Report author: M Hasnip/D Brown

Tel: 89384 / 89207

TREASURY MANAGEMENT STRATEGY UPDATE 2021/22

Date: 17th November 2021

Report of: Chief Officer Financial Services

Report to: Executive Board

Will the decision be open for call in? ☒Yes ☐No

Does the report contain confidential or exempt information? ☐Yes ☒No

What is this report about?

1.1 This report provides a review and update of the treasury management strategy for 2021/22.

1.2 The Council's level of net external debt at 31st March 2022 is forecast to be £2,449m, £7m lower than approved in February 2021. This lower forecast is due to higher MRP (£4m) together with lower capital programme borrowing requirement (£2m) and balance sheet movements (£1m).

1.3 Cash resources have been used in lieu of external long-term borrowing during 2020/21 and this has continued into 2021/22. However, £46m of new long-term borrowing has been taken in 2021/22 as detailed in Table 4. Treasury activity is currently forecast to deliver a saving against budget of £0.9m.

1.4 The investment of surplus monies will continue to have due regard for security of capital in accordance with the Council's approved investment strategy.

Recommendations

That Executive Board note:

2.1 The update on the Treasury Management borrowing and investment strategy 2021/22.

Why is the proposal being put forward?

3.1 The 2021/22 treasury management strategy was approved by Executive Board on 10th February 2021. This report provides a review and update of the strategy for 2020/21.

What impact will this proposal have?

Wards Affected:		
Have ward members been consulted?	☐Yes	☒No

4.1 Borrowing Limits for 2021/22, 2022/23 and 2023/24

4.1.1 The Council is required to set various limits for 2021/22, 2022/23 and 2023/24 in accordance with the Local Government Act 2003, having regard for CIPFA's prudential code (as amended 2017). These limits including prudential indicators are detailed in Appendix A.

4.1.2 It is anticipated that the Council will continue to remain within the Authorised Limit for 2021/22. Both the Authorised Limit and Operational Boundary are made up of a limit for borrowing and a limit for other long-term liabilities.

4.1.3 The Chief Officer Financial Services has delegated authority to make adjustments between the two separate limits for borrowing and other long-term liabilities, provided that the overall limit remains unchanged. No adjustments between the limits have been made, and any such adjustments would be reported to the next available Council meeting following the change.

4.1.4 Borrowing limits for 2021/22 were approved by Council on 10th February 2021 and remain unchanged.

What consultation and engagement has taken place?

5.1 This report is an update on the strategy as presented to Executive Board in February 2021, as such no consultation has taken place. However, consultation with the Council's treasury advisors takes place regularly throughout the year.

5.2 The borrowing requirement is an outcome of the capital programme. Consultation is undertaken by individual services in relation to capital investment schemes. A capital programme update report is included elsewhere on this agenda.

What are the resource implications?

6.1 This update on the treasury strategy recognises the borrowing necessary to fund the capital programme requirements of both General Fund and HRA. Where borrowing is supported, the revenue costs are met by the Government, whilst for unsupported borrowing revenue costs are met either by the General Fund or HRA.

6.2 The execution of the Treasury Strategy enables funds to be raised and managed in the most efficient manner in line with the approved strategy as presented to Executive Board on 10th February 2021.

6.3 The updated strategy 2021/22 is forecast to deliver a saving of £0.9m. This is largely due to lower short term brokerage costs, as the level of revenue balances is higher than anticipated, reducing the need to borrow for short term cashflow reasons. Although short-term borrowing interest costs are also lower than budgeted, this is largely offset by lower interest income on balances. The conclusion of legal action in relation to LIBOR has also resulted in a saving in costs in comparison to the budget.

What are the legal implications?

7.1 There are no legal, or access to information issues arising from this report. The report is subject to call in.

7.2 The operation of the Treasury Management function is governed by provisions set out under part 1 of the Local Government Act 2003 whereby the Council is required to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities as amended 2017 in particular:

- The Prudential Code requires that full Council set certain limits on the level and type of borrowing before the start of the financial year together with a number of prudential indicators.
- Any in year revision of these limits must be set by Council.
- Policy statements are prepared for approval by the Council at least three times a year.

