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AUDIT COMMITTEE/ EXECUTIVE / COUNCIL

Portfolio Area:	Resources
Date:	**7 September 2022 / 15 September 2022 / 19 October 2022**

ANNUAL TREASURY MANAGEMENT REVIEW OF 2021/22 INCLUDING PRUDENTIAL CODE

NON-KEY DECISION

Author	– Brian Moldon	Ext. 2515
Contributor	– Rhona Bellis / Kaha Olad	Ext. 2730
Lead Officer	– Brian Moldon	Ext. 2515
Contact Officer	– Brian Moldon	Ext. 2515

1 PURPOSE

1.1 To review the operation of the 2021/22 Treasury Management and Investment Strategy.

2 RECOMMENDATIONS

2.1 **Audit Committee**
That subject to any comments by the Audit Committee to the Executive, the 2021/22 Annual Treasury Management Review is recommended to Council for approval.

2.2 **Executive**
That subject to any comments made by the Executive, in addition to those made by the Audit Committee, the 2021/22 Annual Treasury Management Review is recommended to Council for approval.

2.3 **Council**
That subject to any comments from the Audit Committee and the Executive, the 2021/22 Annual Treasury Management Review be approved by Council.

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3 BACKGROUND

3.1 Regulatory requirement

3.1.1 The 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).

3.1.2 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 (Council 24/02/2021)
- a mid-year 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).

3.1.3 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.

3.1.4 Officers confirm that they have complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit Committee and the Executive before they were reported to the Council.

3.2 The Economy and Interest rates in 2021/22 and current position

3.2.1 **Bank Rate.** Over the last two years, the coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16th December 2021, 0.50% at its meeting of 4th February 2022 and then to 0.75% in March 2022. Since the new year, there have been a further two increases of 0.25% in June and then on the 4 August the Monetary Policy Committee voted to increase the bank rate to 1.75%.

3.2.2 **GDP.** The UK economy has had several periods of lock down through 2021/22, but with most of the economy now opened up and returning to business-as-usual, the GDP numbers have been robust (9% y/y Q1 2022) and sufficient for the MPC to focus on tackling the second-round effects of inflation, now that the CPI measure has already risen to 10.1% in June 2022 and commentators are now predicting a rise to even 18% by October.

3.2.3 **Inflation.** This was the major change in 2020/21 adopted by the Bank of England in terms of implementing its inflation target of 2%. The key addition to the Bank's forward guidance in August 2020 was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and *achieving the 2% target sustainably*". That does seem out of date in the current economic situation. There is now an issue of supply side shortages, labour shortages, commodity price inflation, the impact of Russia's invasion of Ukraine and subsequent Western sanctions all point to inflation being at elevated levels until well into 2023

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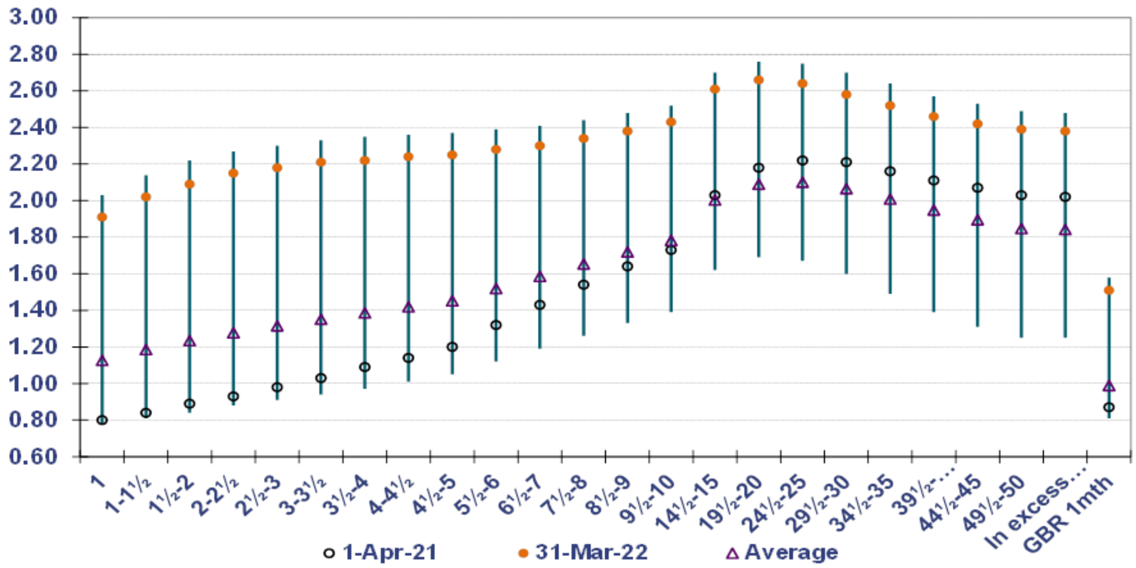
3.2.4 The upward pressure on inflation from higher oil prices and potential knock-on impacts on supply chains all argue for tighter policy (with CPI at 10.1% for June) but the hit to real disposable incomes and the additional uncertainty points in the opposite direction.

3.2.5 **PWLB borrowing 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.

PWLB Certainty Rate Variations 1.4.21 to 31.3.2022



3.2.6 The target average borrowing rate in the latest HRA Business Plan last updated 2021 (HRA BP) was 1.6% for 2020, rising to 1.72% in 2021 and 1.74% in 2022. New HRA borrowing of £10Million was taken externally in March 2021 at 2.06% and in February 2022 the following loans were taken. £5Million for 25.5 years at 2.22% and £4.047Million for 21 years at 2.24%. The HRA BP assumed a 3.5% average rate for future loans. Recent interest rate rises have led to current forecast rates exceeding (for loans longer than 20 years) the original HRA BP forecasts and the HRA BP will be revised and reported to the November 2022 Executive.

