OVERVIEW & SCRUTINY

DATE OF MEETING: 9th August 2022

TITLE OF REPORT: TREASURY MANAGEMENT OUTTURN 2021/22

Report of: Head of Corporate Services & Section 151 Officer

Cabinet Portfolio: Finance

Key Decision: No

Confidentiality: Non-Exempt

PURPOSE OF REPORT

1. To report the Council's Treasury Management activities during the year ended 31 March 2021 for scrutiny and comments in advance of consideration by Cabinet.

RECOMMENDATION

2. To forward comments to Cabinet for consideration at its meeting on September 1st, 2022.

BACKGROUND

3. 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).

4. During 2021/22 the minimum reporting requirements were that the Council should receive the following reports:
   - an annual treasury strategy in advance of the year (25.02.2021)
   - a mid-year (minimum) treasury update report (06.01.2022.)
   - an annual review following the end of the year describing the activity compared to the strategy (this report)

5. 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.

6. 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 Scrutiny Committee before they were reported to the full Council. Member training on treasury management issues was undertaken in December 2020 in order to support members' scrutiny role.

THE COUNCIL'S CAPITAL EXPENDITURE AND FINANCING

7. 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.

	2020-21 Actual £'000	2021-22 Budget £'000	2021-22 Actual £'000
Capital Expenditure	1,334	8,385	21,688
Financed in year	(1,851)	(1,585)	(3,127)
Unfinanced capital expenditure	**(517)**	**6,800**	**18,561**

THE COUNCIL'S OVERALL BORROWING NEED

8. The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2021/22 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

9. 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 2020/21. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	2020-21 Actual £'000	2021-22 Budget £'000	2021-22 Actual £'000
Total CFR	22,889	31,194	41,450
Gross borrowing position	11,535	16,554	18,088
(Under) / over funding of CFR	**(11,354)**	**(14,640)**	**(23,362)**

10. 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.

11. 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.

12. 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	30,000
Maximum gross borrowing position during the year	18,088
Operational boundary	25,000
Average gross borrowing position	14,812
Financing costs as a proportion of net revenue stream	-5.30%

TREASURY POSITION AS AT 31 MARCH 2022

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

	2020-21 £'000	2021-22 £'000
Short-term Borrowing	(1,382)	(2,439)
Long-term Borrowing	(10,152)	(15,649)
Short-term Investments	17,000	15,000
Cash & Cash Equivalents	16,127	14,844

14. The maturity structure of the debt portfolio was as follows:

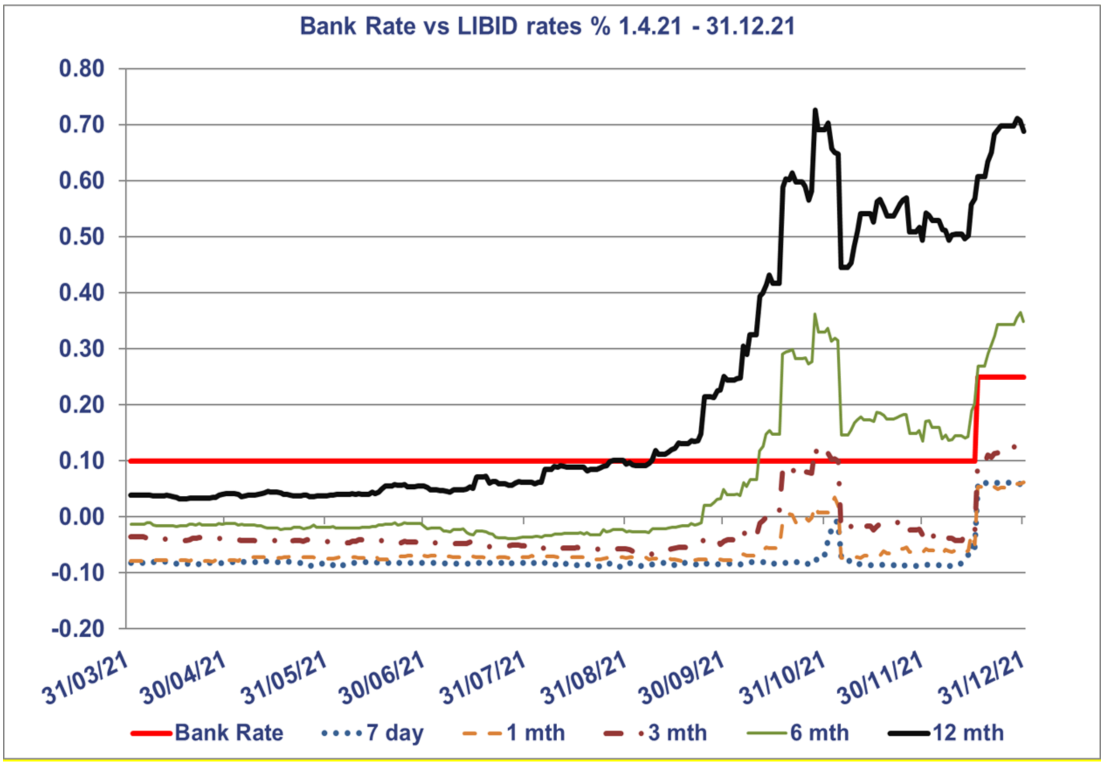
	2020-21 £'000	2021-22 £'000
Less than one year	1,383	2,439
Between one and two years	1,303	1,314
Between two and five years	2,025	1,085
Between five and ten years	1,955	1,998
Between ten and fifteen years	2,180	2,228
Between fifteen and twenty years	2,431	2,224
More than twenty years	257	6,800