7.3 CIPFA are currently consulting on revisions to both the Prudential code for Capital Finance in Local Authorities and the Treasury Management in the Public Services Code of Practice. These revised codes are expected to be finalised and published in late 2021 with the aim being to adopt changes for the 2022/23 financial year. Once these revised codes are published the changes and implications will be fully reported and acted upon.

What are the key risks and how are they being managed?

8.1 This report sets out the framework for the treasury strategy for the year ahead. The execution of strategy and associated risks are kept under regular review through:

- Monthly reports to the Finance Performance Group
- Quarterly strategy meeting with the Chief Officer Financial Services and the Council's treasury advisors
- Regular market, economic and financial instrument updates and access to real time market information

8.2 The above monitoring mitigates the directorate level risk of "Failure to recover money invested in other financial institutions" and in addition the Treasury Management Strategy is linked to the corporate risk on 'Financial Forecasting'.

8.3 Review of Strategy 2021/22

8.3.1 The current borrowing forecasts are shown in Table 1

Table 1

ANALYSIS OF BORROWING 2021/22		2021/22 Feb 21 Report £m	2021/22 This Report £m
Net Borrowing at 1 April		2,283	**2,252**
New Borrowing for the Capital Programme – Non HRA		135	**159**
New Borrowing for the Capital Programme – HRA		53	**51**
Debt redemption costs charged to Revenue (Incl HRA)		(54)	**(56)**
Reduced/(Increased) level of Revenue Balances		39	**43**
Net Borrowing at 31 March*		2,456	**2,449**
Capital Financing Requirement			**2,737**
* Comprised as follows			
Long term borrowing	Fixed	2,172	**2,239**
	Variable (less than 1 Year)	35	**10**
	New Borrowing	173	**197**
Short term Borrowing (Previous years)		116	**43**
Total External Borrowing		2,496	**2,489**
Less Investments		40	**40**
Net External Borrowing		2,456	**2,449**
% borrowing funded by short term and variable rate loans		13%	**10%**

Note: The Capital Financing Requirement (CFR) is the maximum level of debt (i.e. borrowing PFI and finance leasing) that the Council can hold for its current year capital purposes. The Council is also allowed to borrow in advance for up to two future years capital programmes. The above reflects only the borrowing element of the CFR

Table 1 above shows that net external borrowing is now forecast at the end of 2021/22 to be £2,449m, £7m lower than in the report to Executive Board on 10th February 2021. The outturn position at 31st March 2021 was £31m lower than forecast, however this was largely due to slippage in new borrowing for the capital programme into the 2021/22 financial year. Cumulatively the lower forecast for net borrowing at 31st March 2022 is due to higher MRP (£4m) together with lower capital programme borrowing requirement (£2m) and balance sheet movements (£1m). The global economic position and its effect on UK interest rates and therefore on the cost of new borrowing for the Council continues to be uncertain.

8.3.4 Growth in the European Union has recovered after a contraction of 0.3% in Q1 to post 2% in Q2 and it is thought this will continue into Q3. As in the UK, gas and electricity prices are increasing and leading to inflationary pressures which may peak at around 4% but these are thought to be transitory and may not lead to an immediate policy response from the ECB. Germany has held elections which will result in a coalition government however the German leader Angel Merkle has announced that she will be stepping down. Although the direction of German economic policy may change as a result it is not thought that this will be a significant departure from that currently in place.

8.3.5 In China although they acted quickly to get on top of the initial COVID outbreak which resulted in China outperforming western economies this pace is falling back after this initial surge and they are now struggling to contain fresh outbreaks of the delta variant leading to sharp local lockdowns. In Japan more than 50% of the population are now vaccinated and cases are falling as a result. Although GDP growth in Q3 was weak it is thought Q4 will post a stronger number. On Inflation even with very loose monetary policy inflation was negative in July and prospects of this breaking 1% towards the 2% target in the near term seem remote. The new Japanese prime minister has promised a large fiscal stimulus package after the election in November.

