

CABINET

16 November 2021

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| Title: Treasury Management 2021/22 Mid-Year Review | |
| Report of the Cabinet Member for Finance, Performance and Core Services | |
| Open Report | For Decision |
| Wards Affected: None | Key Decision: No |
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| Accountable Director: Philip Gregory, Finance Director (S151 Officer) | |
| Accountable Strategic Leadership Director: Claire Symonds, Managing Director | |
| Summary <p>Regulation changes have placed greater onus on elected Members in respect of the review and scrutiny of treasury management policy and activities. This mid-year review report provides details of the mid-year position for treasury activities and highlights compliance with the Council's policies previously approved by the Assembly on 3 March 2021 as part of the Treasury Management Strategy Statement for 2021/22.</p> | |
| Recommendation(s) <p>The Cabinet is asked to recommend the Assembly to note:</p> <ul style="list-style-type: none">(i) The Treasury Management Strategy Statement Mid-Year Review 2021/22;(ii) The economic update covering the increase in inflation and the potential for an increase in the Bank of England Base Rate;(iii) That the value of the treasury investments and cash as at 30 September 2021 totalled £170.2m and that the treasury investment strategy outperformed its peer group, with a return of 1.51% against an average of 0.24% for London Local Authorities (as at 30 June 2021);(iv) That the value of the commercial and residential loans lent by the Council as at 31 March 2021 totalled £171.5m;(v) That the total borrowing position as at 30 September 2021 totalled £1.0 billion, with £331.2m relating to the Housing Revenue Account and £669.1m to the General Fund;(vi) That interest payable was forecast to be £12.6m against a budget of £13.6m, representing a surplus of £1m; | |

- (vii) That interest receivable was forecast to be £8.2m against a budget of £6.5m, representing a surplus of £1.7m;
- (viii) That capitalised interest was forecast to be £6.5m against a budget of £5.0m, representing a surplus of £1.5m;
- (ix) That Investment and Acquisition Strategy income was forecast to be £4.9m against a budget of £6.6m, representing a deficit of £1.7m;
- (x) That in the first half of the 2021/22 financial year the Council complied with all 2021/22 treasury management indicators.

Reason(s)

To accord with the requirements of the Local Government Act 2003.

1. Introduction and Background

- 1.1 The Council operates a balanced budget whereby cash raised during the year meets the Council's cash expenditure needs. Part of the treasury management operations is to ensure this cash flow is adequately planned, with surplus monies invested with counterparties of an appropriate level of risk, providing adequate liquidity before considering maximising investment return.
- 1.2 A second main function of treasury management is the funding of the Council's capital programme and Investment and Acquisition Strategy (IAS). These capital plans provide a guide to the Council's borrowing need, which is essentially the use of longer-term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer-term cash may involve arranging loans, using cash flow surpluses, or restructuring debt to meet Council risk or cost objectives. To fund the IAS, it is essential that a significant level of borrowing is secured prior to being used to reduce interest rate risk.
- 1.3 A third main function of treasury management is the funding and treasury advice that is required for the Council's Investment and Acquisitions Strategy (IAS).
- 1.4 In accordance with the Chartered Institute of Public Finance Accountancy's (CIPFA) Code of Practice for Treasury Management, there should be a review of that strategy at least half yearly. The principal requirement of the Code includes:
 - 1) Maintain a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management.
 - 2) Maintain a Treasury Management Practices which set out the how the Council will seek to achieve those policies and objectives.
 - 3) Receipt by full Council of a Treasury Management Strategy Statement, (TMSS) including the Annual Investment Strategy and Minimum Revenue Provision (MRP) Policy for the year ahead; a Mid-Year Review Report (this report); and an Annual Report covering activities during the previous year.
 - 4) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

5) Delegation by the Council to a specific named body, for this Council this is Cabinet, to scrutinise the treasury management strategy and policies.

1.5 This mid-year report has been prepared in compliance with CIPFA's Code of practice on Treasury Management, and covers the following:

- 1) Introduction and Background;
- 2) Economic Update and Interest Rate Forecast;
- 3) Council's Cash, Interest Budget and Debt Position as at 30 September 2021;
- 4) Investment Portfolio as at 30 September 2021;
- 5) Investment Strategy Performance and Benchmarking;
- 6) Loans and IAS Income Forecast as at 30 September 2021;
- 7) Accounting Policy change to interest costs; and
- 8) The Council's Capital Position (Prudential Indicators).

2. Economic Update and Interest Rate Forecast

2.1 Economic update

2.1.1 The Monetary Policy Committee (MPC) meeting 24.9.21: voted unanimously to leave Bank Rate (BR) at 0.10%, with no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn; two MPC members voted to stop the last £35bn of purchases as they were concerned that this would add to inflationary pressures.

2.1.2 There was a shift in the tone of the MPC's minutes from indicating that some tightening in monetary policy was now on the horizon, but also not wanting to stifle economic recovery by too early an increase in BR. The MPC indicated there had been a marked increase in concern that more recent increases in prices, particularly the increases in gas and electricity prices in October and due again next April, are likely to lead to faster and higher inflation expectations and underlying wage growth, which would increase the risk that price pressures would prove more persistent next year than previously expected. Indeed, to emphasise its concern about inflationary pressures, the MPC pointedly chose to reaffirm its commitment to the 2% inflation target in its statement; this suggested that it was now willing to look through the flagging economic recovery during the summer to prioritise bringing inflation down next year. This is a reversal of its priorities and a long way from earlier MPC meetings which indicated a willingness to look through inflation overshooting the target for limited periods to ensure that inflation was 'sustainably over 2%'. Now the MPC's primary concern is that underlying price pressures in the economy will embed over the next year and elevate future inflation to stay significantly above its 2% target and for longer.

2.1.3 Financial markets are pricing in an increase in BR from 0.10% to 0.25% in February 2022, but this looks ambitious as the MPC has stated that it wants to see what happens to the economy, and particularly to employment once furlough ends at the end of September. At the Feb 2022 MPC's meeting it will only have available the employment figures for November: to get a clearer picture of employment trends, it must wait until the May meeting when it will have data up until February. At its May meeting, it will also have a clearer understanding of the likely peak of inflation. The MPC's forward guidance on its intended monetary

policy on raising BR versus selling (quantitative easing) holdings of bonds is as follows: -

- Place focus on raising BR as “the active instrument in most circumstances”.
- Raising BR to 0.50% before starting on reducing its holdings.
- Once BR is at 0.50% it would stop reinvesting maturing gilts.
- Once BR had risen to at least 1%, it would start selling its holdings.

