Cabinet
14 June 2022

Annual Treasury Management Review 2021/22

Cabinet Member: Councillor Andrew Moore
Responsible Officer: Deputy Chief Executive (S151), Andrew Jarrett

Reason for Report: To provide Members with a review of activities and the prudential treasury indicators on actuals for 2021/22.

Recommendations(s):

1. **That Members note the treasury activities for the year.**
2. **That the actual 2021/22 prudential and treasury indicators in this report be approved.**

Relationship to the Corporate Plan: Maximising our return from all associated treasury activities enables the Council to support current levels of spending in accordance with our Corporate Plan.

Financial Implications: Good financial management and administration underpins the entire strategy.

Legal Implications: Authorities are required by regulation to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003.

Risk Assessment: The S151 Officer is responsible for the administration of the financial affairs of the Council. Implementing this strategy and the CIPFA Code of Practice on Treasury Management manages the risk associated with the Council's treasury management activity.

1. Introduction

1.1 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).

1.2 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 24/02/2021)
- a mid-year (minimum) treasury update report (Council 15/12/2021)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

1.3 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.

1.4 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 Cabinet before they were reported to the full Council. Member training on treasury management issues was undertaken during 2019 in order to support members' scrutiny role.

2. The Council's Capital Expenditure and Financing

2.1 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.

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

Capital Expenditure & Financing **General Fund**	**2020/21 Actual £000**	**2021/22 Actual £000**
Capital expenditure	6,086	7,479
Financed in year	2,130	1,545
Unfinanced capital expenditure	3,956	5,934
HRA		
Capital expenditure	2,714	4,241
Financed in year	2,637	4,195

Unfinanced capital expenditure	77	46

3. The Council's Overall Borrowing Need

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

3.2 **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 (2020/21) plus the estimates of any additional capital financing requirement for the current (2021/22) 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.

Capital Financing Requirement	31 March 2021 Actual £000	31 March 2022 Actual £000
CFR General Fund	18,295	21,525
CFR HRA	39,550	39,603
Total CFR	57,845	61,127
Gross borrowing position	39,467	37,424
(Under) / over funding of CFR	-18,378	-23,703

3.3 **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.

3.4 **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.

Borrowing Limits	2021/22 £000
Authorised limit	91,000
Maximum gross borrowing position during the year	39,467
Operational boundary	82,000
Average gross borrowing position	38,446

4. Treasury Position as at 31 March 2022

4.1 At the beginning and the end of 2021/22 the Council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

Debt Portfolio	31 March 2021 Principal £000	31 March 2022 Principal £000
Fixed rate funding:		
-PWLB	37,104	35,234
Total debt	37,104	35,234
CFR	55,409	58,938
(Under) / over borrowing	-18,305	-23,704
Total investments	17,500	27,000
Net debt	19,604	8,234

4.2 The maturity structure of the debt portfolio was as follows:

Debt Maturity Structure	31 March 2021 Actual £000	31 March 2022 Actual £000
Under 12 months	1,870	1,924
12 months and within 24 months	1,924	1,937
24 months and within 5 years	5,944	6,100
5 years and within 10 years	11,095	11,420
10 years and within 20 years	16,271	13,853
20 years and within 30 years	0	0

4.3 The Council's investment portfolio as at 31 March was as follows:

Investment Portfolio	31 March 2021 Actual £000	31 March 2021 Actual %	31 March 2022 Actual £000	31 March 2022 Actual %
Treasury investments				
Banks	0	0%	12,000	38%
Local authorities	15,500	69%	15,000	47%
Other Government Organisations	2,000	9%	0	0%
Total managed in house*	**17,500**	**78%**	**27,000**	**84%**
Property funds (CCLA)	5,000	22%	5,000	16%
Total managed externally	**5,000**	**22%**	**5,000**	**16%**
Total Treasury Investments	**22,500**	**100%**	**32,000**	**100%**

*See Appendix 1 for a breakdown of internally managed investments held as at 31 March.