8.3.6 In the United States significant stimulus packages have been announced including $900bn in December 2020, $1.9trn (equal to 8.8% of US GDP) under the new administration and further ambitions for spending on infrastructure. This stimulus is against a backdrop of an economy already growing strongly in 2021, FOMC stimulus through QE together with labour shortages and supply bottlenecks. These factors are thought to be inflationary and may bring forward the rise in US policy interest rates from near zero and /or the start of the US unwinding its QE programme.

8.3.7 In the United Kingdom the Monetary Policy Committee (MPC) have maintained base rate at 0.10% for the year to date although at the last meeting in September, 2 members voted against continuing with the programme of Quantitative Easing (QE) of which £35bn remains out of the £895bn target. Inflation has increased to 3.2% and is expected to move higher which is above the MPC target of 2%. Even though the MPC have been relaxed about a temporary increase in inflation the level of inflation and its expected duration is leading to a more hawkish tone from the MPC. This has been driven by concerns around gas and electricity prices in October 2021 and next April as well as underlying wage growth. The roll out of the COVID 19 vaccination programme has boosted economic confidence generally and this is in part due to the pent-up demand in the economy as a result of the early COVID lock down measures.

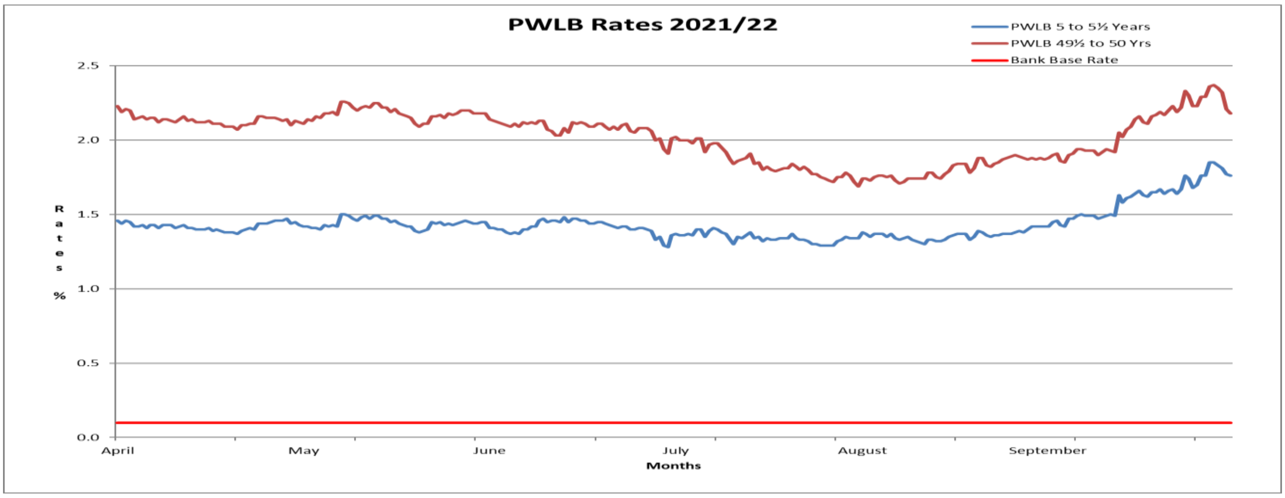
8.3.8 World Growth was in recession in 2020 but recovered during 2021 but it has been losing momentum recently with inflation rising due to gas and electricity prices globally and supply shortages. Evidence of worldwide disruption of supply chains is emerging leading to increasing shipping prices as well as shortages of items such as semi-conductors. It is expected that these issues will be sorted out in time, but it is recognised that they are contributing to a spike upwards in inflation.