2.1.4 COVID-19 vaccines - These have boosted confidence that life in the UK could largely return to normal during the summer after a third wave of the virus threatened to overwhelm hospitals in the spring. With the household saving rates high since the first lockdown in March 2020, there is pent-up demand and purchasing power stored up for services in hard hit sectors like restaurants, travel and hotels. The big question is whether mutations of the virus could develop which render current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread.

2.1.5 World growth: This was in recession in 2020 but recovered during 2021 until starting to lose momentum more recently. Inflation has been rising due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022. It is likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products, and vice versa. This is likely to reduce world growth rates from those in prior decades.

2.1.6 Supply shortages: the pandemic and extreme weather events have disrupted supply chains and have led to misdistribution of shipping containers around the world and an increase in the cost of shipping. Combined with a shortage of semi-conductors, these issues have had a disruptive impact on production in many countries. Many western countries are also experiencing difficulties in filling job vacancies. It is expected that these issues will be sorted out, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods on shelves.

2.2 Interest Rate Forecast.

2.2.1 The Council’s treasury advisor, Link Group, provided the following forecasts (PWLB rates are certainty rates):

| Link Group Interest Rate View | | 29.9.21 | | | | | | | | |
|-------------------------------|--------|---------|--------|--------|--------|--------|--------|--------|--------|--------|
| | Dec-21 | Mar-22 | Jun-22 | Sep-22 | Dec-22 | Mar-23 | Jun-23 | Sep-23 | Dec-23 | Mar-24 |
| BANK RATE | 0.10 | 0.10 | 0.25 | 0.25 | 0.25 | 0.25 | 0.50 | 0.50 | 0.50 | 0.75 |
| 3 month ave eamings | 0.10 | 0.10 | 0.20 | 0.20 | 0.30 | 0.40 | 0.50 | 0.50 | 0.60 | 0.70 |
| 6 month ave eamings | 0.20 | 0.20 | 0.30 | 0.30 | 0.40 | 0.50 | 0.60 | 0.60 | 0.70 | 0.80 |
| 12 month ave eamings | 0.30 | 0.40 | 0.50 | 0.50 | 0.50 | 0.60 | 0.70 | 0.80 | 0.90 | 1.00 |
| 5 yr PWLB | 1.40 | 1.40 | 1.50 | 1.50 | 1.60 | 1.60 | 1.60 | 1.70 | 1.70 | 1.70 |
| 10 yr PWLB | 1.80 | 1.80 | 1.90 | 1.90 | 2.00 | 2.00 | 2.00 | 2.10 | 2.10 | 2.10 |
| 25 yr PWLB | 2.20 | 2.20 | 2.30 | 2.30 | 2.40 | 2.40 | 2.40 | 2.50 | 2.50 | 2.60 |
| 50 yr PWLB | 2.00 | 2.00 | 2.10 | 2.20 | 2.20 | 2.20 | 2.20 | 2.30 | 2.30 | 2.40 |

2.2.2 Forecasts for Bank Rate

BR is not expected to go up quickly after the initial rate rise as the supply potential of the economy has not generally taken a major hit during the pandemic, so should cope with meeting demand without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the surge to around 4% towards the end of 2021. Three increases in BR are forecast in the period to March 2024, ending at 0.75%. However, these forecasts may well need changing within a relatively short time frame for the following reasons:

- There are increasing grounds for viewing the economic recovery as running out of steam during the summer and now into the autumn. This could lead into stagflation which would create a dilemma for the MPC as to which way to face.
- Will some current key supply shortages e.g., petrol and diesel, spill over into causing economic activity in some sectors to take a significant hit?
- Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on BR to cool inflation. Then we have the Government's upcoming budget in October, which could also end up in reducing consumer spending power.
- On the other hand, consumers are sitting on +£200bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total?
- There are 1.6 million people coming off furlough at the end of September; how many of those will not have jobs on 1st October and will, therefore, be available to fill labour shortages in many sectors of the economy? So, supply shortages which have been driving up both wages and costs, could reduce significantly within the next six months or so and alleviate the MPC's current concerns.
- There is a risk that there could be further nasty surprises on the Covid front, on top of the flu season this winter, which could depress economic activity.

In summary, with the high level of uncertainty on several fronts, it is likely that these forecasts will need to be revised again soon - in line with what the new news is.

It is important to remember that BR was cut to 0.10% as an emergency measure to deal with the Covid crisis hitting the UK in March 2020. At any time, the MPC could decide to simply take away that final emergency cut from 0.25% to 0.10% on the grounds of it no longer being warranted and as a step forward in the return to normalisation. In addition, any BR under 1% is both highly unusual and highly supportive of economic growth.

2.2.3 PWLB Rates: The current margins over gilt yields for PWLB rates are:

- **PWLB Standard Rate & HRA is gilt plus 100 basis points (G+100bps)**
- **PWLB Certainty Rate & HRA is gilt plus 80 basis points (G+80bps)**
- **Local Infrastructure Rate is gilt plus 60bps (G+60bps)**

Gilt yields - Since the start of 2021, there has been significant volatility in gilt yields, and hence PWLB rates. During September, gilt yields from 5 – 50 years have steadily risen and rose further after the hawkish tone of the MPC's minutes last week. Link's forecasts show a steady, but slow, rise in both BR and gilt yields during the forecast period to March 2024.

While monetary policy in the UK will have a major impact on gilt yields, there is also a need to consider the impact that rising treasury yields in America could have. As an average since 2011, there has been a 75% correlation between movements in US 10-year treasury yields and UK 10 year gilt yields. This is a significant UPWARD RISK exposure to Link's forecasts for longer term PWLB rates.

