rate borrowing in accordance with the TMSS interest rate exposure targets:



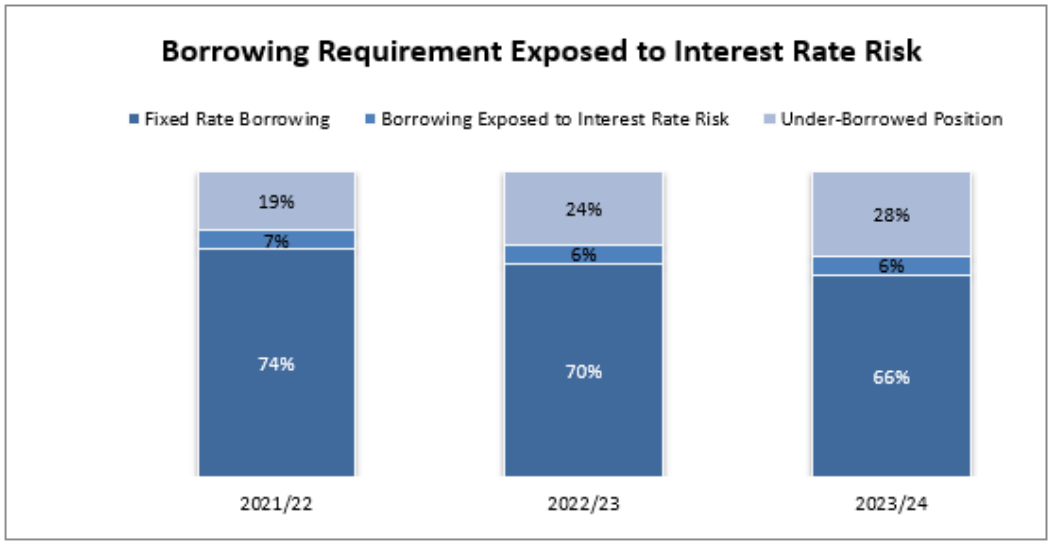
2.9 The Council is committed to maintaining its interest rate risk exposure within the following agreed limits (in line with the Council's Treasury Management Strategy 2021/22):

Projected external borrowing requirement 2022/23 – 2023/24	**£M**
Planned capital investment	45.686
Maturing loans / reduced support from useable reserves	149.311
Amounts set aside to repay debt	(9.856)

Total	185.141

Interest Rate Exposures	2021/22	2022/23	2023/24
Limit on Variable Rate Borrowing / Unfinanced CFR	35%	30%	25%
Fixed Rate Borrowing Target	65%	70%	75%

2.10 As illustrated by the charts below, the Council has delivered to the target levels in 2021/22 and met the 2022/23 exposure target earlier than planned. Should no further fixed rate borrowing be undertaken, the Council's borrowing requirement will be potentially exposed to 34% interest rate risk by the end of 2023/24.



2.11 To achieve the target of 25%, an additional £78.0M of fixed rate borrowing is anticipated over the period to 2023/24. 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 6crutini costs.

2.12 The exposure targets are kept under review and may be updated should the interest rate environment change, or the profile of capital expenditure spend changes. Additionally, the Council's cash levels, will be assessed in the decision to fix out further borrowing, with the aim being to reduce cost of carry and 6crutini investment risk.

2.13 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 Section 151 Officer is to undertake prudent and modest additional borrowing to effectively manage the Council's risk exposure, which in a current economic climate of rising interest rates becomes even more relevant. Updates in relation to the Council's TM

policy and the impact on the capital financing requirement will be provided to Members throughout 2022/23.

2.14 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 they may no longer be cheaper than the PWLB, 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** – following the reduction in lending margin, the Council has access to long-term PWLB funding at rates in the region of 2.2% to 2.5%. The latest forecasts (at paragraph 2.3) show a steady, but slow, rise in PWLB rates during the forecast period to March 2025. There is likely to be unpredictable volatility during this period as detailed in the economic summary section of the report. 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.

- **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 now likely to be more expensive than the PWLB, therefore is not one of the preferred options at present.

Investment Activity

Highlights:

- *Total investment balance of £189.0M as at 31 March 2022;*
- *A net increase in investment balances of £74.0 Million during the year, primarily as a result of the new loans (£57.7 Million) detailed in the Borrowing Activity section;*
- *Security and liquidity remained the key priorities, with the majority of new investments placed in secure Money Market Funds and instant access accounts;*
- *Investment rates have improved during Quarter 4 of 2021/22 and are expected to improve further, in-line with Bank Rate forecast increases over the next two years.*

2.15 The Treasury Management Strategy Statement (TMSS) for 2021/22, which includes the Annual Investment Strategy, was approved by the Council in February 2021. 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

2.16 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.

2.17 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 2 for further details).

2.18 The key investment issues managed by the Council during 2021/22 have included:

- **Short-Term Investments** – the Council continued to invest funds on an overnight basis in order to meet day to day spending commitments and fluctuating cashflows. Investment returns reduced as a result of this approach, but it helped to reduce the risk of unplanned temporary borrowing (which would have been at an additional cost). As cashflows 8crutinize during the year, officers invested more funds in 3-to-12-month deposits (in line with the 2021/22 Treasury Management Strategy counterparty limits) achieving a slightly higher yield.