8.3.9 During 2021/22, £40m of PWLB borrowing has been taken as detailed below in Table 4 below (paragraph 8.3.14). The markets continue to be monitored for further opportunities to secure long term borrowing. However, it should be noted that due to current balance sheet strength and the low interest rates available on investments this would result in a net cost of carry in the short term.

8.3.10 The Council has however taken advantage of 0% long term funding in 2021/22 for energy efficient capital investments and £5.959m of SALIX finance has been drawn down so far. The Council will continue to seek longer term funding opportunities both from the PWLB as well as from other sources.

8.3.11 The general trend in interest paid on debt is a widening between longer term rates and short/medium term rates particularly in the last few months. Chart 1 shows how the cost of longer term borrowing from the Government through Public Works Loan board (PWLB) loans has performed since the start of the financial year. Long term rates shown by 50-year PWLB has hovered around the 2.0% mark whilst short term rates as shown by 5-year PWLB have edged up from below 1.5% to around 1.75%. Please note the Council is entitled to a reduction of 20bp on all PWLB rates, including those listed above, reflecting eligibility for PWLB certainty rates.

Chart 1



8.3.12 Market expectations of Bank Rate movements in the UK are increasing due to domestic and international inflation concerns. The Council's advisors are now forecasting a rate rise in quarter 1 2022/23 although it should be noted that markets are reacting to the evolving economic picture and some economists are currently suggesting the 1st increase to 0.25% may come as early as November 2021. The last rate movement was a reduction from 0.75% to 0.25% on 11th March 2020 followed by a further reduction on 19th March 2020 to 0.10%, which is the lowest since this rate was introduced in 1694. Table 3 below shows current assumptions for budget purposes based on these market expectations. These rates although above current base rate provides scope for taking longer term borrowing on board as opportunities arise.

Table 3

Budget Rate Assumptions	2021/22	2022/23	2023/24	2024/25	2025/26
Exec Board Feb 21	1.75	2.25	2.50	n/a	n/a
Now	1.75	2.25	2.50	2.75	3.00

8.3.13 Securing long term low funding has reduced the Council's reliance on short term funding. The Council will continue to seek to lock in low longer-term funding as well as continuing the strategy to fund its borrowing requirement from its balance sheet strength and short-term funding.

8.3.14 Table 4 below details the long-term funding activity undertaken during 2021/22 which includes a SALIX finance facility of £9.9m which is being drawn in tranches during the year with £5.96m already drawn as detailed below

Table 4

Repayments and Funding 2021/22							
Repayments				New / Replacement Borrowing			
Date	Amount (£m)	Original Rate (%)	Discount Rate	Date	Amount (£m)	Term (Years)	Interest Rate (%)
PWLB				PWLB			
12/06/2021	26.436	3.97%	n/a	23/07/2021	20.000	49½ Years	1.67%
				09/08/2021	20.000	50 years	1.52%
Sub Total	**26.436**				**40.000**		
Market Loans				Market Loans			
01/10/2021	0.315	0.00%		Salix	5.959	8 year	0.00%
15/09/2021	0.024	0.00%					
01/03/2022	0.024	0.00%					
Sub Total	**0**				**5.959**		
Total	**26.436**			**Total**	**45.959**		

8.3.15 The Council's current long-term debt at 31/03/2022 of £2.250bn has an average maturity of just under 36 years if all debts run to maturity. Approximately 10% of the Council's long-term debt has lender options for repayment, in the unlikely event that all these options were exercised at the next option date then the average maturity of long-term debt would be lowered to approximately 31 years. This compares favourably for example with the average maturity of the UK Government debt portfolio of nearly 15 years. The existing profile of the Council's debt provides considerable certainty of funding costs. Prudential Indicator 16 in Appendix A shows the maturity profile of the Council's long term fixed debt and highlights that approximately 79% or £1,745m matures in periods greater than 10 years.