US treasury yields - During the first part of the year, US President Biden's, and the Democratic party's, determination to push through a \$1.9trn (equivalent to 8.8% of GDP) fiscal boost for the US economy as a recovery package from the Covid pandemic was what unsettled financial markets. However, this was in addition to the \$900bn support package agreed in December 2020. This was followed by additional Democratic ambition to spend huge sums on infrastructure and an American families plan over the next decade which are caught up in Democrat / Republican haggling. Markets were alarmed that stimulus was happening at a time when: -

1. A fast vaccination programme has enabled a rapid opening up of the economy.
2. The economy has been growing strongly during 2021.
3. It started from a position of little spare capacity due to less severe lockdown measures than in many other countries.
4. And the Fed was still providing stimulus through monthly QE purchases.

These factors could cause an excess of demand in the economy which could lead to strong inflationary pressures, forcing the Fed to take earlier action to increase the Fed rate from near zero, despite their stated policy being to target average inflation. It is notable that in the September Fed meeting, Fed members again moved forward their expectation of when the first increases in the Fed rate will occur. In addition, shortages of workers appear to be stoking underlying wage inflationary pressures which are likely to feed through into CPI inflation. A run of stronger jobs growth figures could be enough to meet the threshold set by the Fed of "substantial further progress towards maximum employment" for a first increase in the Fed rate.

A further concern in financial markets is when will the Fed end QE purchases of treasuries and how will they gradually wind them down. These purchases are currently acting as a downward pressure on treasury yields. In his late August speech at the Jackson Hole conference, Fed Chair Powell implied that the central bank plans to start tapering its asset purchases before the end of this year. But the

plan is conditional on continued improvement in the labour market, which the August employment report suggests is proceeding more slowly than the Fed anticipated. That may mean that any announcement of tapering is pushed back possibly even into early 2022.

As the US financial markets are, by far, the biggest financial markets in the world, any upward trend in treasury yields will invariably impact and influence financial markets in other countries. Inflationary pressures and erosion of surplus economic capacity look much stronger in the US compared to those in the UK, which would suggest that Fed rate increases are likely to be faster and stronger than BR increases in the UK. Nonetheless, any upward pressure on treasury yields could put upward pressure on UK gilt yields too.

There are also possible DOWNSIDE RISKS from the huge sums of cash that the UK populace have saved during the pandemic; when savings accounts earn little interest, it is likely that some of this cash mountain could end up being invested in bonds and so push up demand for bonds and support their prices i.e., this would help to keep their yields down. How this will interplay with the Bank of England eventually getting round to not reinvesting maturing gilts and then later selling gilts, will be interesting to keep an eye on.

2.2.4 Significant risks to the forecasts

- COVID vaccines do not work to combat new mutations and/or new vaccines take longer than anticipated to be developed for successful implementation.
- The pandemic causes major long-term scarring of the economy.
- Government implements an austerity programme that suppresses GDP growth.
- The MPC tightens monetary policy too early – by raising BR or unwinding QE.
- The MPC tightens monetary policy too late to ward off inflationary pressures.
- Major stock markets e.g. in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to “moral hazard” of buying shares & corporate bonds.

The balance of risks to the UK economy: the overall balance of risks to economic growth in the UK is now to the downside, including residual risks from Covid and its variants - both domestically and their potential effects worldwide.

The balance of risks to medium to long term PWLB rates: there is a balance of upside risks to forecasts for medium to long term PWLB rates.

A new era – a fundamental shift in central bank monetary policy: One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks (Fed, BoE and ECB), to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target to bear down on so as to stop it going above a target rate. There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on ‘achieving broad and inclusive “maximum” employment in its entirety’ in the US.

- The Fed in America has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep under), so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time.
- The BoE has also amended its target for monetary policy so that inflation should be 'sustainably over 2%' and the ECB now has a similar policy.
- For local authorities, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.
- Labour market liberalisation since the 1970s has helped to break the wage-price spirals that fuelled high levels of inflation and has now set inflation on a lower path which makes this shift in monetary policy practicable. In addition, recent changes in flexible employment practices, the rise of the gig economy and technological changes, will all help to lower inflationary pressures.
- Governments will also be concerned to see interest rates stay lower as every rise in central rates will add to the cost of vastly expanded levels of national debt; (in the UK this is £21bn for each 1% rise in rates). On the other hand, higher levels of inflation will help to erode the real value of total public debt.

3. Council's Cash Position as at 30 September 2021

3.1 Table 1 details the Council's mid-year treasury position. Overall, the Council's borrowing has increased by £1.2m since 31/03/2021 with the following changes:

- short-term borrowing reduced from £67.5m to £38.0m, a reduction of £29.5m;
- £40m of PWLB debt was borrowed at an average rate of 1.54%, split into £20m repayment on maturity for 50 yrs at 1.71% & £20m EIP for 18 yrs at 1.38%.
- £9.3m of debt was repaid for Annuity and Equal Instalment Repayment Debt.

3.2 Treasury investments have reduced from £255.4m at 31 March 2021 to £144.4m at 30 September 2021, with the average rate reducing from 1.62% to 1.46%. Commercial loans total £171.5m at an average rate of 3.56%. The reduction in cash is due to funding the investment strategy and will continue for the rest of the financial year. In addition, some loans will potentially be repaid during 2022 and will be used to further fund the investment strategy.

Table 1: Council's Treasury Position at 30 September 2021

| | Principal Outstanding £000s | Rate of Return % | Average Life (yrs.) |
|--|--------------------------------|---------------------|---------------------|
| General Fund Fixed Rate Borrowing | | | |
| LOBO | 10,000 | 3.98 | 55.78 |
| Local Authority (Short-term) | 38,000 | 0.03 | 0.35 |
| European Investment Bank | 76,820 | 2.21 | 22.51 |
| L1 Renewables (Street Lighting) | 6,782 | 3.44 | 25.02 |
| PWLB | 537,506 | 2.02 | 25.92 |

| | | | |
|------------------------------------|------------------|-------------|--------------|
| Total General Fund Debt | 669,107 | 1.97 | 24.51 |
| HRA Fixed Rate Borrowing | | | |
| PWLB | 265,912 | 3.50 | 34.31 |
| Market Loans | 30,000 | 4.03 | 44.21 |
| HRA – Internal Borrowing | 35,332 | 1.98 | 1.00 |
| Total HRA Debt | 331,244 | 3.38 | 35.31 |
| Total Council Borrowing | | | |
| | 1,000,351 | 2.44 | 37.67 |
| Cash | | | |
| Short-Term Investments | 25,805 | 0.01 | - |
| Investments | | | |
| Financial Institutions | 5,500 | 1.59 | 0.55 |
| Pension Fund | 23,650 | 0.50 | - |
| Local Authorities | 115,250 | 1.65 | 1.8 |
| Total Investment Income | 144,400 | 1.46 | 1.39 |
| Commercial and Reside Loans | | | |
| | 171,541 | 3.56 | |
| Total Investments | | | |
| | 283,300 | 2.60 | |

4. Interest and IAS Position at 30 September 2021

4.1 The funding of the IAS will require a significant amount of borrowing. Pressure on the net interest budget could be from:

- a delay in developments becoming operational, delaying interest receivable;
- an increase in borrowing requiring more interest payable than forecast; and
- a drop in treasury returns through lower returns or lower investible cash.