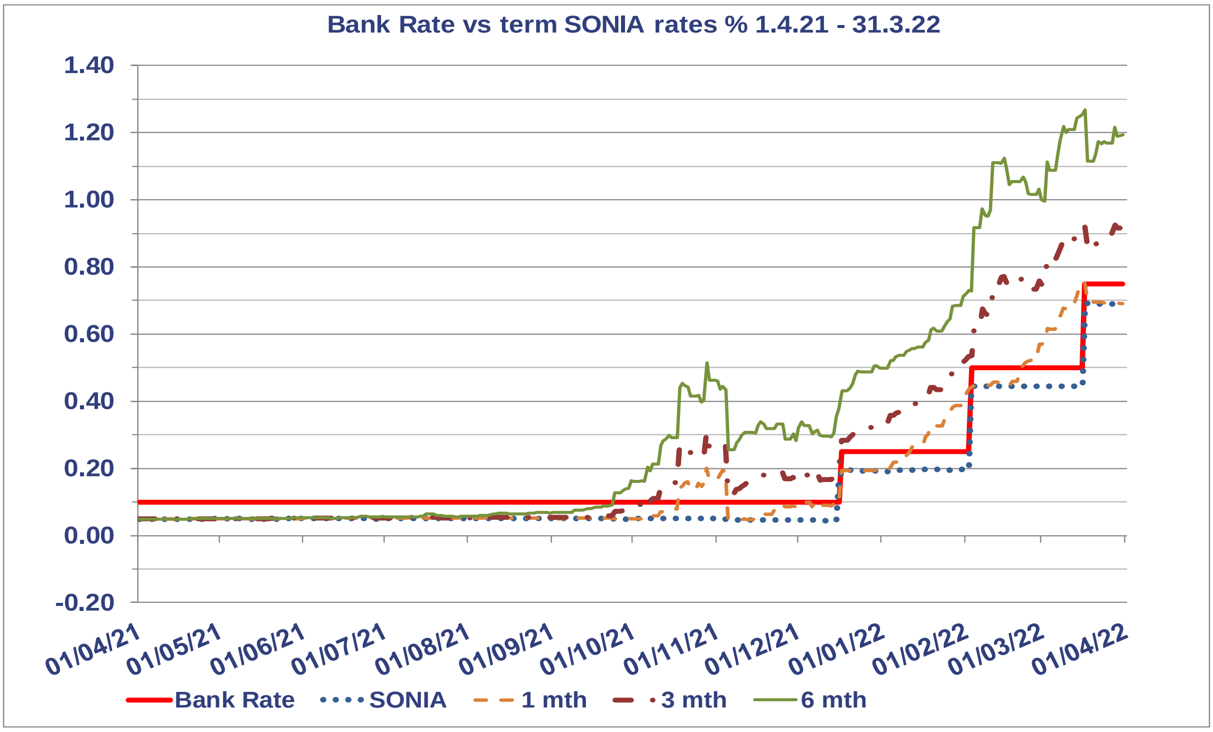
Investment Portfolio	31 March 2021 Actual £000	31 March 2021 Actual %	31 March 2022 Actual £000	31 March 2022 Actual %
Non Treasury investments				
Subsidiaries (3 Rivers Developments Ltd)	10,163	100%	13,590	100%
Total Non Treasury Investments	**9,061**	**100%**	**9,061**	**100%**

4.4 The value shown in the above table for the Council's CCLA investment is the amount paid by the Council on share acquisition. This differs to the carrying amount in the year end accounts of £5,554k (£4,725k in 2020/21) as there is a requirement to carry the investment at fair value. The fair value of the fund will continue to change over the longer term, and so this increase in value may only be temporary in which case it would not be realised as a gain to Council funds.

5. The strategy for 2021/22

5.1 Investment strategy and control of interest rate risk

5.1.1. The following chart shows how Bank Rate and SONIA (Sterling Overnight Index Average) rates have changed during the year.



