London Borough of Waltham Forest Annual Treasury Management Review

2021/22

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Annual Treasury Management Review 2021/22

Introduction

This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2021/22. This report 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).

During 2021/22 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 27/02/2021).
- a mid-year, (minimum), treasury update report (Council 03/03/2022).
- an annual review following the end of the year describing the activity compared to the strategy, (this report)

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit and Governance Committee before they were reported to the full Council. Member training on treasury management issues was undertaken during the year on 15/01/2019 in order to support members' scrutiny role.

Executive Summary

During 2021/22, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators – the 2021/22 comparators are the original budget presented to council on the 27th Feb 2021 and amended - are as follows:

Prudential and treasury indicators **Capital Expenditure**	**2020/21 Actual £000**	**2021/22 Original Estimate £000**	**2021/22 Actual £000**
General Fund	74,611	114,579	88,298
HRA	61,075	64,073	54,639
Total Capital Programme	135,686	178,652	142,937
Capital Financing Requirement: • Non-HRA • HRA • Total	 305,138 200,631 505,768	 354,961 231,765 586,726	 332,656 212,255 544,911
Gross borrowing	400,445	502,889	423,395
External debt* Finance Leases/PFI	355,314 45,131	460,632 42,252	381,144 42,251
Investments • Longer than 1 year • Under 1 year • Total	 - (71,048) (71,048)	 (70,000) (70,000)	 (74,423) (74,423)
Net borrowing	329,397	432,889	348,972

At the onset of 2021/22 it was envisaged to externalise borrowing of £105m (this was the under-borrowing position for 2020/21). The Council's actual under-borrowing position for 2021/22 is £121m. Investments in the special purpose vehicle and property investments did not materialise. Balances in reserves did not deplete as expected to externalise debt so reliance was made on internal borrowing.

- The Council's average investments for the year is £75m with an average rate 0.11% against the benchmark of the average o/n SONIA of 0.08%.
- In 2021/22 the investment income is £0.127m.

Other prudential and treasury indicators are to be found in the main body of this report. The Strategic Director of Finance and Governance (S151 Officer) confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit, (the authorised limit), was not breached.

The financial year 2021/22 continued with the challenging investment environment of previous years, namely low investment returns.

1. The Council's Capital Expenditure and Financing

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

General Fund	2020/21 Actual £000	2021/22 Original Estimate £000	2021/22 Actual £000
Capital expenditure	**74.611**	**114,579**	**88,298**
Capital Receipts	(18,552)	(13,132)	(5,552)
Capital Grants & Reserves	(41,487)	(29,645)	(26,655)
Self- Financing	-	(33,205)	(37,101)
Revenue	(13,924)	(8,696)	(1,122)
Unfinanced capital expenditure	**(648)**	**(29,901)**	**(17,868)**

HRA	2020/21 Actual £000	2021/22 Original Estimate £000	2021/22 Actual £000
Capital expenditure	**61,075**	**64,073**	**54,639**
Financed in year	(61,075)	(64,073)	(43,016)
unfinanced capital expenditure	**-**	**-**	**(11,624)**

Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

General Fund - Balance Sheet Resources	31 March 2021 £000	31 March 2022 £000
Capital receipts	28,843	17,555
Unapplied Capital Grants	1,527	1,204
Earmarked Reserves	86,530	78,330
Grant Reserves	26,792	23,229
Provisions	21,689	21,225
General fund Balance	14,911	14,906
Total	**180,292**	**156,449**

HRA Balance Sheet Resources (£m)	31 March 2021 £000	31 March 2022 £000
Balances	3,318	5,479
Earmarked reserves	5,878	3,436
Total	**9,196**	**8,915**

2. The Council's Overall Borrowing Need

The Council's underlying need to borrow to finance capital expenditure is termed as the Capital Financing Requirement (CFR).