4.2 Table 2 provides the latest interest receivable and payable budgets forecast for the Council. The current net interest forecast is for a large surplus of £4.1m, even factoring in the increased budget of £5m of capitalised interest supporting the MTFS.

Table 2: General Fund (GF) Interest Budget Forecast 2021/22

| Interest Forecast | 2021/22 | 2021/22 | 2021/22 |
|--------------------------------------|---------------|---------------|-------------|
| | Budget | Forecast | Variance |
| | £'000s | £'000s | £'000s |
| GF Interest Payable Budget | | | |
| LT Borrowing | | 12,378 | |
| ST Borrowing | | 37 | |
| Brokerage and other costs | | 200 | |
| Total Interest Payable | 13,593 | 12,614 | -979 |
| GF Interest Receivable Budget | | | |
| Treasury Income | | -2,080 | |
| Other Loans | | -3,537 | |

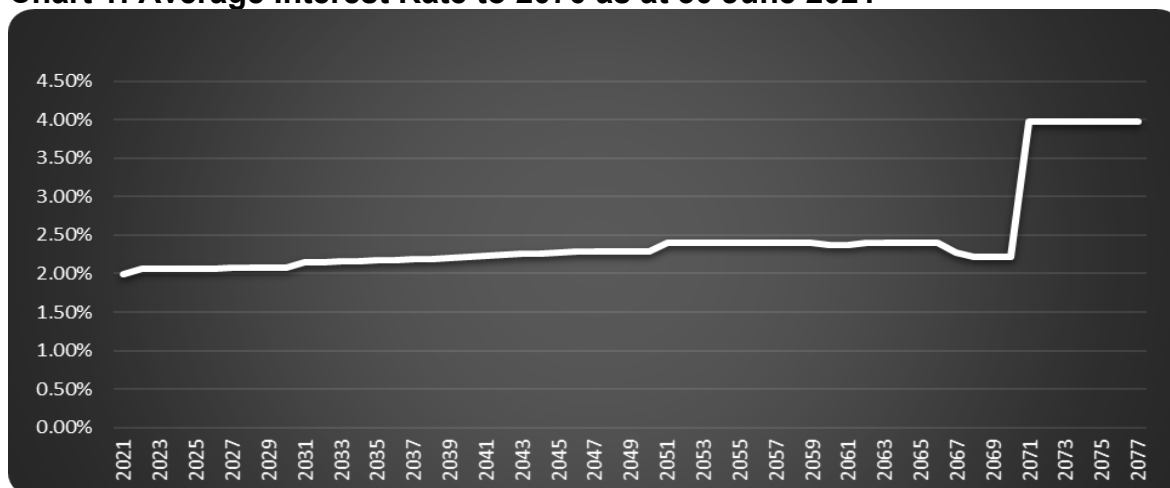
| | | | |
|----------------------------------|---------------|---------------|---------------|
| Pension Fund Prepayment | | -1,240 | |
| Reside | | -1,297 | |
| Total Interest Receivable | -6,503 | -8,154 | -1,651 |
| | | | |
| Capitalised Interest | -5,000 | -6,498 | -1,498 |
| Net Interest | 2,090 | -2,038 | -4,127 |

4.3 Borrowing

4.3.1 Interest payable budget is forecast to have a surplus of £979k against a budget of £13.6m (excluding capitalised interest). £40m was borrowed in July 2021 but an increase in borrowing costs has resulted in no further long-term borrowing, with cash and short-term borrowing used to cover cashflow requirements. Capitalised interest is forecast to be £6.5m. As the 2020/21 accounts will not be audited until the end of 2021, there remains a risk that the capitalised interest will be adjusted, but this is low risk. Currently all the income from capitalised interest for 2019/20 and 2020/21 is part of the reserve.

4.3.2 **General Fund Interest Costs:** Currently the average long-term interest rate on borrowing is 1.97% for £669.1m. The long-term borrowing rate increases to 2.4% by 2051 but on a balance of £140m, as cheaper borrowing is repaid and older, more expensive borrowing remains. The rate drops to 2.21% in 2068 but on a balance of £30m. The average interest rate to 2070 is provided in chart 1:

Chart 1: Average Interest Rate to 2070 as at 30 June 2021



4.3.3 If future borrowing can keep the longer-term average borrowing rate to under 2%, then this will provide a margin against the on-lending rate to Reside of approximately 2.9%. The average rate could increase if PWLB margin increases, if borrowing costs increase or more expensive borrowing, i.e. index linked borrowing, is used.

4.4 Debt Position at 30 September 2021

4.4.1 The total GF borrowing was £669.1m and £331.2m of HRA borrowing. The total borrowing as at 30 September 2021 was £1.0bn. Ensuring low cost of carry and debt repayment is at the forefront of any borrowing decisions made. Although the size of the Council's overall borrowing is significant, Members are asked to note that the majority of debt includes a repayment profile and that the repayment is

linked to income streams that are sufficient to cover the interest costs and debt repayment.