5.1.2. Investment returns remained close to zero for much of 2021/22. Most local authority lending managed to avoid negative rates and one feature of the year was the continued growth of inter local authority lending. The expectation for interest rates within the treasury management strategy for 2021/22 was that Bank Rate would remain at 0.1% until it was clear to the Bank of England that the emergency level of rates introduced at the start of the Covid-19 pandemic were no longer necessitated.

5.1.3. The Bank of England and the Government also maintained various monetary and fiscal measures, supplying the banking system and the economy with massive amounts of cheap credit so that banks could help cash-starved businesses to survive the various lockdowns and the negative impact on their cash flow. The Government also supplied huge amounts of finance to local authorities to pass on to businesses. This meant that for most of the year there was much more liquidity in financial markets than there was demand to borrow, with the consequent effect that investment earnings rates remained low until towards the turn of the year when inflation concerns indicated central banks, not just the Bank of England, would need to lift interest rates to combat the second-round effects of growing levels of inflation (CPI was 6.2% in February).

5.1.4. 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 far more able to cope with extreme stressed market and economic conditions.

5.1.5. 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 counterparty risk exposure, by having fewer investments placed in the financial markets.

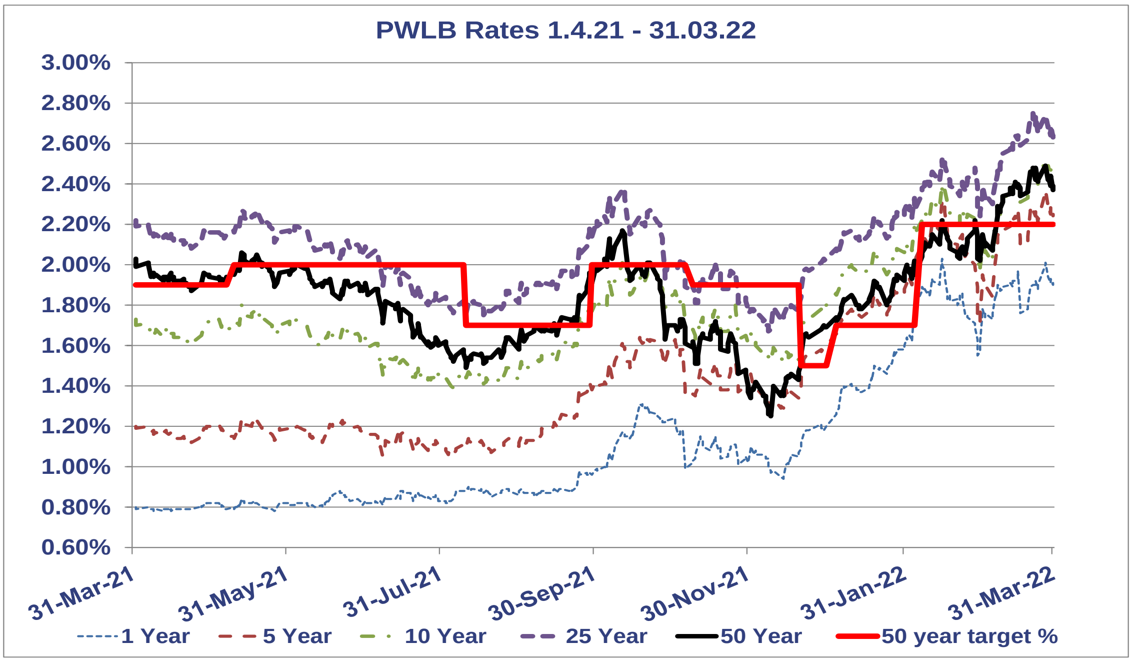
5.2 **Borrowing strategy and control of interest rate risk**

5.2.1. 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.

5.2.2. 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.