15. Investment portfolio:

	(£) Balance	Interest Rate	Maturity (days)
Standard Chartered	5,000,000	0.28%	162
Qatar National Bank	5,000,000	0.72%	180
Barclays Ltd - Green Account 95 days	5,000,000	0.30%	95 days notice
Bank of New York Mellon - Federated	4,900,000	0.39%	Instant
Insight Liquidity Funds plc	4,000,000	0.39%	Instant
Aberdeen Liquidity- Standard Life	5,000,000	0.40%	Instant
Barclays-FIBCA	746,598	0.00%	Instant
Total	**29,646,598**		

THE STRATEGY FOR 2021/22

16. Investment strategy and control of interest rate risk



	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
High	0.25	0.06	0.06	0.14	0.36	0.73
High Date	17/12/2021	29/12/2021	31/12/2021	31/12/2021	30/12/2021	28/10/2021
Low	0.10	-0.09	-0.08	-0.07	-0.04	0.04
Low Date	01/07/2021	27/08/2021	17/09/2021	08/09/2021	27/07/2021	08/07/2021
Average	0.11	-0.07	-0.05	-0.01	0.09	0.31
Spread	0.15	0.15	0.14	0.20	0.40	0.68

17. 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. 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/negative impact on their cashflow. 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).

18. 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.

19. 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.

