Brent	**Full Council** 21 September 2022
	Report from the Corporate Director Finance & Resources

Treasury Management Outturn Report 2021/22

Wards Affected:	All
Key or Non-Key Decision:	Key Decision
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:	Three Appendix 1: Debt and Investment Portfolio Appendix 2: Prudential Indicators Appendix 3: Internal Investments – Average Rate vs Credit Risk
Background Papers:	2021/22 Treasury Management Strategy Report to Council – 22 February 2021
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1.0 Introduction

1.1 This report updates members on Treasury Management activity and confirms that the Council has complied with its Prudential Indicators for 2021/22.

2.0 Recommendations

2.1 Council is asked to note and approve, following its consideration by Audit & Standards Advisory Committee on 7 June 2022 and Cabinet on 18 July 2022 the 2021/22 Treasury Management outturn report, in compliance with CIPFA's Code of Practice on Treasury Management (the Code).

2.2 Council is asked to note that for 2021/22 the Council has complied with its Prudential Indicators which were approved by Full Council on 22 February 2021 as part of the Council's Treasury Management Strategy Statement and Capital Strategy Statement.

3.0 Background

3.1 The Council's treasury management activity is underpinned by the CIPFA Code, which requires authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year.

3.2 The Council has borrowed money over the long term to support investment in the Council's infrastructure and also invests cash balances held for short periods. It is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are central to the Council's treasury management strategy.

3.3 Treasury risk management at the Council is conducted 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 and, as a minimum, a semi-annual and annual treasury outturn report.

3.4 The Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 22 February 2021.

4.0 Economic Background

4.1 The continuing economic recovery from coronavirus pandemic, together with the war in Ukraine, higher inflation, and higher interest rates were major issues over the period.

4.2 The Bank of England's base rate was 0.1% at the beginning of the reporting period. April and May 2021 saw the economy gathering momentum as the pandemic restrictions were eased. Despite the improving outlook, market expectations were that the Bank of England would delay rate rises until 2022. Rising, persistent inflation changed that.

4.3 UK CPI inflation was 0.7% in March 2021 but thereafter began to steadily increase. Initially driven by energy price effects and by inflation in sectors such as retail and hospitality which were re-opening after the pandemic lockdowns, inflation then was believed to be temporary. Thereafter price rises slowly became more widespread, as a combination of rising global costs and strong demand was exacerbated by supply shortages and transport dislocations. The surge in wholesale gas and electricity prices led to elevated inflation expectations. CPI for February 2022 registered 6.2% year on year, up from 5.5% in the previous month and the highest reading in the National Statistic series. Core inflation, which excludes the more volatile components, rose to 5.2% year on year from 4.4%.

4.4 The government's jobs furlough scheme insulated the labour market from the worst effects of the pandemic. The labour market began to tighten and demand for workers grew strongly as employers found it increasingly difficult to find workers to fill vacant jobs. Having peaked at 5.2% in December 2020, unemployment continued to fall and the most recent labour market data for the three months to January 2022 showed the unemployment rate at 3.9% while the employment rate rose to 75.6%. Headline 3-month average annual growth rate for wages were 4.8% for total pay and 3.8% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 0.1% while regular pay fell by 1.0%.

4.5 With the fading of lockdown – and, briefly, the 'pingdemic' – restraints, activity in consumer-facing sectors improved substantially as did sectors such as oil and mining with the reopening of oil rigs but materials shortages and the reduction in the real spending power of households and businesses dampened some of the growth momentum. Gross domestic product (GDP) grew by an upwardly revised 1.3% in the fourth calendar quarter of 2021 according to the final estimate (initial estimate 1.0%) and took UK GDP to just 0.1% below where it was before the pandemic. The annual growth rate was revised down slightly to 7.4% (from 7.5%) following a revised 9.3% fall in 2020.

4.6 Having increased Bank Rate from 0.10% to 0.25% in December, the Bank of England have steadily increased rates in 2022, to 0.50% in February,0.75% in March, 1.0% in May and 1.25% in June. Further information on inflation and interest rate expectations and the impact on the Council are set out in the Medium Term Financial Outlook report also on this agenda. At the meeting in February, the Monetary Policy Committee (MPC) voted unanimously to start reducing the stock of its asset purchase scheme by ceasing to reinvest the proceeds from maturing bonds as well as starting a programme of selling its corporate bonds.