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2021/22) plus the estimates of any additional capital financing requirement for the current (2022/23) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2021/22. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

General Fund	31 March 2021 Actual £'000	31 March 2022 Estimate £'000	31 March 2022 Actual £'000
CFR General Fund (£m)	305,138	354,961	332,656
CFR HRA (£m)	200,631	231,765	212,255
Total CFR (£m)	505,768	586,726	544,911
Gross borrowing position	(400,445)	(502,889)	(423,395)
Under funding of CFR	**105,323**	**83,837**	**121,516**

Borrowing activity is constrained by prudential indicators for gross borrowing and the CFR, and by the authorised limit.

As at 31st March 2022 the Council under-borrowed position is £163m, less finance lease and PFI of £42m is £121m. In 2020/21 the under-borrowed position was £150m less finance and PFI of £45m was £105m.

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2021/22 the Council has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream.

	2021/22 £000
Authorised limit	645,399
Maximum gross borrowing position during the year	423,395
Operational boundary	586,726

3.Treasury Position

The Council's investments and debts outstanding as at 31st March 2022 are £74m and £381m respectively. The Council's Investments and debts summary are as follow:

	31 March 2021 Principal £'000	Rate/ Return	Interest £'000	31 March 2022 Principal £'000	Rate/ Return	Interest £'000
Fixed rate funding:						
-PWLB	189,700	4.64%	(9,047)	236,286	4.08%	(8,793)
-Market	55,614	3.83%	(1,932)	60,856	3.60%	(2,165)
-Temporary Loan	110,000	0.43%	(575)	84,000	0.30%	(457)
Total debt	**355,314**	**3.20%**	**(11,554)**	**381,142**	**3.16%**	**(11,415)**
CFR	**505,768**			**544,911**		
Over / (under) borrowing	(150,454)			(163,769)		
Investments:						
- in house	71,048	0.08%	0.304	74,423	0.28%	0.127
Total investments	**71,048**	**0.08%**	**(11,250)**	**74,423**	**0.28%**	**(11,288)**

The maturity structure of the investment portfolio as follows.

	31 March 2021 Actual £000	2021/22 Original Estimate £000	31 March 2022 Actual £000
Investments			
Longer than 1 year	-	-	-
Under 1 year	71,048	70,000	74,423
Total	71,048	70,000	74,423

The maturity structure of the debts portfolio as follows:

	31 March 2021 Actual £000	2021/22 original limits £000	31 March 2022 Actual £000
Under 12 months	108,664	18,368	102,822
12 months and within 24 months	23,650	33,446	
24 months and within 5 years	20,238	13,511	16,204
5 years and within 10 years	35,777	29,818	24,074
10 years and within 20 years	34,600	46,727	45,637
20 years and within 30 years	132,385	64,600	5,115
30 years and within 40 years		111,785	104,318

Over 40 years		50,362	82,972
Total	**355,314**	**368,617**	**381,142**

The Council's treasury management debts and investments position is organised by the treasury management service to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices.

4. The Strategy for 2021/22

4.1 Investment Strategy

Investment Policy – the Council's investment policy is governed by DLUHC investment guidance, which has been implemented in the annual investment strategy approved by the Council on 27/02/2021. This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data.

In 2021/22 market-implied expectations for the path of Bank Rate over the year ahead had risen, with market pricing consistent with an increase in Bank Rate of 0.10 percentage points, in March 2021, gradually to 0.25% in December 2021, 0.50% in February 2022 and to 0.75% in March 2022. Hence the strong case for running down the authority' cash balances to help fund the capital programme. The Council had no liquidity difficulties.

The Treasury team kept the investments short-term (within 365 days). Investment returns remained low during 2021/22. The expectation for interest rates within the treasury management strategy for 2021/22 was that Bank Rate would stay at 0.25% during 2021/22 as it was not expected that the MPC would be able to deliver on an increase in Bank Rate. Over the last two years, the coronavirus outbreak has done huge economic damage to the UK and to economies around the world.

While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now able to cope with extreme stressed market and economic conditions.

Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates as illustrated in the charts shown above and below. Such an approach has also provided benefits in terms of reducing the counterparty risk exposure, by having fewer investments placed in the financial markets.

4.2 Borrowing strategy

During 2021-22, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Strategic Director of Finance and Governance (S151 Officer) therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks.

Borrowing in advance of need
The Council has not borrowed more than, or in advance of its needs, purely to profit from the investment of the extra sums borrowed.

Rescheduling
The Council did not undertake any long-term loan rescheduling in the year.

Other Issues (Regulatory changes) Appendix A

The Department for Levelling Up, Housing and Communities (DLUHC) issued “Consultation on changes to the capital framework: Minimum Revenue Provision” on 30th November 2021 to last for 10 weeks until 8th February 2022.
The outcome of consultation expected to come into effect from 2023/24.

- The paper primarily covers the concerns that the government has in respect of compliance with the duty to make a prudent revenue provision, which in their view, results in an underpayment of MRP
- The scope of the consultation includes the statement that local authorities have flexibility in how they calculate MRP, providing it is ‘prudent’. It goes on to say that recent reviews by the National Audit Office report on Local Authority Commercial Investments (Feb 2020) and subsequent report to Public Accounts Committee (Jul 2020) raised concerns that some authorities employ practices that are not fully compliant with the duty to make a prudent revenue provision, resulting in underpayment of MRP.

The proposed change to the regulation is set out below:

- Capital receipts may not be used in place of the revenue charge. The intent is to prevent authorities avoiding, in whole or part, a prudent charge to revenue. It is not the intention to prevent authorities using capital receipts to reduce their overall debt position, which may have the effect of reducing the MRP made with respect to the remaining debt balance.

- Prudent MRP must be determined with respect to the authority’s total capital financing requirement. The intent is to stop the intentional exclusion of debt from the MRP determination because it relates to an investment asset or capital loan. Authorities should still be able to charge MRP over the period in which their capital expenditure provides benefits and begin charging MRP in the year following capital expenditure, in accordance with proper accounting practices set out in the government’s statutory guidance on Minimum Revenue Provision.

The CIPFA prudential and Treasury Management code updates 2021. This is applied with immediate effect but can be defer until 2023/24.

Prudential code
Annual strategy to consider exiting commercial investment**.**

- Reference to ESG (Environment, Social and Governance) in capital strategy.

- Quarterly monitoring of Prudential indicators (PIs).
- New PI - net income commercial and service of investments as a % of net revenue.

- PWLB circular 162 and PWLB Guidance.
  Sets out 5 categories local authorities can borrow for
  PWLB will Not lend for debt for yield asset.
  The authority must not borrow primarily for financial returns.

Treasury Management Code

- Risk management to include ESG
- Knowledge and skills schedule
- Introduction of investment management practise (imp's) e.g. investment objective/criteria, risk management and decision making
- Liability benchmark – relationship between debts and CFR.