4.4.2 As an example, the EIB borrowing of £89m is an annuity repayment (AP), which means a proportion of the loan will be repaid each year. Currently the balance owed on the EIB loan is £76.8m, with all repayment made from returns from the investment strategy (Abbey Road and Weavers). In addition, £347.5m of the long-term PWLB borrowing is Equal Instalment Payments or AP, which means there is repayment of a portion of the debt each year. As a result, the Council has a loan repayment profile that is similar to its forecast property debt repayment schedule. The Council's GF long-term borrowing repayment schedule is outlined in Chart 2:

Chart 2: General Fund Long Term Debt Maturity Profile



4.4.3 **Debt Repayment and Rescheduling:** For the first half of the financial year, the treasury section has repaid approximately £9.3m of long-term borrowing through equal instalment and annuity repayments. In addition, short-term borrowing reduced to £38.0m at 30 September 2021.

Debt rescheduling opportunities are limited in the current economic climate and no debt rescheduling were undertaken during the first six months of the financial year.

5. Treasury and Loan Portfolio at 30 September 2021

5.1 It is the Council's priority to ensure security of capital and liquidity before obtaining an appropriate level of return which is consistent with the Council's risk appetite. In the current economic climate, the Council's risk appetite remains relatively low, with the treasury section looking to take advantage of the fluctuations in rates offered by Local Authorities (LAs) and Financial Institutions.

5.2 As at 30 September 2021 the Council held £170.2m in treasury investments, with £115.25m invested with LAs, £5.5m held with banks, a short-term position of £25.8m to cover liquidity risk and as part of building up a short-term borrowing position. Building up a short-term borrowing position will continue for the near future as short-term borrowing rates are very low, the Council does not have an immediate need to borrow long-term and long-term borrowing rates are currently elevated when compared to recent levels. The Council also held a £23.65m position with the pension fund. The pension fund is in the process of exiting a property fund and will repay a significant part of this balance over the next month.

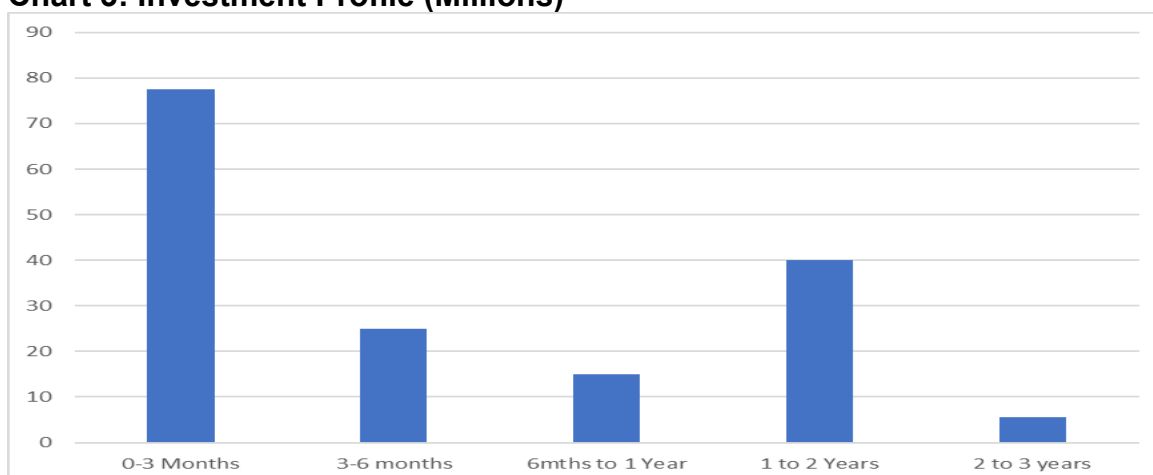
5.3 A breakdown of the Council's treasury investments is provided in the table 3:

Table 3: Treasury Investments as at 30 September 2022

| Counterparty | Start Date | End Date | Amount £000s | Interest Rate (%) |
|------------------------|------------|------------|-----------------|----------------------|
| LBBB Pension Fund | 01/10/2021 | 01/10/2021 | 23,650 | 0.50 |
| Cash - Lloyds Bank | 01/10/2021 | 01/10/2021 | 25,805 | 0.01 |
| Lloyds Bank | 18/04/2019 | 19/04/2022 | 5,500 | 1.59 |
| Rugby BC | 18/10/2019 | 18/10/2021 | 5,000 | 1.80 |
| Rugby BC | 15/11/2019 | 15/11/2021 | 5,000 | 1.80 |
| Rugby BC | 25/11/2019 | 25/11/2021 | 10,000 | 1.60 |
| Wokingham BC | 28/01/2020 | 28/01/2022 | 15,000 | 1.65 |
| Folkstone & Hythe DC | 31/01/2020 | 31/01/2022 | 5,000 | 1.60 |
| Birmingham CC | 24/04/2020 | 22/04/2022 | 10,000 | 1.70 |
| L B Croydon | 06/07/2020 | 06/07/2022 | 10,000 | 1.70 |
| L B Croydon | 14/07/2020 | 14/07/2022 | 10,000 | 1.70 |
| Runnymede BC | 20/12/2019 | 20/12/2022 | 5,000 | 1.80 |
| Colchester BC | 02/03/2020 | 03/01/2023 | 5,000 | 1.75 |
| Cardiff Council | 10/01/2020 | 10/01/2023 | 10,250 | 1.75 |
| Dudley Metropolitan BC | 21/02/2020 | 21/02/2023 | 10,000 | 1.80 |
| Northumberland CC | 27/02/2020 | 27/02/2023 | 5,000 | 1.80 |
| Cambridgeshire CC | 11/01/2021 | 11/01/2024 | 10,000 | 1.00 |
| Total | | | 170,205 | |

5.4 The Council's investment maturity profile in Chart 3 shows that, at 30 September 2021, 72.1% of the Council's investments had a maturity of one year or less. The Council is reducing its long-term investment positions as reinvestment returns are low and as the Council reduces its cash balance to fund the investment strategy. Due to the economic uncertainty, treasury has sought to reduce the Council's exposure to banks and has reduced its investments in banks to just £5.5m.