BORROWING STRATEGY AND CONTROL OF INTEREST RATE RISK

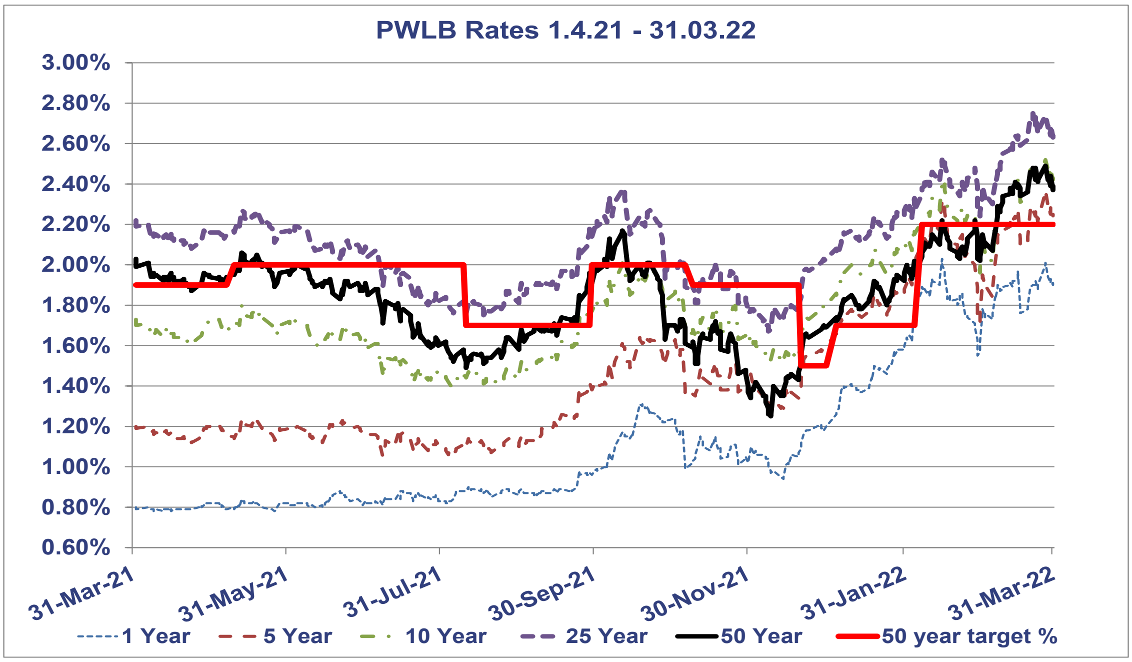
20. During 2021-22, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy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

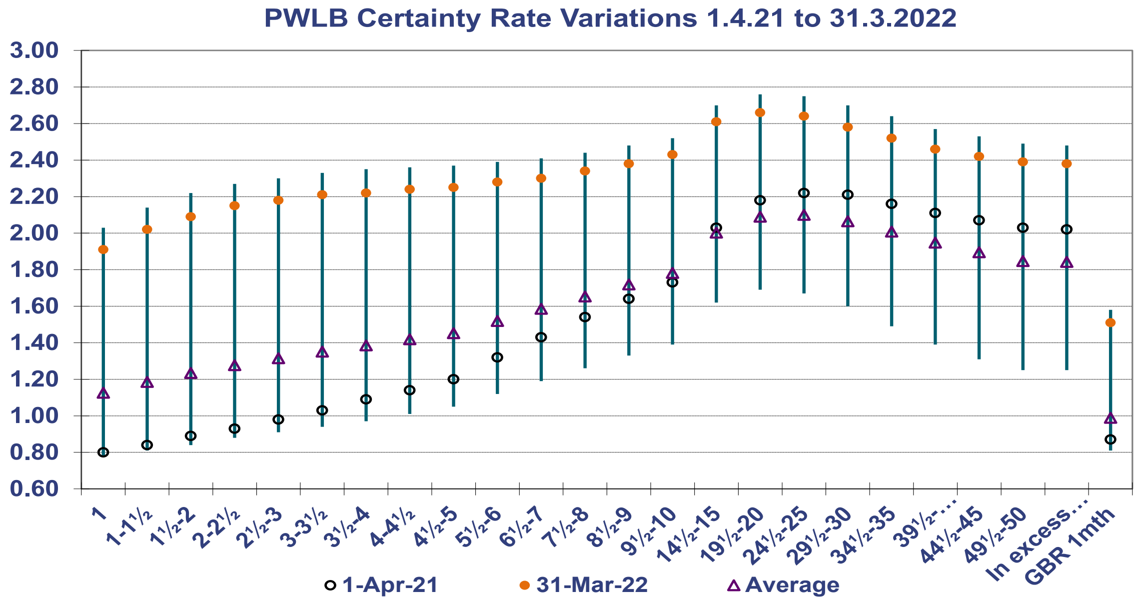
21. The policy of avoiding new borrowing by utilising cash balances has been implemented where possible.