8.3.16 The management of the debt budget is forecast to deliver savings of £0.9m in 2021/22. This is largely due to a saving on short term brokerage costs, as the level of revenue balances is higher than anticipated, reducing the need to borrow for short term cashflow reasons. Although short-term borrowing interest costs are also lower than budgeted, this is largely offset by lower interest income on balances. The conclusion of legal action in relation to LIBOR has also resulted in a saving in costs in comparison to the budget.

8.4 Investment Strategy & Limits

8.4.1 The Council's external debt is reduced by the availability of revenue balances. The Treasury policy also allows for the external investment of these balances at advantageous rates but with due regard for security of capital invested. At present the Council's surplus monies continue to be held in short periods until required. As market sentiment to counter-party risk improves, together with enhanced returns, surplus monies will be invested in accordance with the approved lending list. This lending list is based upon the assessment of the financial standing of counterparties as determined by international credit rating agencies and further refined and updated by the Council's advisors on a continual basis. The lending list is often further restricted based upon the Council's view of the credit worthiness of counterparties.

8.4.2 The investment strategy, as re-affirmed by Executive Board and full Council in February, allows for the Council to invest in only the most highly rated financial institutions around the world. The Council will only lend up to a maximum of £15m to financial institutions that are rated as excellent. There is also a limit of £5m for financial institutions that are rated as very good.

Does this proposal support the council's 3 Key Pillars?

☒Inclusive Growth ☒Health and Wellbeing ☒Climate Emergency

9.1 Treasury Management strategy secures funding to support the Council's Policies and City Priorities as set out in the Council capital programme and is consistent with the Best Council Plan and 3 key pillars.

9.2 Equality, diversity, cohesion and integration requirements are addressed as part of individual capital scheme and programme approvals. The borrowing to deliver these capital schemes is executed through treasury strategy and as such there are no further equality, diversity, cohesion and integration issues.

9.3 Treasury management strategy secures funding for the council's capital programme that supports the authority's policies and priorities as set out in the Best Council Plan. These include our Best Council ambition to be an efficient and enterprising organisation.

Options, timescales and measuring success

a) What other options were considered?

This report provides and update to the board regarding the Treasury Management operation and activity. As such other options are not considered in this report.

b) How will success be measured?

Treasury Management continues to adhere to its governance framework including the CIPFA Code of Practice, the Prudential Codes 2017 and revised CIPFA guidance notes issued in 2018. All borrowing and investments undertaken have been compliant with the governance framework. Success will therefore be the continued optimal performance of the Treasury Management function within this framework.

Benchmarking of Treasury Management activity is only undertaken on an ad-hoc basis as the structure of debt portfolios and balance sheets of similar authorities often reflect the timing of past spending and financing decisions and therefore can lead to anomalies. The CIPFA Prudential Code makes it clear that prudential indicators should not be used for benchmarking purposes for this reason. The latest benchmarking exercise was undertaken in January 2021 as at the balance sheet date of 31/03/2020 for a comparison of external debt in relation to fixed assets for the core cities and significant variations in the resultant metrics were noted.

c) What is the timetable for implementation?

This report is to confirm the successful operation of the Treasury Management strategy within the established legal and operational framework and is a continuous and on-going process.

Appendices

1. Appendix A Prudential indicators 2021/22 to 2023/24
2. Appendix B Prudential Code Monitoring 2021/22 - Debt

Background papers

None

Appendix A

Leeds City Council - Prudential Indicators 2021/22 - 2023/24

No.	PRUDENTIAL INDICATOR	2021/22	2022/23	2023/24
	(1). EXTRACT FROM BUDGET AND RENT SETTING REPORTS			
	Ratio of Financing Costs to Net Revenue Stream			
1a	General Fund (Borrowing Only)	20.70%	21.90%	21.53%
1b	General Fund (Borrowing and Other Long Term Liabilities)	30.22%	31.08%	30.13%
2	HRA	11.27%	11.67%	11.88%
5	**Gross external borrowing requirement (Gross Debt and CFR)**	3,039,292	3,176,104	3,228,586
	The Gross Borrowing Requirement should not exceed the capital financing requirement **(Note 3)**	OK	OK	OK
	Estimate of total capital expenditure			
6	Non HRA	417,696	265,879	128,336
7	HRA	156,535	169,905	132,369
	TOTAL	574,231	435,784	260,705
	Capital Financing Requirement (as at 31 March)	**£'000**	**£'000**	**£'000**
8	Non HRA	2,425,244	2,512,689	2,533,018
9	HRA	862,204	915,348	952,918
	TOTAL	3,287,448	3,428,037	3,485,936