Chart 3: Investment Profile (Millions)

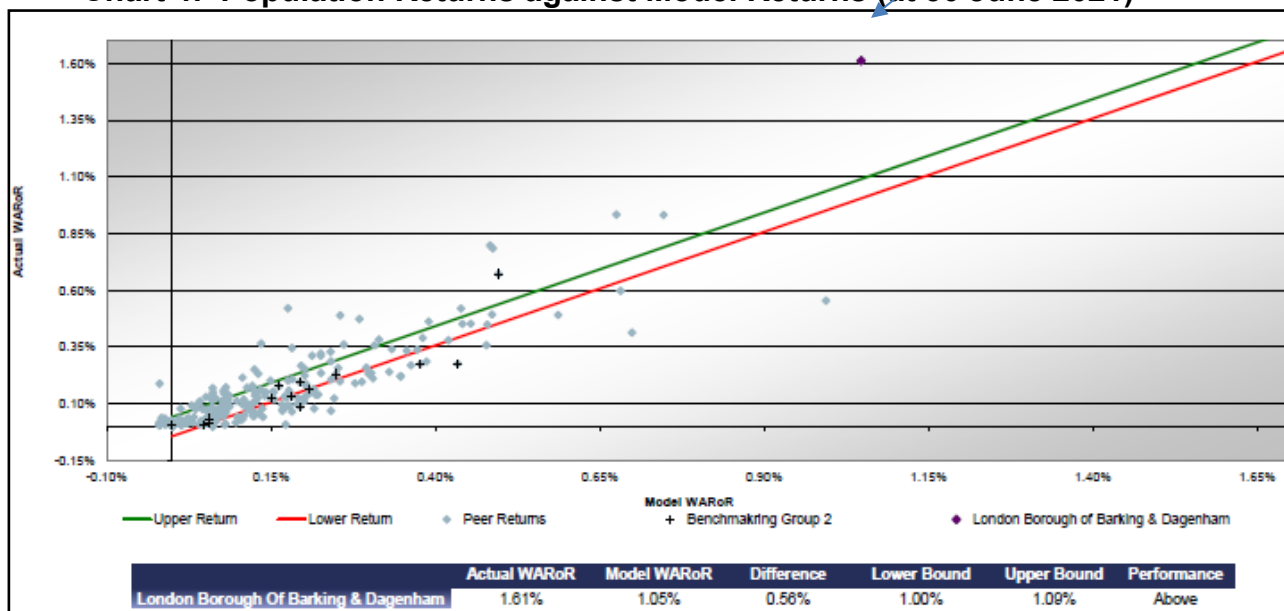


6. Treasury Investment Strategy Performance and Benchmarking

6.1 Although yields are at very low levels, the longer-term investment the Council holds has resulted in a stable average return of **1.46%** for the first six months of 2021/22.

6.2 **Benchmarking at 30 June 2021:** The treasury strategy, which excludes loans and the pension prepayment, continues to outperform its peer group, with a return of 1.61% against an average of 0.24% for London LAs. This is highlighted in chart 4:

Chart 4: Population Returns against Model Returns (at 30 June 2021)



6.3 The strategy has a significantly lower credit risk of 1.43 against a London LA average of 2.80, which means the Council gets a higher return while having a lower credit risk exposure.

7. Commercial and Reside Loans

7.1 In addition to its treasury investments, the Council has several loans to its subsidiary companies, including Reside and a prepayment to the pension fund. These loans all have repayment schedule agreed. At 30 September 2021 the Council's loans totalled £171.5m and are summarised in table 4 below:

Table 4: Commercial and Reside Loans at 30 September 2021

| Entity | Loan Type | Value £000s |
|--------------------------|-------------------------|-------------|
| Barking & Redbridge FC | Commercial Loan | 92.79 |
| Grafton Primary School | Commercial Loan | 55.07 |
| Gascoigne Primary School | Commercial Loan | 63.55 |
| Southwood Primary | Commercial Loan | 19.36 |
| BARKING RIVERSIDE LTD | Commercial Loan | 5,500.00 |
| BE-FIRST LTD | Commercial Loan | 4,599.56 |
| BD ENERGY LTD | Commercial Loan | 925.33 |
| BDTP LEUK | Commercial Loan | 23,857.02 |
| LBBD Pension Fund | Pension Fund Prepayment | 30,000.00 |

| | | |
|-------------------------|-----------------|-------------------|
| TPFL Regeneration Ltd | Commercial Loan | 27.46 |
| B&D Reside Roding ltd | Commercial Loan | 792.36 |
| Reside Regeneration Ltd | Commercial Loan | 164.28 |
| Reside Regeneration LLP | Commercial Loan | 6,400.43 |
| Reside Weavers LLP | Commercial Loan | 34,553.14 |
| Reside Ltd | Commercial Loan | 288.62 |
| Reside Abbey Roding LLP | Commercial Loan | 47.68 |
| BD Muller Developments | Commercial Loan | 24,571.38 |
| BD Muller Developments | Equity | 23,348.97 |
| Reside Weavers LLP | Commercial Loan | 66.29 |
| Reside Weavers LLP | Commercial Loan | 2,200.73 |
| Reside Weavers LLP | Commercial Loan | 1,343.85 |
| BD ENERGY LTD | Commercial Loan | 1,892.70 |
| CARE CITY | Commercial Loan | 30.00 |
| B&D Homes Ltd | Commercial Loan | 4,100.00 |
| B&D Homes Ltd | Commercial Loan | 6,450.70 |
| Barking Enterprise CIC | Commercial Loan | 150.00 |
| Total | | 171,541.27 |

- 7.2 The majority of the loans outlined above are secured against an asset. Where the loan is unsecured the company is closely monitored to ensure that it remains financially viable. Loans against residential properties are very long term, with the loan duration of up to 55 years (to match the asset life of the asset it is secured against). A repayment schedule, based on an annuity repayment, is in place for each loan.
- 7.3 Commercial loans durations vary, with some loans to schools maturing in 14 years but most of the loans have a maximum duration of 5 years. Each loan has been agreed at Cabinet. The Pension Fund prepayment is of contributions totalling £40m. The prepayment provides the pension fund with cash, which it uses to fund investments in infrastructure but also provides a return to the Council from making the payment early. Each month a portion of the loan is repaid and the actual contribution for the month is paid by the Council to ensure the correct contribution rate is paid to the pension fund.