4.7 In its March interest rate announcement, the MPC noted that the invasion of Ukraine had caused further large increases in energy and other commodity prices, with the expectation that the conflict will worsen supply chain disruptions around the world and push CPI inflation to around 8% later in 2022, even higher than forecast only a month before in the February Monetary Policy Report. The Committee also noted that although GDP in January was stronger than expected with business confidence holding up and the labour market remaining robust, consumer confidence had fallen due to the squeeze in real household incomes.

4.8 GDP growth in the euro zone increased by 0.3% in calendar Q4 2021 following a gain of 2.3% in the third quarter and 2.2% in the second. Headline inflation remains high, with CPI registering a record 7.5% year-on-year in March, the ninth successive month of rising inflation. Core CPI inflation was 3.0% y/y in March, was well above the European Central Bank's target of 'below, but close to 2%', putting further pressure on its long-term stance of holding its main interest rate of 0%.

4.9 The US economy expanded at a downwardly revised annualised rate of 6.9% in Q4 2021, a sharp in increase from a gain of 2.3% in the previous quarter. In its March 2022 interest rate announcement, the Federal Reserve raised the Fed Funds rate to between 0.25% and 0.50% and outlined further increases should be expected in the coming months. The Fed also repeated it plan to reduce its asset purchase programme which could start by May 2022.

4.10 The conflict in Ukraine added further volatility to the already uncertain inflation and interest rate outlook over the period. The Dow Jones started to decline in January but remained above its pre-pandemic level by the end of the period while the FTSE 250 and FTSE 100 also fell and ended the quarter below their pre-March 2020 levels.

4.11 Bond yields were similarly volatile as the tension between higher inflation and flight to quality from the war pushed and pulled yields, but with a general upward trend from higher interest rates dominating as yields generally climbed.

4.12 The 5-year UK benchmark gilt yield began the quarter at 0.82% before rising to 1.41%. Over the same period the 10 year gilt yield rose from 0.97% to 1.61% and the 20-year yield from 1.20% to 1.82%.

4.13 The Sterling Overnight Rate (SONIA) averaged 0.39% over the quarter.

5.0 Revised CIPFA code and PWLB Lending guidance

5.1 In August 2021 HM Treasury significantly revised guidance for the PWLB lending facility with more detail and 12 examples of permitted and prohibited use of PWLB loans. Authorities 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. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

5.2 CIPFA published its revised Prudential Code for Capital Finance and Treasury Management Code on 20th December 2021. The key changes in the two codes are around permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments.

5.3 The principles of the Prudential Code took immediate effect although local authorities could defer introducing the revised reporting requirements until the 2023/24 financial year if they wish. The Council has chosen to delay introducing the revised reporting requirements until the 2023/24 financial year.

5.4 To comply with the Prudential Code, authorities must not borrow to invest primarily for financial return. This Code also states that it is not prudent for local authorities to make investment or spending decision that will increase the CFR unless directly and primarily related to the functions of the Council. Existing commercial investments are not required to be sold; however, authorities with existing commercial investments who expect to need to borrow should review the options for exiting these investments.

5.5 Borrowing is permitted for cashflow management, interest rate risk management, to refinance current borrowing and to adjust levels of internal borrowing. Borrowing to refinance capital expenditure primarily related to the delivery of a local Council's function but where a financial return is also expected is allowed, provided that financial return is not the primary reason for the expenditure. The changes align the CIPFA Prudential Code with the PWLB lending rules.

5.6 Unlike the Prudential Code, there is no mention of the date of initial application in the Treasury Management Code. The TM Code now includes extensive additional requirements for service and commercial investments, far beyond those in the 2017 version.

5.7 The Council will follow the same process as the Prudential Code, i.e. delaying changes in reporting requirements to the 2023/24 financial year.

6.0 Local Context

6.1 On 31st March 2022, the Council had total borrowing of £684.6m arising from its revenue and capital income and expenditure. The Council's 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. These factors are summarised in Table 1 below.