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

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

23. PWLB Rates 1.4.21 – 31.03.22



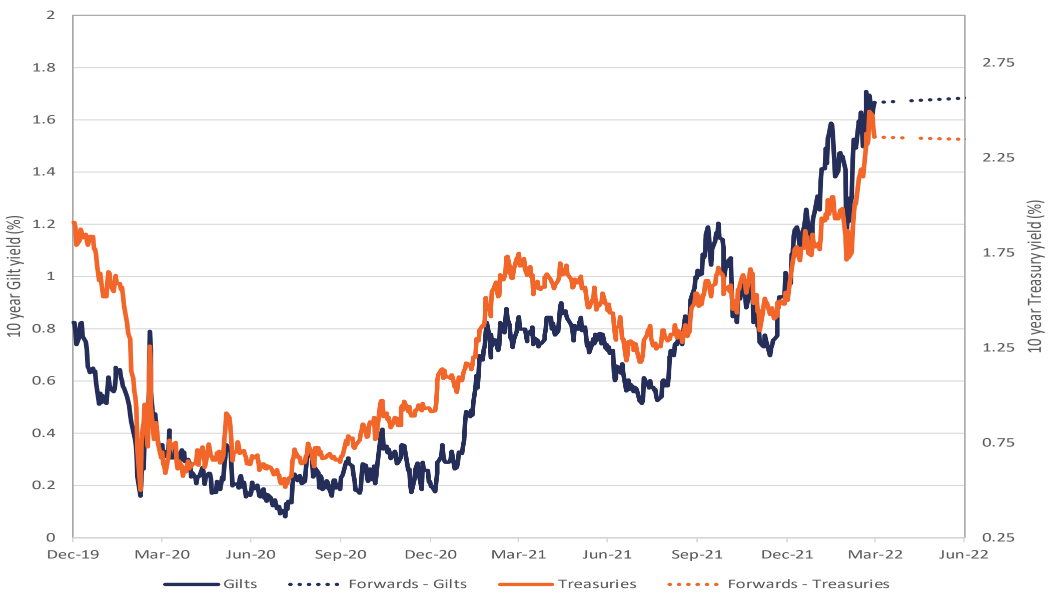


HIGH/LOW/AVERAGE PWLB RATES FOR 2021/22

	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%

24. 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. Inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation and the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. We have seen over the last two years, many bond yields up to 10 years in the Eurozone turn 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.

Graph of UK gilt yields v. US treasury yields



25. 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 rates 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.

BORROWING OUTTURN

26. Treasury Borrowing – breakdown of borrowing at 31st March 2022:

Lender	Balance (£'000)	Type	Interest Rate	Maturity
PWLB 1	8,338	Fixed Rate	2.19%	25 years
PWLB 2	6,800	Fixed Rate	1.91%	50 years
Hampshire County Council	2,950	Fixed Rate	0.00%	7 years

27. Borrowing – New £6.8mil PWLB loan has been undertaken during the year to finance purchase of Edenbrook apartments with the housing accommodation purpose.

28. 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.

INVESTMENT OUTTURN

29. 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 19/01/2021. 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, (such as rating outlooks, credit default swaps, bank share prices etc.).

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

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

Balance Sheet Resources	2020-21	2021-22
Balances	£'000	£'000
Earmark Reserves	(25,556)	(26,454)
Provisions	(274)	(527)
Usable Capital Receipts	(387)	(382)
Total	**(26,216)**	**(27,363)**

32. Investments held by the Council – at the end of the financial year the Council held the funds detailed in 6.3 which were managed internally. The total investment income for 2021/22 was £118k compared to a budget of £100k.

OTHER ISSUES

33. Counter Party Limits. The council permanently extended the counterparty limits for Barclays bank accounts from £5mil to £10mil to accommodate for Barclays green 95 days' notice account.

34. Counter Party limits for Barclays have been authorised for overnight limit breach on two occasions during 2021-22:
    - when council received PWLB £6.8mil
    - in preparation for Centenary house £12mil payments

EQUALITIES

35. There are no impacts to equality from the recommendations of this paper

CLIMATE CHANGE IMPLICATIONS

36. There are no direct carbon/environmental impacts arising from the recommendations of this paper

CONCLUSION

37. This report provides Members with information on the level of investment and interest earned during the last financial year and demonstrates the council's compliance with the Treasury Management Strategy.

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BACKGROUND PAPERS:
Treasury Management Strategy Statement (19. January 2021.)

APPENDICES
1- Prudential and Treasury Indicators
2- Approved countries for investments as at 31.3.22