	Cabinet 17 January 2022
	Report from the Director of Finance
Treasury Management Mid-Year Report 2021-22	

Wards Affected:	All
Key or Non-Key Decision:	Non-key
Open or Part/Fully Exempt: (If exempt, please highlight relevant paragraph of Part 1, Schedule 12A of 1972 Local Government Act)	Open
No. of Appendices:	One Appendix 1: Treasury Management Indicators
Background Papers:	None
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1.0 Purpose of the Report

1.1 This report updates Members on treasury activity for the first half of the financial year 2021-22.

2.0 Recommendation(s)

2.1 Cabinet is asked to note the 2021-22 Mid-Year Treasury report and ask that it be forwarded to Council, in compliance with CIPFA's Code of Practice on Treasury Management (the Code).

3.0 Detail

Background

- 3.1 The Council's Treasury Management Strategy is underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year.
- 3.2 The Code also recommends that Members be informed of Treasury Management activities at least twice a year. This update report therefore ensures this authority is embracing best practice in accordance with CIPFA's recommendations.
- 3.3 Treasury Management is defined as: "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."
- 3.4 In addition to reporting on risk management, the Code requires the Council to report on any financial instruments entered into to manage treasury risks.

Economic Background

- 3.5 The economic recovery from coronavirus pandemic continued to dominate the first half of the financial year. By the end of the period over 48 million people in the UK had received their first dose of a COVID-19 vaccine and almost 45 million their second dose.
- 3.6 The Bank of England (BoE) maintained Bank Rate at 0.1% and its Quantitative Easing programme at £895 billion. In its September 2021 policy announcement, the BoE noted it now expected the UK economy to grow at a slower pace than was predicted in August, as the pace of the global recovery had shown signs of slowing and there were concerns inflationary pressures may be more persistent.
- 3.7 Bank expectations for GDP growth for the third (calendar) quarter were revised down to 2.1% (from 2.9%), in part reflecting tighter supply conditions. The path of CPI inflation is now expected to rise slightly above 4% in the last three months of 2021, due to higher energy prices and core goods inflation.
- 3.8 Government initiatives continued to support the economy through the first half of the financial year but came to an end on 30th September 2021, with businesses required to either take back the 1.6 million workers on the furlough scheme or make them redundant.
- 3.9 In the three months to July, the unemployment rate fell to 4.6%. The employment rate increased, and economic activity rates decreased, suggesting an improving labour market picture. Latest data showed growth in average total pay (including bonuses) and regular pay (excluding bonuses) among employees was 8.3% and 6.3% respectively over the period. However, part of

the robust growth figures is due to a base effect from a decline in average pay in the spring of last year associated with the furlough scheme.

- 3.10 Annual CPI inflation rose to 3.2% in August, exceeding expectations for 2.9%, with the largest upward contribution coming from restaurants and hotels. The Bank of England now expects inflation to exceed 4% by the end of the calendar year owing largely to developments in energy and goods prices. The Office of National Statistics' (ONS') preferred measure of CPIH which includes owner-occupied housing was 3.0% year/year, marginally higher than expectations for 2.7%.
- 3.11 The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% but announced a change to its inflation-targeting regime. The European Central Bank maintained its base rate at 0% and deposit rate at -0.5%.
- 3.12 The 5-year UK benchmark gilt yield began the financial year at 0.36% before declining to 0.33% by the end of June 2021 and then climbing to 0.64% on 30th September. Over the same period the 10 year gilt yield fell from 0.80% to 0.71% before rising to 1.03% and the 20-year yield declined from 1.31% to 1.21% and then increased to 1.37%.
- 3.13 The movement in standard rates at which local authorities can borrow from the Public Works Loans Board (PWLB) on maturity loans is shown in the table below including the highest and lowest rates during the period.

PWLB Rates %

Period	Mar-21	Jun-21	Sep-21	Period Low	Period High
1 year	0.98	1.03	1.10	0.95	1.18
5 year	1.36	1.38	1.43	1.25	1.62
10 year	1.85	1.86	1.80	1.59	2.01
20 Year	2.29	2.28	2.15	1.93	2.44
30 year	2.33	2.30	2.14	1.92	2.46

Debt Management

- 3.14 Local authorities can borrow from the PWLB provided they can confirm they are not planning to purchase 'investment assets primarily for yield' in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 Officer. Councils that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing. The Council is not planning to purchase any investment assets primarily for yield within the next three years and so is able fully access the PWLB.
- 3.15 Competitive market alternatives may be available for Councils with or without access to the PWLB. However, the financial strength of the individual Council

and borrowing purpose will be scrutinised by commercial lenders. Further changes to the CIPFA Prudential Code expected in December 2021 are likely to prohibit borrowing for the primary purpose of commercial return even where the source of borrowing is not the PWLB.