Table 1: CFR and Borrowing Summary

Table 1: Balance Sheet Summary

	31.3.22 Actual £m
General Fund CFR	730.2
HRA CFR	269.4
Total CFR	**999.6**
*Other debt liabilities	25.6
Borrowing CFR	**1,025.2**
External borrowing	684.6
Internal (over) borrowing	
Less: Usable reserves	(384.0)
Less: Working capital	(202.0)
Investments (or new borrowing)	**98.6**

* finance leases, PFI liabilities and transferred debt that form part of the Council's total debt

6.2 Lower official interest rates have lowered the cost of short-term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing. The Council pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

6.3 The treasury management position at 31st March 2022 and the change during the year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.21 Balance £m	**Movement £m**	**31.3.22 Balance £m**	**31.3.22 Rate %**
Long-term borrowing Short-term borrowing	537.6 125.5	27.6 (6.1)	565.2 119.4	3.80% 0.38%
Total borrowing	**663.1**	**21.5**	**684.6**	
Cash and cash equivalents:* Money Market Funds	82.7	15.9	98.6	**0.06%**
Local Authority	20.0	(20.0)	-	
Total investments	**102.7**	**(4.1)**	**98.6**	
Net borrowing	**560.4**	**25.6**	**586.0**	

* This relates to our short term Treasury investments (Money Market Funds and DMA deposits). Cash balances held are not deemed an investment so are not included in the above total.

6.4 Cash and cash equivalent investments represent deposits which are readily convertible into cash at immediate notice. Included within this total are Money Market Funds (MMF's) which are mutual funds which invest in high-quality short-term debt. Also included is the Debt Management Agency Deposit Facility (DMADF), which provides fixed deposits and is managed by the Debt Management Agency, which is a part of HM Treasury.

6.5 Borrowing has increased slightly in the past year, in order to meet the requirements of our long term Capital investment programme.

6.6 The Council is not planning to borrow to invest primarily for commercial return and so is unaffected by the changes to the Prudential Code.

7.0 Borrowing Strategy

7.1 At 31st March 2022 the Council held £684.6m of loans, (an increase of £21.5m in year), as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 31st March are summarised in Table 3 below

Table 3: Borrowing Position

	31.3.21 Balance £m	**Net Movement £m**	**31.3.22 Balance £m**	**31.3.22 Weighted Average Rate %**	**31.3.22 Weighted Average Maturity (years)**
Public Works Loan Board	376.7	30.4	407.1	3.99%	26.7
LOBO loans	70.5	-	70.5	3.34%	42.5
Fixed Rate Loans (LT)	95.0	-	95.0	3.34%	23.7
Local Authority Loans (LT)	5.0	(5.0)	-		
Local Authority Loans (ST)	115.9	(3.9)	112.0	0.38%	0.36
Total External Borrowing	**663.1**	**21.5**	**684.6**		

7.2 The Council has continued to borrow where necessary over the past year to meet the funding requirements of the agreed capital programmes.

7.3 The Council's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short-term and long-term borrowing was maintained.

7.4 The Council has an increasing CFR due to the capital programme and an estimated borrowing requirement as determined by the Liability Benchmark, which also takes into account usable reserves and working capital. Having considered the appropriate duration and structure of borrowing based on realistic projections, it was decided to take a combination of both short-term borrowing and long-term repayment loans (with a mixture of both EIP and Maturity loan structures). The Council has borrowed through a combination of long-term fixed rate loans. Details around the new loans taken out in the current financial year are provided below. These loans provide some longer-term certainty and stability to the debt portfolio.

Loan-dated Loans borrowed	**Amount (£m)**	**Rate (%)**	**Period to maturity (years)**
PWLB EIP Loan	30	1.72	14.62
PWLB Maturity Loan	5	2.06	19.94
PWLB Maturity Loan	5	1.98	19.94

7.5 PWLB funding margins have lurched quite substantially and there remains a strong argument for diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields + 0.80%. The Council will evaluate and pursue these lower cost solutions and opportunities with its advisor Arlingclose.

7.6 The Council 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 year.

Other Debt Activity

7.7 During the year, the Council entered into a 999-year lease for property at 330 Ealing Road, Alperton, which is to be developed into affordable housing. The Council will make 47 annual payments for the property, starting at £1.1m in 2026 and rising each year by CPI+1%.

7.8 Since the housing will be let to tenants using the Council's powers under the Housing Act 1985, the lease will be accounted for within the Housing Revenue Account.

7.9 When construction of the housing is complete, expected to be in March 2025, the housing will be shown on the balance sheet as an asset at an estimated value of £46.5m, with the liability increased by an identical amount.