8. IAS Income Forecast

- 8.1 The IAS is forecasting to achieve £1.7m less than the target, which is £6.6m for 2021/22. The strategy is supported by higher-than-expected level of commercial income. The return from current residential schemes, increased Reside costs, security costs on some schemes and delays with schemes becoming operational are putting pressure on achieving the target return. A number of loans from the Council to Reside are included as interest receivable and the treasury and IAS return are therefore interlinked and, at times, one underperforms while the other outperforms.
- 8.2 The IAS has received significant income contributions from rental received from land assembly purchases on Thames Road and from commercial loans made for the purchase of Muller and for LEUK. Although this is short-term income received during land assembly, this income has provided additional support to the IAS and allows for the costs of borrowing to be covered for part of the development. Table

5 below outlines the income received from the various commercial investments and includes costs to fund additional resources in the investment strategy.

Table 5: IAS Income Forecast as at 30 September 2021

| IAS Forecast | Budget | Forecast | Variance | Comments |
|---------------------------------|---------------|-----------------|-----------------|---|
| Residential | | | | |
| Regen LLP | -94 | -98 | -4 | Best current forecast |
| Abbey | -1,175 | -647 | 528 | |
| Weavers | -329 | -452 | -123 | |
| Reside Ltd | 236 | 798 | 562 | |
| Security costs | 689 | 689 | 109 | |
| Abbey Road MRP | -600 | -600 | 0 | |
| Temporary Accommodation | -509 | -509 | 0 | |
| Total Residential | -1,782 | -819 | 1,073 | |
| Commercial Income | | | | |
| BBC | -900 | -901 | -1 | Interest secured, risk on net profit allocated to Be First |
| Heathway | -237 | -237 | 0 | |
| Welbeck | -816 | -866 | -50 | |
| Restore | -409 | -409 | 0 | |
| Travelodge | -235 | -235 | 0 | |
| Thames Road | -866 | -514 | 352 | |
| Piano Works | -408 | -408 | 0 | |
| CR27 | -867 | -867 | 0 | |
| Total Commercial | -4,738 | -4,438 | 300 | |
| Expenses | Budget | Forecast | Variance | Comments |
| New build asset manager role | 75 | 50 | -25 | Investment in resource to support the delivery on the IAS return. |
| ST housing man. transformation | 50 | 50 | 0 | |
| Contribution to handover prog. | 50 | 50 | 0 | |
| Fund industrial intensification | 200 | 200 | 0 | |
| Total Costs | 375 | 350 | -25 | |
| Surplus / (Deficit) | -445 | 0 | 445 | |
| IAS Target | -6,590 | -4,907 | 1,683 | |

- 8.3 There are a number of caveats, both positive and negative, around the figures including:
- i) uncertainty on the impact of bad debts and reduced rental from Reside schemes. This has been reflected in the returns above but there is potential for this to deteriorate further.
 - ii) Part of the Reside return is dependent on the handover of properties.
 - iii) Temporary Accommodation had a number of issues around voids and handover. Currently just the borrowing costs are included in the strategy.
- 8.4 Overall there is the potential for a net surplus of £2.4m to be available to transfer to the IAS Reserve, which will potentially increase to £24.0m. In addition, £5m

will be contributed to the Council's financing requirements from Capitalised interest.

Table 6: Forecast Reserve Movements 2021/22

| IAS Reserves | £'000s |
|--|---------------|
| Investment Reserve | 10,998 |
| Transfer to support dividends* | 1,254 |
| Capital Reserve | 3,779 |
| CR27 Reserve | 5,500 |
| Reserves at 31 March 2021 | 21,531 |
| Potential Year End Transfer 2021/22 | 2,444 |
| Reserves at 31 March 2022 | 23,975 |

*Due to timing differences in the dividend payment from Be First, £1.25m used to cover the impact. This amount will be repaid to IAS in 2021/22.

9. Capitalised Interest

- 9.1 The Council uses a mix of short-term and long-term borrowing to fund the capital costs for the various IAS schemes. To fund this borrowing the Council has allocated an interest budget for the IAS borrowing. The interest budget includes both interests received, and interest expensed.
- 9.2 The Council, from 1 April 2019, has capitalised interest costs against qualifying assets. A qualifying asset is an asset that takes in excess of two years to get ready for intended use and is where the forecast expenditure is in excess of £10m. Qualifying assets are therefore the majority of the IAS schemes. Capitalisation of interest will start from when the asset has been agreed at Gateway 2, which is the point at which the development is initially agreed and will be on all qualifying expenditure. Where land has been purchased as part of land assembly the capitalisation of interest will be from the later date of the either the completion date of the purchase or the date of this accounting policy.
- 9.3 Interest will be capitalised quarterly and is based on the weighted average of the borrowing costs. Cessation of capitalisation will occur when substantially all the activities necessary to prepare the qualifying asset for its intended use are complete.
- 9.4 As part of the Treasury outturn report, an outturn figure for the amount of interest that was capitalised for the year, will be provided to Members.

10. The Council's Capital Position (Prudential Indicators)

10.1 Table 7 shows the changes to the original capital expenditure budgets.

Table 7: Revised Estimate to Capital Programme at 30 September 2021

| Capital Expenditure | 2020/21 actual | 2021/22 Initial Budget | 2021/22 Forecast |
|--|-------------------|---------------------------|---------------------|
| | £000s | £000s | £000s |
| General Fund | | | |
| Adults Care & Support | 1,449 | 1,582 | 1,582 |
| Community Solutions | 113 | 74 | 74 |
| CIL | 622 | 1,501 | 1,501 |
| Core | 1,860 | 2,118 | 1,989 |
| Culture, Heritage & Recreation | 623 | 8,901 | 7,495 |
| Enforcement | 389 | 724 | 724 |
| Transport for London | 1,000 | 1,193 | 516 |
| My Place | 4,145 | 8,348 | 8,348 |
| Public Realm | 924 | 1,657 | 1,657 |
| Education, Youth and Childcare | 19,999 | 44,095 | 30,743 |
| Inclusive Growth | 0 | 15,533 | 15,533 |
| Other | 700 | 1,765 | 1,765 |
| Transformation | 3,999 | 2,063 | 5,702 |
| General Fund | 35,823 | 89,555 | 77,630 |
| | | | |
| HRA | | | |
| Stock Investment (My Place) | 17,428 | 35,130 | 24,813 |
| New Build Schemes (Be First) | 1,064 | 2,931 | 2,931 |
| Estate Renewal (Be First) | 7,645 | 5,155 | 5,900 |
| HRA Total | 26,137 | 43,216 | 33,644 |
| | | | |
| IAS | | | |
| Residential Developments | 153,939 | 271,679 | 258,771 |
| Temporary Accommodation | 10,777 | 5,439 | 18 |
| Commercial Investments | 94,570 | 29,252 | 18,621 |
| Investments Total | 259,286 | 306,370 | 277,409 |
| | | | |
| Add: PFI Additions (lifecycle costs) | 144 | 184 | 184 |
| Add: New Finance Lease (CR27) | 74,333 | 0 | 0 |
| Approved Capital Programme | 395,723 | 439,325 | 388,867 |
| | | | |
| Financed by: | | | |
| Grants | -37,721 | -66,109 | -52,080 |
| Section 106 | -5,196 | -456 | -456 |
| CIL | -775 | -2,347 | -2,347 |
| Capital Receipts | -3,999 | -2,063 | -5,702 |
| GF Contributions | 0 | -1,832 | -1,832 |
| HRA Contributions | -26,138 | -30,235 | -30,235 |
| Sub Total | -73,829 | -103,041 | -92,652 |
| | | | |
| Net financing need for the year | 321,894 | 336,284 | 296,215 |