No.	PRUDENTIAL INDICATOR	2021/22	2022/23	2023/24
	(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'000**	**£'000**	**£'000**
10	**Authorised limit for external debt - (Note 5)**			
	borrowing	3,000,000	3,150,000	3,200,000
	other long term liabilities	670,000	630,000	600,000
	TOTAL	3,670,000	3,780,000	3,800,000
11	**Operational boundary - (Note 5)**			
	borrowing	2,850,000	2,850,000	2,850,000
	other long term liabilities	650,000	610,000	580,000
	TOTAL	3,500,000	3,460,000	3,430,000
14	**Upper limit for fixed interest rate exposure**			
	expressed as either:-			
	Net principal re fixed rate borrowing / investments OR:-	115%	115%	115%
	Net interest re fixed rate borrowing / investments			
15	**Upper limit for variable rate exposure**			
	expressed as either:-			
	Net principal re variable rate borrowing / investments OR:-	40%	40%	40%
	Net interest re variable rate borrowing / investments			
17	**Upper limit for total principal sums invested for over 364 days (Note 5)**	150,000	150,000	150,000
	(per maturity date)			
18	**Net Debt as a percentage of Gross debt**	98.4%	98.5%	98.5%

16	**Maturity structure of fixed rate borrowing as at 31/03/2022**	Lower Limit	Cumulative Upper Limit	Projected 31/03/2022
	under 12 months	0%	15%	3%
	12 months and within 24 months	0%	20%	6%
	24 months and within 5 years	0%	35%	5%
	5 years and within 10 years	0%	40%	7%
	10 years and within 20 years 20 years and within 30 years 30 years and within 40 years 40 years and within 50 years 50 years and above	25%	90%	79%
				100%

Notes.

1 **The indicator for the ratio of financing costs to net revenue stream for General Fund is now calculated based on the External Borrowing costs only and Borrowing and Other long term**