8.0 Investment Activity

8.1 CIPFA published a revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes on 20th December 2021. These define treasury management investments as investments that arise from the organisation's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

8.2 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves. During the year, the Council's investment balances ranged between £38.6m and £150.2m due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.21	Net	31.3.22	31.3.22	31.3.22
	Balance	Movement	Balance	Income Return	Weighted Average Maturity
	£m	£m	£m	%	days
Local authority deposit	20.0	(20.0)	-		
Money Market Funds	82.7	15.9	98.6	0.14	131
Total investments	**102.7**	**(4.1)**	**98.6**		**131**

8.3 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.

8.4 Ultra low short-dated cash rates, which were a feature since March 2020 when Bank Rate was cut to 0.1%, prevailed for much of the 12-month reporting period which resulted in the return on sterling low volatility net asset value (LVNAV) Money Market Funds being close to zero even after some managers have temporarily waived or lowered their fees. However, higher returns on cash instruments followed the increases in Bank Rate in December, February and March. At 31st March, the 1-day return on the Council's MMFs ranged between 0.38% - 0.47% per annum.

8.5 Given the low interest rate environment and the Council's borrowing need, there was a focus on holding short term investments, providing the Council with improved liquidity. There was also a focus on holding funds with high credit ratings, providing increased security over the Council's investment portfolio.

8.6 The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below.

Table 5: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	**Credit Rating**	**Bail-in Exposure**	**Weighted Average Maturity (days)**	**Rate of Return %**
31.03.2021	4.92	A+	81%	2	0.03%
31.03.2022	5.06	A+	100%	1	0.52%
Similar LAs	4.38	AA-	62%	40	1.25%
All LAs	4.39	AA-	60%	14	2.10%

*Weighted average maturity

8.7 In light of Russia's invasion, Arlingclose contacted the fund managers of our MMF funds and confirmed no direct exposure to Russian or Belarusian assets had been identified. Indirect exposures were immaterial. It should be noted that that any assets held by banks and financial institutions (e.g. from loans to companies with links to those countries) within MMFs and other pooled funds cannot be identified easily or with any certainty as that level of granular detail is unlikely to be available to the fund managers or Arlingclose in the short-term, if at all.

Non-Treasury Investments

8.8 The definition of investments in CIPFA's revised 2021 Treasury Management Code covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return). The non-Treasury investments are held to further service objectives and are therefore categorised as for service purposes. The non-Treasury investments are classified under shareholdings to subsidiaries and loans to subsidiaries, detailed in 8.10 below. The Council does not hold any non-treasury investments for commercial purposes.

8.9 Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) and Welsh Government also broadens the definition of investments to include all such assets held partially or wholly for financial return.

8.10 The Council also held £213.5m of such investments in:

- Shareholding in subsidiaries £79.7m.

- Loans to subsidiaries £133.8m.

8.11 I4B Holdings Limited is a company wholly owned by Brent Council that was incorporated on 16 December 2016. The primary purpose of the company is to deliver the housing options defined in the Temporary Accommodation reform plan. As of 31st March 2022, the Council had provided funding of £178.4m to i4B (2020/21: £158.3m) comprised of a number of soft loans and equity. The Council received £4.0m (2020/21: £3.7m) in interest and fees for loans to I4B. The loans are secured against the company's 523 properties.

8.12 First Wave Housing (FWH) is a registered provider of housing in Brent and is wholly owned by Brent Council. FWH was setup to manage properties previously owned by Brent Housing Partnership (BHP). The Council received £1.1m (2020/21: £1.1m) in interest for loans to FWH. As of 31 March 2022, there were outstanding loans to Brent Council totalling £35.1m (2020/21: £36.0m) which are secured against the company's 329 properties.

8.13 These investments generated £5.1m (2020/21 £4.8m) of investment income for the Council in 2021/22. This investment income covers the borrowing cost of investing in housing through wholly owned subsidiaries. These borrowing costs would be incurred by the Council regardless of the method through which the Council develops new housing, however this is the vehicle of choice for such investments.

9.0 Compliance

9.1 The Director of Finance reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

9.2 Compliance with the authorised limit and operational boundary for external debt is demonstrated within Appendix 2 (Debt Limits).

10.0 Investment Training

10.1 The needs of the Council's treasury management staff for training in investment management are kept under review. These are considered as part of the staff appraisal process and additionally, when the responsibilities of individual members of staff change.

11.0 Financial Implications

11.1 Already noted within the report as this is the Treasury Management Outturn Report.

12.0 Legal Implications

12.1 None identified.

13.0 Diversity Implications

13.1 None identified.

Report sign off: ***Minesh Patel*** Director of Finance