Economic and Interest rates Forecast Appendix B

The Bank of England's MPC hiked Bank Rate for a fifth consecutive meeting in June, taking it to 1.25%, their highest since the Great Financial Crisis. Markets had been mixed as to whether the MPC would move by 25bps or a larger 50bps given concerns over the current levels and outlook for inflation. As in May, the Committee voted 6-3 for the change in the policy rate with the three dissenters voting for a 50bps hike. In a change from the previous meeting, all nine members of the Committee endorsed the accompanying statement (two dissented in May), whose wording was also toughened up with regards the outlook and the appropriate monetary policy response that might be required. The statement said “the scale, pace and timing of any further increases in Bank Rate will reflect the Committee’s assessment of the economic outlook and inflationary pressures” and that “the Committee will be particularly alert to indications of more persistent inflationary pressures, and will if necessary act forcefully in response". This compared to May, when it said that "some degree" of further tightening in policy may be appropriate. In terms of forecasts, the Bank has revised down its Q2 growth expectations from +0.1% to -0.3%, while it has shifted on the peak of inflation from "slightly over 10%" to "above 11% in October", reflecting the next energy price cap. Overall, while the MPC did not follow the Fed's decision on a more aggressive policy rate hike, it has seemingly laid the groundwork for potential 50bps at upcoming meetings. Markets think the same, although pricing has been somewhat volatile in recent sessions. The latest shift has seen hike expectations reined in, although markets still expect the heavy-lifting to come near term, with only a modest pullback from a 50bps hike for August followed by a move to 2% by September, and then to 2.5% in November and 2.75% by the final meeting of the year in December. For 2023, pricing has shifted out, with a move to 3% now showing for March, with May seeing little further upside pressure. However, June figures, which may still be little traded, actually showing a decline to between 2.75% and 2.5%. The table below includes Link's forecast, which has been updated following the June MPC meeting. On the investment front, many banks still require investments of out to one month before providing the full extent of recent Bank Rate hikes, with their offerings reflecting their lack of appetite for yet more short-term, liquid cash. Further along the maturity spectrum, actual increases and market expectations are more fully priced in for the year ahead. Our ATS facility continues to offer a range of potential deposit options, including Standard Chartered's Sustainable

Bank Rate													
	NOW	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
Link Group	1.25%	1.25%	1.50%	1.75%	2.00%	2.00%	2.00%	2.00%	2.00%	1.75%	1.75%	1.75%	1.75%
Capital Economics	1.25%	1.25%	1.75%	2.25%	2.50%	2.75%	3.00%	3.00%	3.00%	3.00%	2.75%	2.50%	-

5yr PWLB Rate													
	NOW	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
Link Group	3.09%	2.50%	2.50%	2.60%	2.60%	2.60%	2.60%	2.60%	2.60%	2.50%	2.50%	2.50%	2.50%
Capital Economics	3.09%	3.10%	3.40%	3.80%	3.70%	3.60%	3.50%	3.50%	3.30%	3.20%	3.10%	2.90%	-

10yr PWLB Rate													
	NOW	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
Link Group	3.31%	2.80%	2.80%	2.90%	2.90%	2.90%	2.90%	2.90%	2.90%	2.80%	2.80%	2.80%	2.80%
Capital Economics	3.31%	3.30%	3.60%	3.80%	3.80%	3.70%	3.60%	3.60%	3.50%	3.30%	3.20%	3.10%	-

25yr PWLB Rate													
	NOW	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
Link Group	3.55%	3.00%	3.10%	3.10%	3.20%	3.20%	3.20%	3.10%	3.10%	3.00%	3.00%	3.00%	3.00%
Capital Economics	3.55%	3.50%	3.70%	3.80%	3.80%	3.80%	3.80%	3.70%	3.60%	3.50%	3.40%	3.30%	-

50yr PWLB Rate													
	NOW	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
Link Group	3.29%	2.70%	2.80%	2.80%	2.90%	2.90%	2.90%	2.80%	2.80%	2.70%	2.70%	2.70%	2.70%
Capital Economics	3.29%	3.30%	3.60%	3.80%	3.80%	3.70%	3.70%	3.70%	3.60%	3.50%	3.40%	3.40%	-

Glossary of Terms Appendix C

ALMO: An Arm's Length Management Organisation is a not-for-profit company that provides housing services on behalf of a local authority. Usually an ALMO is set up by the authority to manage and improve all or part of its housing stock.

LAS: Link Asset Services, Treasury solutions – the council's treasury management advisers.

CE: Capital Economics - is the economics consultancy that provides Link Asset Services, Treasury solutions, with independent economic forecasts, briefings and research.

CFR: capital financing requirement - the council's annual underlying borrowing need to finance capital expenditure and a measure of the council's total outstanding indebtedness.

CIPFA: Chartered Institute of Public Finance and Accountancy – the professional accounting body that oversees and sets standards in local authority finance and treasury management.