5.2.3. Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2021/22 and the two subsequent financial years until the turn of the year, when inflation concerns increased significantly. Internal, variable, or short-term rates, were expected to be the cheaper form of borrowing until well into the second half of 2021/22.

5.2.4. PWLB rates during 2021/22 are illustrated by the following chart:



	1 Year	5 Year	10 Year	25 Year	50 Year
01/04/2021	0.80%	1.20%	1.73%	2.22%	2.03%
31/03/2022	1.91%	2.25%	2.43%	2.64%	2.39%
Low	0.78%	1.05%	1.39%	1.67%	1.25%
Low date	08/04/2021	08/07/2021	05/08/2021	08/12/2021	09/12/2021
High	2.03%	2.37%	2.52%	2.75%	2.49%
High date	15/02/2022	28/03/2022	28/03/2022	23/03/2022	28/03/2022
Average	1.13%	1.45%	1.78%	2.10%	1.85%
Spread	1.25%	1.32%	1.13%	1.08%	1.24%

5.2.5. The following table shows forecast interest rates over the next three years:

Link Group Interest Rate View	7.2.22												
	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
3 month av. earnings	0.80	1.00	1.00	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20
6 month av. earnings	1.00	1.10	1.20	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30
12 month av. earnings	1.40	1.50	1.60	1.70	1.70	1.60	1.60	1.50	1.40	1.40	1.40	1.40	1.40
5 yr PWLB	2.20	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30
10 yr PWLB	2.30	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40
25 yr PWLB	2.40	2.50	2.50	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60
50 yr PWLB	2.20	2.30	2.30	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40

5.2.6. PWLB rates are based on gilt (UK Government bonds) yields through H.M.Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields. Over the last two years, many bond yields up to 10 years in the Eurozone have turned negative on expectations that the EU would struggle to get growth rates and inflation up from low levels. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. Recently, yields have risen since the turn of the year on the back of global inflation concerns.

5.2.7. Gilt yields fell sharply from the spring of 2021 through to September and then spiked back up before falling again through December. However, by January sentiment had well and truly changed, as markets became focussed on the embedded nature of inflation, spurred on by a broader opening of economies post the pandemic, and rising commodity and food prices resulting from the Russian invasion of Ukraine. At the close of the day on 31 March 2022, all gilt yields from 1 to 5 years were between 1.11% – 1.45% while the 10-year and 25-year yields were at 1.63% and 1.84%.

5.2.8. Regarding PWLB borrowing rates, the various margins attributed to their pricing are as follows:

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

5.2.9. There is likely to be a further rise in short dated gilt yields and PWLB rates over the next three years as Bank Rate is forecast to rise from 0.75% in March 2022 to 1.25% later this year, with upside risk likely if the economy proves resilient in the light of the cost-of-living squeeze. Medium to long dated yields are driven primarily by inflation concerns but the Bank of England is also embarking on a process of Quantitative Tightening when Bank Rate hits 1%, whereby the Bank's £895bn stock of gilt and corporate bonds will be sold back into the market over several years. The impact this policy will have on the market pricing of gilts, while issuance is markedly increasing, is an unknown at the time of writing.

6. Borrowing Outturn

6.1 **Borrowing** – due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

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

6.3 **Rescheduling** – no rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

7. Investment Outturn

7.1 **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 24/02/2021. 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 from our treasury advisers (Link Asset Services).

7.2 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

7.3 **Investments held by the Council**

- The Council maintained an average balance of £29.8m of internally managed funds.
- The internally managed funds earned interest of £54k giving an average rate of return of 0.18%.
- The comparable performance indicator is the 365 day backward looking SONIA rate, which was 0.0605%.
- The Council held £5m invested in Churches, Charities and Local Authorities (CCLA) property funds earning dividends of £183k (3.66%) in 2021/22.
- Interest received from 3 Rivers Ltd amounted to £558k in 2021/22.