Table 7 also highlights the original supported and unsupported elements of the capital programme and the expected financing arrangements of this capital expenditure. The borrowing need increases the underlying indebtedness of the Council by way of the CFR, although this will be reduced by MRP. This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

10.2 Prudential Indicator – CFR

Table 7 shows that the Council’s revised CFR will not exceed the Operational boundary. The S151 reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

The Authorised Limit represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Overall table 7 and 8 show the forecast capital spend is lower than originally forecast, predominantly due to delays caused by Covid-19. Expenditure is still significant in the IAS but there are delays in completing some of the schemes. There is a significant gap between the borrowing of £1.248bn, the forecast CFR of £1.411bn and the Operational Boundary of £1.700bn. Most of this has been caused by delays to investment schemes and by some pipeline schemes not being progressed. Borrowing will only be made when there is certainty over schemes being progressed.

Table 8: Revised Capital Financing Requirement as at 30 September 2021

| Prudential Indicator – CFR | | |
|--|-----------------------|-------------------------|
| Capital Expenditure | 2020/21 actual | 2021/22 Forecast |
| Opening CFR as at 31 March 2020 | 867,933 | 1,121,438 |
| Change in Year – General Fund | 253,505 | 286,261 |
| Change in Year – Housing | 0 | 3,409 |
| Total CFR as at 31 March 2021 | 1,121,438 | 1,411,108 |
| Net movement in CFR | 253,505 | 289,670 |
| | | |
| Net financing need for the year | 325,893 | 301,917 |
| Less: MRP* | -12,038 | -12,247 |
| Less: Capital Receipts | -60,350 | 0 |
| Movement in CFR | 253,505 | 289,670 |
| | | |
| Long & Short-Term Borrowing | 963,850 | 1,050,351 |
| PFI and finance lease liabilities* | 200,365 | 197,357 |
| Total debt 31 March 2021 | 1,164,215 | 1,247,708 |
| Operational Boundary | 1,250,000 | 1,700,000 |
| Authorised Limit | 1,350,000 | 1,800,000 |

10.3 Treasury Indicators: Limits to Borrowing Activity

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive, they will impair the opportunities to reduce costs / improve performance. The indicators are:

- i. Upper limits on variable interest rate exposure: identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- ii. Upper limits on fixed interest rate exposure: similar to the previous indicator and covers a maximum limit on fixed interest rates; and
- iii. Maturity structure of borrowing: gross limits to reduce the Council's exposure to large fixed-rate sums requiring refinancing.

The S151 officer reports that there were no breaches in any of the limits outlined below:

| Interest rate exposures | 2021/22 | 2021/22 | 2021/22 |
|--|----------------|----------------|----------------|
| | Upper | Upper | Upper |
| Limits on fixed interest rates based on net debt | 100% | 100% | 100% |
| Limits on variable interest rates based on net debt | 70% | 70% | 70% |
| Limits on fixed interest rates: | | | |
| • Debt only | 100% | 100% | 100% |
| • Investments only | 90% | 90% | 90% |
| Limits on variable interest rates | | | |
| • Debt only | 70% | 70% | 70% |
| • Investments only | 80% | 80% | 80% |

| Maturity structure of fixed interest rate borrowing 2021/22 | | |
|--|--------------|--------------|
| | Lower | Upper |
| Under 12 months | 0% | 50% |
| 12 months to 2 years | 0% | 60% |
| 2 years to 5 years | 0% | 70% |
| 5 years to 10 years | 0% | 70% |
| 10 years and above | 0% | 100% |

| Maturity structure of variable interest rate borrowing 2021/22 | | |
|---|--------------|--------------|
| | Lower | Upper |
| Under 12 months | 0% | 50% |
| 12 months to 2 years | 0% | 50% |
| 2 years to 5 years | 0% | 70% |
| 5 years to 10 years | 0% | 70% |
| 10 years and above | 0% | 80% |

11. Consultation

- 11.1 The Finance Director, in his role as statutory chief finance officer, has been informed of the approach, data and commentary in this report.

12. Financial Implications

Implications completed by: Katherine Heffernan, Head of Services Finance

- 12.1 This report sets out the mid-year position on the Council's treasury management position and is concerned with the returns on the Council's investments as well as its short and long-term borrowing positions.

13. Legal Implications

Implications completed by: Paul Feild, Senior Governance Lawyer

- 13.1 The Local Government Act 2003 (the "Act") requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.
- 13.2 The Council also has to 'have regard to' the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities when carrying out its functions under the Act.
- 13.3 The Assembly agreed the Treasury Management Strategy Statement for 2021/22 on 3 March 2021. This report is a mid-year review of the strategy's application and there are no further legal implications to highlight.

14. Options Appraisal

- 14.1 There is no legal requirement to prepare a TMSS Mid-Year Review. However, it is good governance to do so and meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

15. Other Implications

- 15.1 **Risk Management** - The whole report concerns itself with the management of risks relating to the Council's cash flow. The report mostly contains information on how the Treasury Management Strategy has been used to maximise income during the first 6 months of the year.

Public Background Papers Used in the Preparation of the Report: None

List of appendices: None