CPI: consumer price index – the official measure of inflation adopted as a common standard by countries in the EU. It is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. It is calculated by taking price changes for each item in the predetermined basket of goods and averaging them.

ECB: European Central Bank - the central bank for the Eurozone
EU: European Union
EZ: Eurozone -those countries in the EU which use the euro as their currency

Fed: The Federal Reserve System, often referred to simply as "the Fed," is the central bank of the United States. It was created by the Congress to provide the nation with a stable monetary and financial system.

FOMC: The Federal Open Market Committee – this is the branch of the Federal Reserve Board which determines monetary policy in the USA by setting interest rates and determining quantitative easing policy. It is composed of 12 members--the seven members of the Board of Governors and five of the 12 Reserve Bank presidents.

GDP: gross domestic product – a measure of the growth and total size of the economy.

G7: the group of seven countries that form an informal bloc of industrialised democracies--the United States, Canada, France, Germany, Italy, Japan, and the United Kingdom--that meets annually to discuss issues such as global economic governance, international security, and energy policy.

Gilts: gilts are bonds issued by the UK Government to borrow money on the financial markets. Interest paid by the Government on gilts is called a coupon and is at a rate that is fixed for the duration until maturity of the gilt, (unless a gilt is index linked to inflation); while the coupon rate is fixed, the yields will change inversely to the price of gilts i.e. a rise in the price of a gilt will mean that its yield will fall.

HRA: housing revenue account.

IMF: International Monetary Fund - the lender of last resort for national governments which get into financial difficulties.

LIBID: the London Interbank Bid Rate is the rate bid by banks on deposits i.e., the rate at which a bank is willing to borrow from other banks. It is the "other end" of the LIBOR (an offered, hence "ask" rate, the rate at which a bank will lend).

MHCLG: the Ministry of Housing, Communities and Local Government -the Government department that directs local authorities in England.

MPC: the Monetary Policy Committee is a committee of the Bank of England, which meets for one and a half days, eight times a year, to determine monetary policy by setting the official interest rate in the United Kingdom, (the Bank of England Base Rate, commonly called Bank Rate), and by making decisions on quantitative easing.

MRP: minimum revenue provision -a statutory annual minimum revenue charge to reduce the total outstanding CFR, (the total indebtedness of a local authority).

PFI: Private Finance Initiative – capital expenditure financed by the private sector i.e. not by direct borrowing by a local authority.

PWLB: Public Works Loan Board – this is the part of H.M. Treasury which provides loans to local authorities to finance capital expenditure.

QE: quantitative easing – is an unconventional form of monetary policy where a central bank creates new money electronically to buy financial assets, such as government bonds, (but may also include corporate bonds). This process aims to stimulate economic growth through increased private sector spending in the economy and also aims to return inflation to target. These purchases increase the supply of liquidity to the economy; this policy is employed when lowering interest rates has failed to stimulate economic growth to an acceptable level and to lift inflation to target. Once QE has achieved its objectives of stimulating growth and inflation, QE will be reversed by selling the bonds the central bank had previously purchased, or by not replacing debt that it held which matures. The aim of this reversal is to ensure that inflation does not exceed its target once the economy recovers from a sustained period of depressed growth and inflation. Economic growth, and increases in inflation, may threaten to gather too much momentum if action is not taken to ‘cool’ the economy.

RPI: the Retail Price Index is a measure of inflation that measures the change in the cost of a representative sample of retail goods and services. It was the UK standard for measurement of inflation until the UK changed to using the EU standard measure of inflation – CPI. The main differences between RPI and CPI is in the way that housing costs are treated and that the former is an arithmetical mean whereas the latter is a geometric mean. RPI is often higher than CPI for these reasons.

TMSS: the annual treasury management strategy statement reports that all local authorities are required to submit for approval by the full council before the start of each financial year.

VRP: a voluntary revenue provision to repay debt, in the annual budget, which is additional to the annual MRP charge, (see above definition).