8. Other Issues

8.1 **IFRS 9 fair value of investments**

8.1.1. Following the consultation undertaken by the Ministry of Housing, Communities and Local Government (MHCLG, now renamed the Department of Levelling Up, Housing & Communities [DLUHC]) on IFRS 9 the Government previously introduced a mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds. This came into effect on 1 April 2018 for 2018/19. The statutory override applies for five years from this date. Local authorities are required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve throughout the duration of the override in order for the Government to keep the override under review and to maintain a form of transparency.

8.1.2. Risk management will need to take account of the 2018/19 Accounting Code of Practice proposals for the valuation of investments. Whilst for many authorities, this may not be a significant issue, key considerations include:

- Expected credit loss model. Whilst this should not be material for vanilla treasury investments such as bank deposits, this is likely to be problematic for some investments such as property funds, loans to third parties or loans to subsidiaries.
- The valuation of investments previously valued under the available for sale category e.g. equity related to the "commercialism" agenda, property funds, equity funds and similar, have been changed to **Fair Value through the Profit and Loss (FVPL).**

8.2 **Non-treasury management investments**

8.2.1. As shown in the non-treasury investments table in section 4, the Authority holds a 100% interest in 3 Rivers Developments Limited, a private limited company engaged in construction in the Mid Devon area. The Authority advances funds to the Company to facilitate operations with the intention that they are repaid from the proceeds of the sale of the developments.

8.2.2. During the year ended 31 March 2022, £4.636m was loaned to the Company and £1.209m of existing loans was repaid. This brings the total loan value at 31 March 2022 to £13.590m. During the year £558k interest was paid to the Authority in respect of these loans.

8.2.3. These loans are subject to overarching management review on a regular basis. This is reflected in the impairments of £790k made in both periodic monitoring reports and in the year end financial statements for 2019/20. The year-end review, carried out in compliance with IFRS 9 Financial Instruments, determined that no further impairments were required for the year ending 31 March 2022.

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Appendix 1: Investment Portfolio

Internally managed investments held as at 31 March:

Bank/Building Society/Local Authority/PCC	Term		Fixed Interest Rate %	31/03/2021	31/03/2022
	From	To		£000	£000
Blackpool Borough Council	22/09/2020	06/04/2021	0.23%	2,000	
Spelthorne Borough Council	27/07/2020	26/07/2021	0.42%	1,500	
Broxbourne Borough Council	02/09/2020	01/09/2021	0.40%	2,000	
Salford City Council	14/09/2020	14/06/2021	0.20%	2,000	
Staffordshire Moorlands DC	16/10/2020	15/10/2021	0.22%	1,000	
South Somerset	20/10/2020	20/07/2021	0.20%	3,000	
Surrey Heath Borough Council	10/12/2020	10/06/2021	0.10%	2,000	
Nottinghamshire PCC	21/12/2020	21/06/2021	0.12%	2,000	
Ashford Borough Council	25/02/2021	25/11/2021	0.08%	2,000	
Surrey Heath Borough Council	10/12/2021	10/06/2022	0.10%		2,000
Thurrock Council	26/04/2021	25/04/2022	0.40%		2,000
NBK International PLC	27/07/2021	27/07/2022	0.23%		1,500
NBK International PLC	22/10/2021	21/10/2022	0.56%		1,500
Lancashire County Council	25/10/2021	24/10/2022	0.15%		3,000
Coventry BS	24/11/2021	24/05/2022	0.17%		4,000
Surrey Heath Borough Council	16/12/2021	16/06/2022	0.10%		2,000
Thurrock Council	16/12/2021	16/09/2022	0.18%		2,000
Thurrock Council	14/01/2022	14/07/2022	0.20%		2,000
Goldman Sachs International Bank	01/02/2022	01/08/2022	0.82%		3,000
NBK International PLC	04/02/2022	03/02/2023	1.30%		2,000
Slough Borough Council	15/02/2022	14/02/2023	1.10%		2,000
Total				**20,000**	**27,000**