- 3.16 The settlement time for a PWLB loan has been extended from two working days (T+2) to five working days (T+5). In a move to protect the PWLB against negative interest rates, the minimum interest rate for PWLB loans has also been set at 0.01% and the interest charged on late repayments will be the higher of Bank of England Base Rate or 0.1%.
- 3.17 The Infrastructure Bank which is wholly owned and backed by HM Treasury has earmarked £4bn for lending to local authorities. The availability of this lending, for which there will be a bidding process, is yet to commence. Loans will be available for qualifying projects at gilt yields plus 0.6%, which is 0.2% lower than the PWLB certainty rate
- 3.18 The Municipal Bonds Agency (MBA) is working to deliver a new short-term loan solution, available in the first instance to principal local authorities in England, allowing them access to short-dated, low rate, flexible debt. The minimum loan size is expected to be £25 million. Importantly, local authorities will borrow in their own name and will not cross guarantee any other authorities.

The table below demonstrates no new long term loans have been raised so far this year:

	Balance on 01/04/2021	Debt repaid*	New Borrowing	Balance on 30/09/2021
	£m	£m	£m	£m
Short Term Borrowing	117.0	70.0	10.0	57.0
Long Term Borrowing	542.1	6.6	0.0	535.5
TOTAL BORROWING	659.1	76.6	10.0	592.5
Average Rate of Borrowing %	3.3%	0.3%	0.3%	3.6%

** £91.1m of the PWLB loans are referred to as EIP, whereby the Councils pays down the loans in half-yearly equal installments over the lifetime of the loan. The marginal increase in the average interest rate can be attributed to the Council paying back its EIP loans and short-term borrowing. This is because the EIP loans have a much lower average interest rate of 1.79% and the short-term borrowing had an average interest rate of 0.20% compared with the rest of the debt, which is 5.13%.*

- 3.19 The Council's main objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.
- 3.20 In keeping with these objectives, new external borrowing was kept to a minimum of £10m to meet cash flow requirements. This strategy enabled the Council to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. With short-term interest rates remaining much

lower than long-term rates and temporary investments earning Bank Rate or lower, the Council considered it more cost effective in the near term to use internal resources and borrowing short-term loans to manage cash flow.

- 3.21 The Council has an increasing Capital Financing Requirement due to the elements of the capital programme funded by borrowing. An estimated borrowing requirement is determined by the liability benchmark, which takes into account the Council's usable reserves, planned capital expenditure and minimum revenue provision. This has shown that further borrowing of £60m will be required during 2021/22.
- 3.22 PWLB funding margins have remained relatively low in the first half of 21/22, there has been no evidence that lower rates can be achieved through alternative sources of funding. Given the low rates of borrowing, the Council will also consider forward funded deals in order to secure low rates. The Council will continue to monitor alternative sources of funding and pursue the lower cost solutions and opportunities as they arise. The Council will evaluate and pursue these lower cost solutions and opportunities as they arise and will look to take advantage of the low borrowing rates for the HRA to provide certainty for its business plan.
- 3.23 The persistence of low interest rates (see para 3.13) means that it would be uneconomic to reschedule PWLB debt, because early repayment of the loan would incur a heavy penalty, to compensate the PWLB for having to lend the money on at lower rates. The cost of re-financing our loans under the Government's approach means is not economical however, this analysis might change if interest rates returned to higher levels.
- 3.24 The Authority continues to hold £70.5m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during the quarter.

Treasury Investment Activity

- 3.25 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Council's investment balances ranged between £152.9m and £42.5m due to timing differences between income and expenditure.
- 3.26 Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.
- 3.27 The Council's investment position is shown in the table below.