- **Local Authority Creditworthiness / Reputation Management** – this remained an ongoing issue throughout the year, particularly in light of the COVID 19 crisis. Whilst there are no issues foreseen from a credit perspective (there are regulations in place to avoid local authorities going bankrupt), officers 9crutiniz the reputational risk associated with such investments and this was taken into consideration when deciding where to invest the Council's surplus cash. Due to reputation management, the Council does not invest in Local Authorities where a Section 114 Notice has been issued even though they are not considered to be a serious credit risk.

  In May 2021 the Council entered into an advance agreement with Slough Borough Council to invest £4M commencing from September 2021, and in July 2021 Slough Borough Council issued a section 114 notice. The Council cannot exit the current transaction which will be in place until September 2022, but no further investments will be placed with Slough Borough Council at this time. Members are advised that this situation will be monitored, and the risk of funds not being returned is deemed to be extremely low.

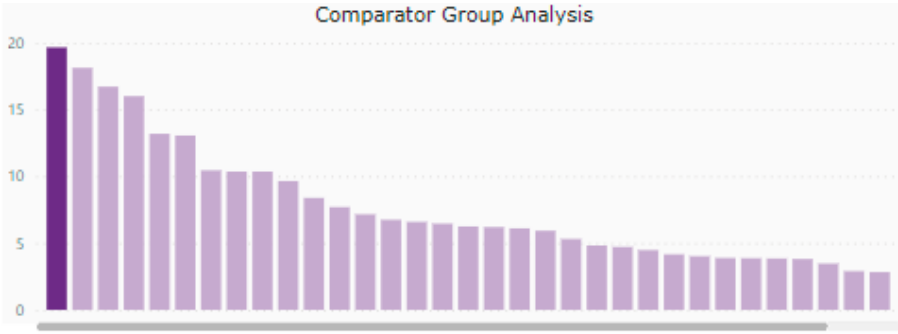
<u>CIPFA Financial Resilience and Benchmarking</u>

2.19 As part of the 2019-2021 Medium Term Financial Strategy, the S151 Officer presented a paper highlighting the Council's position in terms of its financial resilience and ability to continue to meet future financial challenges.

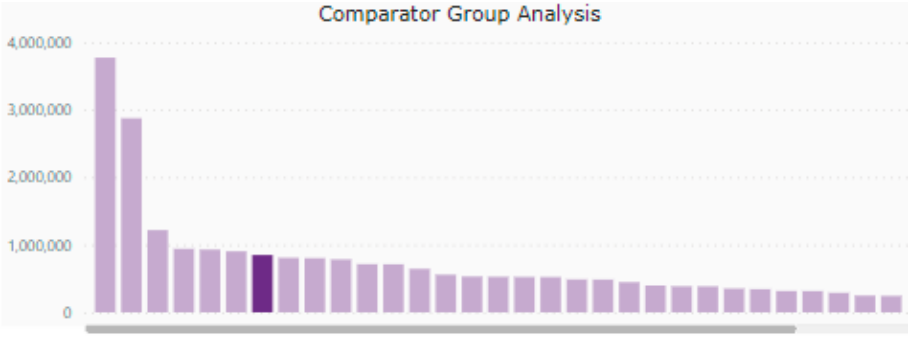
2.20 This paper demonstrated that, whilst there were some concerns over the Council's relatively high debt levels and financing costs as compared to others, the Council continues to demonstrate a strong financial grip, holding a robust and stable reserves position with a sound strategy in place to meet the immediate challenges faced by the Council.

2.21 The results below are based on 2020/21 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 2020/21 was £849.127M 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; 19.66% in 2020/21.



Gross External Debt indicator
This indicator compares the gross external debt held by the Council; £849.127M in 2020/21.



2.22 The Section 151 Officer 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.

Performance Measurement / Compliance with Prudential and Treasury Limits

2.23 Whilst the Council's capital financing budget underspent during the year, the final outturn was impacted by the late rise in interest rates in the final quarter of the financial year. Although not as large as initially forecast, the underspend is primarily due to maintaining an appropriate level of internal borrowing. The impact of rising interest rates on the Council's capital financing budget has been mitigated as a result of the strategy to fix out borrowing earlier than planned and by securing £57.7M in PWLB loans at historically low rates as detailed at paragraph 2.7. This underspend is expected to reduce in future years as reserves are 11crutini and the Council considers further external borrowing.

2.24 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the year to 31 March 2022, the Council has operated with the prudential and treasury indicators set out in the agreed Treasury Management Strategy Statement for 2021/22, subject to the comments at 2.13 and 2.22. The Service Director 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

2.25 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.

2.26 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.

2.27 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 current assessment of Treasury Management systems is 'reasonable', with no outstanding recommendations.

2.28 Treasury Management activities are also 11crutinized as part of the Council's External Auditors annual accounts and VfM opinion process with any recommendations to be included as part of their 2021/22 Annual Reports. As a result the Council will continue to closely monitor treasury management activities and the associated risks.

3. IMPLICATIONS OF THE DECISION

3.1 Financial and Risk

The financial and risk implications arising from the treasury management activities for the year (paragraph 2.23 refers) are reported to Cabinet separately as part of the Council's revenue outturn report for 2021/22.

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 2021/22
Appendix 2: BMBC Borrowing 2021/22
Appendix 3: BMBC Investments 2021/22

9. BACKGROUND PAPERS

Service and Financial Planning 2021/22 – The Council's Medium Term Financial Strategy – 2021/22 Budget recommendations (Cab.10.2.2021/6 refers).

10. REPORT SIGN OFF

Financial consultation & sign off	Report prepared by Service Director Finance

Report Author: Neil Copley
Post: Service Director Finance
Date: 18/05/2022