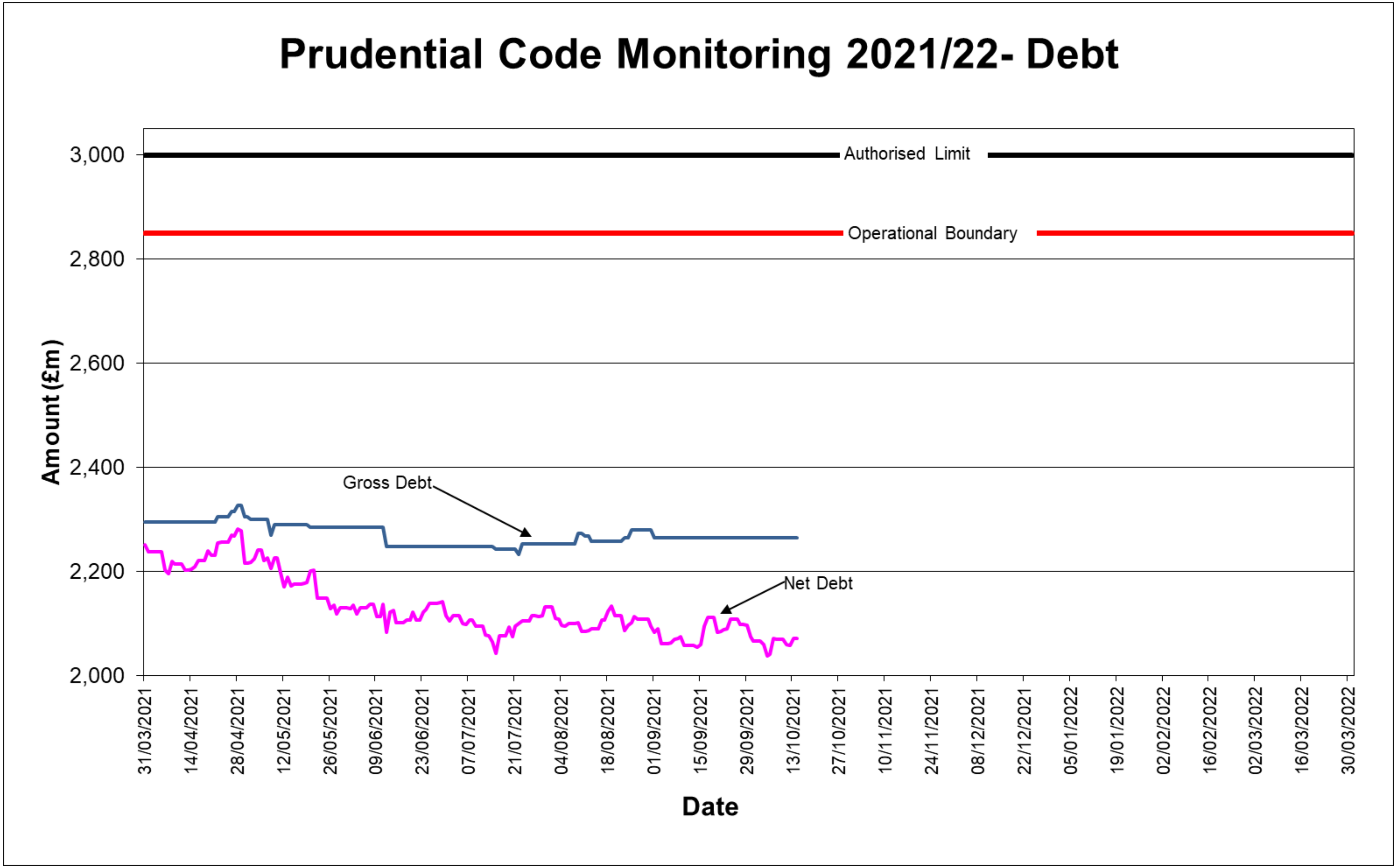
2 **The Changes to the Prudential Code 2017 retired the Indicator 3 and 4 on the incremental impact of New Capital decision on HRA and GF as well as Indicator 13 the need to explicitly adopt the Code of Practice. In addtion Indicator 9 the relating to the MHCLG imposed HRA borrowing debt ceiling has been recinded and is therefore no longer reported**

3 **In order to ensure that over the medium term gross borrowing will only be for a capital purpose, the Council should ensure that gross external borrowing does not exceed the total capital financing requirement in the preceding year plus estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence and was changed from Net Borrowing to gross borrowing under the update to the Codes in 2017.**

4 **Prudential indicator 12 relates to actual external debt at 31st March, which will be reported in the Treasury Management Annual Report pending further review**

5 **Indicators 14 and 15 are no longer explicit within the updated codes however these have been but have been retained**

6 **Indicator 17 relates solely to Treasury Management investments made under Section 12 of the Local Governement act 2003**


Prudential Code Monitoring 2021/22- Debt
Amount (£m)
3,000
2,800
2,600
2,400
2,200
2,000
Authorised Limit
Operational Boundary
Gross Debt
Net Debt
31/03/2021
14/04/2021
28/04/2021
12/05/2021
26/05/2021
09/06/2021
23/06/2021
07/07/2021
21/07/2021
04/08/2021
18/08/2021
01/09/2021
15/09/2021
29/09/2021
13/10/2021
27/10/2021
10/11/2021
24/11/2021
08/12/2021
22/12/2021
05/01/2022
19/01/2022
02/02/2022
16/02/2022
02/03/2022
16/03/2022
30/03/2022
Date