	Balance on 01/04/2021	Investments Repaid	Investments Made	Balance on 30/09/2021
	£m	£m	£m	£m
Debt Management Account Deposit Facility	0.0	0.0	0.0	0.0
Money Market Funds	82.7	331.3	314.3	65.7
TOTAL INVESTMENTS	82.7	331.3	314.3	65.7
Average Rate of Investments	0.01%	0.01%	0.02%	0.02%

- 3.28 The Council held most of its cash in Money Market Funds. The return on Money Market Funds net of fees also fell over the six months and for many funds net returns range between 0% and 0.3%. In many instances, the fund management companies have temporarily lowered or waived fees to maintain a positive net return.
- 3.29 On 30th September the overnight deposit rates on Debt Management Account Deposit Facility (DMADF) deposits dropped below zero percent to -0.015% due to a fall in the Q3 Gilt markets. The rate was 0.01% for all other longer maturities. All rates returned to 0.01% the following day. The Council did not incur any negative interest rate during the first half of 2021/22.
- 3.30 The inter-local authority market has remained above zero throughout the first half of the year but rates have remained extremely low. There is limited availability for investments with local authorities for less than one-month so the Council utilised money market funds to manage these short-term differences between income and expenditure.
- 3.31 There was a £17m downward movement in short-term investments as short-term borrowing matured throughout the first half of the year. Investment balances are expected to remain low over the next 6 months as the Council's internal resources have been utilised and new borrowing is required. The Council is reviewing its borrowing options which may include short-term loans, PWLB borrowing and forward borrowing.
- 3.32 Security of capital has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2021/22. In accordance with the policy, new investments can be made with the following classes of institutions:
- A+ or above rated banks;
 - AAA rated Money Market Funds;
 - Other Local Authorities;
 - Housing Associations;
 - UK Debt Management Office;
 - Corporate Bonds
 - Collective Investment Schemes (Pooled Funds)
 - Real Estate Investment Trusts

A short summary of the investment products available to the council along with an indication of relative risk is provided below:

3.33 The table below shows the different assets classes available to the council for its investment portfolio together with the major driver of the return and a summary of the key risks for each asset class.

Asset Classes (approx. return)	Cash (0.3%)	Bonds (1.0%)	Equities (4.0%)	Property (3.25%)
Income driven by	Short term interest rates	Medium term interest rates	Dividends / share prices	Rental income / vacancies
Key Risk(s)	Bank defaults	Company defaults	Company performance and perception of future performance	Property prices, least liquid asset class

3.34 Detailed consideration of the other asset classes would need to be undertaken by the Council prior to investment in conjunction with its treasury advisors. However, investments in Equities and Property classes tend to be considered over a longer time frame, which are not currently suitable for the Council given its significant capital spending plans.

Risks

3.35 Regardless of the approach taken, the Council will be required to manage significant risks in relation to its treasury investment portfolio. Some key risks are: -

- Liquidity risk - that is the council having funds tied up in long-term investments when it needs to use that money. Increasing the duration of fixed cash deposits increases liquidity risk, however this can be mitigated through good cash flow management.

Mitigation – see Prudential Indicator 2 – Appendix 1

- Credit risk - the risk that a bank or other institution will not be able to pay back the money invested with it. For longer term investments, the council is more exposed to credit risk. Should a counterparty's credit worthiness change, the council may not be able to get all their money back or may face heavy penalties if it can do so.

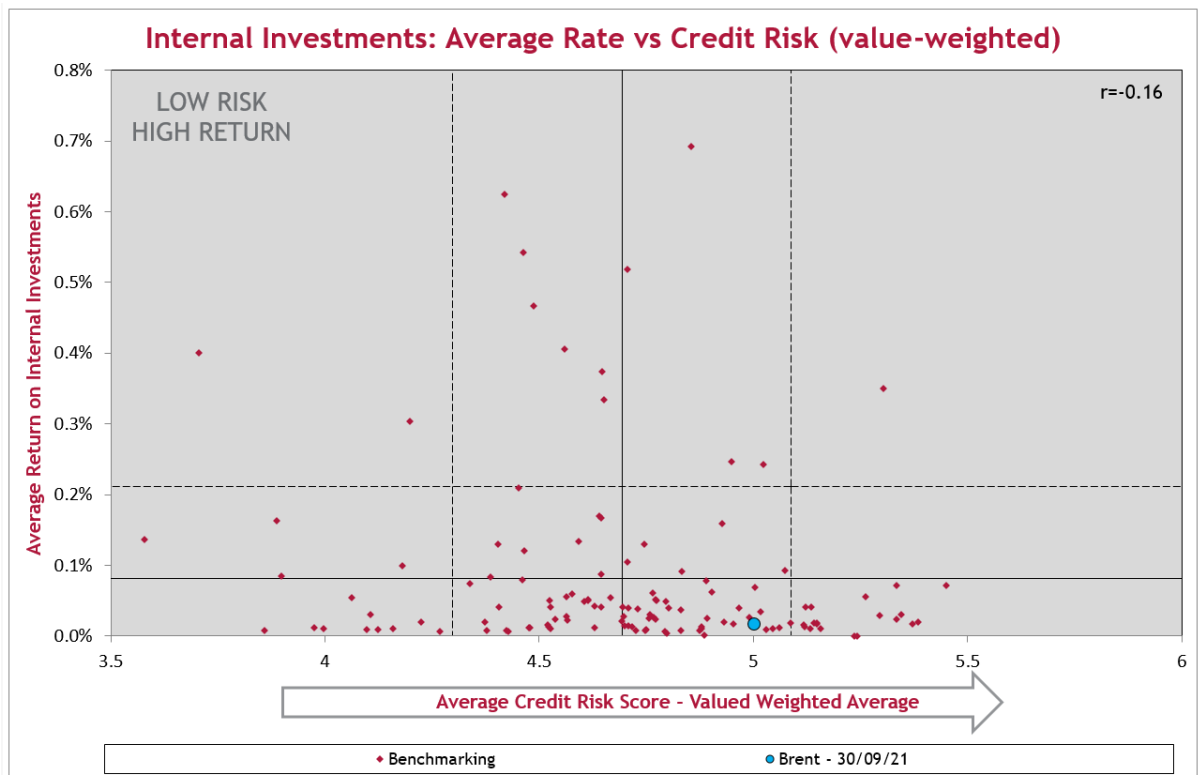
Mitigation – see Prudential Indicator 1 – Appendix 1

- Interest rate risk – the risk of the council's budget being affected by unforeseen changes in interest rates. Longer term cash deposits increase this risk and will negatively affect the council should interest rates rise. On the other hand, the council may benefit should interest rates fall.

Mitigation – see prudential Indicator 3 – Appendix 1

Benchmarking to other councils

- 3.36 The graph below shows a comparison between Brent's investment portfolio and that of Arlingclose's (the Council's treasury advisor) other Local Authority clients. Brent's portfolio has a very low risk profile compared with many of the others and has a much shorter dated, which also equates to a lower yield. However, many authorities are to the left of Brent, obtaining similar yields for much higher risk.



- 3.37 A credit rating of 4 is equivalent to credit score of AA-. The Council has a target rating of A which is a rating of 6. The current portfolio has a credit rating of A+ (Credit score 5) which exceeds our target rating.

Budgeted Income And Outturn

- 3.38 The Council's external interest budget for the year is £23.6m, and for investment income is £6.6m. The average cash balances, representing the Council's reserves and working balances, were £107m during the period to 30 September 2021. The Council expects to receive significantly lower income from its cash and short-dated money market investments than it did in 2020/21 and earlier years due to the low interest rate environment and the immediate cash requirements, which only allow for short-term investments. Dividends and income paid will ultimately depend on many factors including but not limited to the duration of COVID-19 and the extent of its economic impact.

Compliance

- 3.39 Officers confirm that they have complied with its Treasury Management Indicators for 2021/22, which were set in February 2021 as part of the Council's Treasury Management Strategy Statement (TMSS). Details can be found in Appendix 1.

Summary

- 3.40 In compliance with the requirements of the CIPFA Code of Practice, this report provides Members with a summary report of the treasury management activity during the first half of 2021/22. As indicated in this report, none of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

4.0 Financial Implications

- 4.1 These are covered throughout the report.

5.0 Legal Implications

- 5.1 There are no direct legal implications.

6.0 Equality Implications

- 6.1 No direct implications.

7.0 Consultation with Ward Members and Stakeholders

- 7.1 None.

8.0 Human Resources/Property Implications

- 8.1 No direct implications.

Related Document:

Treasury Management Strategy – Report to Full Council as part of the Budget Report – February 2021.

Report sign off:

Minesh Patel
Director of Finance