Rates* as at:	Mar-21	Feb-22	Aug-22
Years	Actual Rate %	Actual Rate %	Actual Rate %
5			3.46
10			3.37
15			3.38
20	2.06		3.53
21		2.24	3.57
25.5		2.22	3.71

* Rates include a 0.2% Certainty Rate reduction

3.2.7 There are alternatives to the PWLB for borrowing, for both the General Fund and the HRA, including the UK Municipal Bonds Agency. The UKMBA provides funding through three lending programmes.

- Proportionally guaranteed, pooled loans of £1 million or more for maturities greater than one year.
- Standalone loans to a single local authority for £250 million or more for maturities greater than one year. These loans are outside of the proportional guarantee and are guaranteed solely by the borrower, who must obtain an external credit rating from one or more of the major credit rating agencies.
- Short term, pooled loans, outside of the proportional guarantee for maturities of less than one year.

The UKMBA borrow primarily in the capital markets to lend to local authorities to fund pre-agreed loans. Borrowing rates may be lower using the UKMBA but lead times and administration are greater than for PWLB borrowing arrangements.

4 TREASURY MANAGEMENT ACTIVITIES

4.1 OVERALL TREASURY POSITION AS AT 31 MARCH 2022

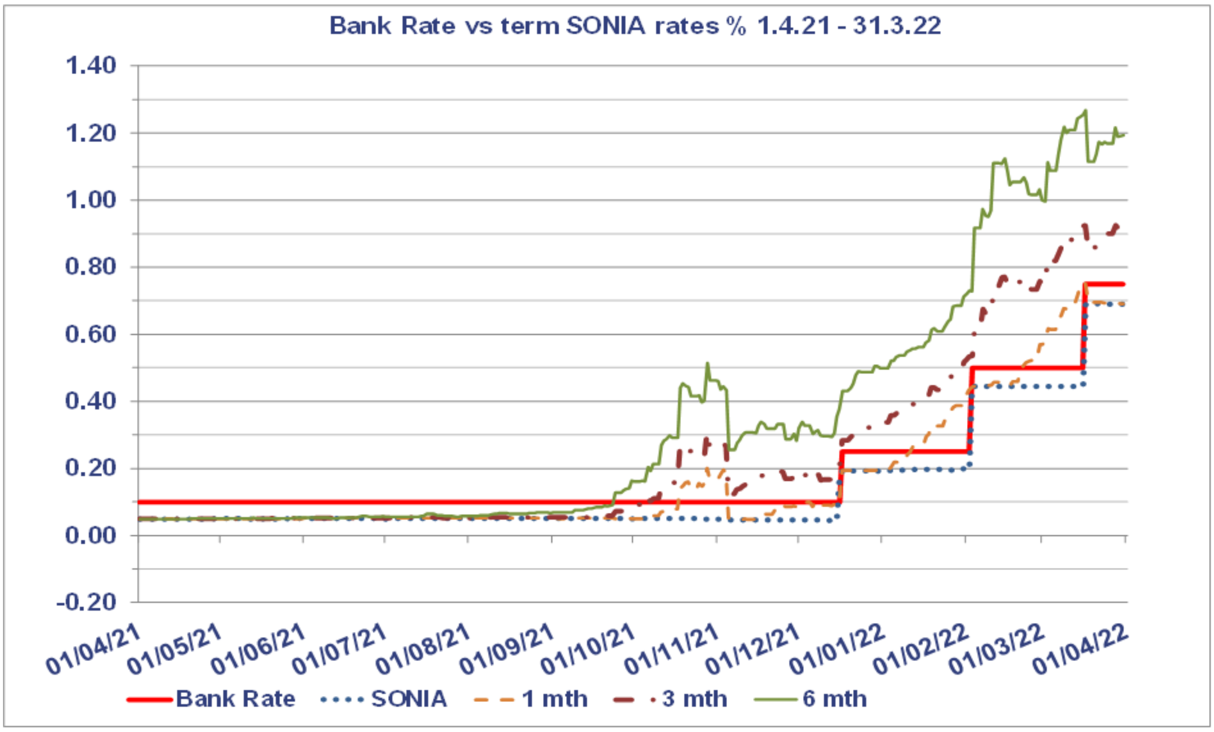
4.1.1 As at 31 March 2021 and 2022 the Council's treasury position was as follows:

Table two: Treasury Position						
	2020/21			2021/22		
	31 March 2021 Principal £'000s	Rate / Return %	Average Life (Yrs)	31 March 2022 Principal £'000s	Rate / Return %	Average Life (Yrs)
Total PWLB Borrowing	**218,966**	**3.34**	**12.53**	**227,750**	**3.28**	**12.89**
Capital Financing Requirement	267,432			305,223		
Over/(under) borrowing	(48,466)			(77,473)		
Investments Portfolio (see section 4.2.5)	**69,700**	**0.65**		**68,750**	**0.35**	

4.1.2 Investment balances reduced year-on-year by £950k. The balances include restricted use funds that can only be used to finance capital spend, money set aside as provisions and monies held on behalf of others including council tax and business rates provisions and advance payments (see paragraph 4.2.3.2). Members should note the investment balances have been distorted by COVID related grants to be paid to businesses and residents and the reliefs given by the government to compensate the Council for changes to the business rate regime. compared to a 'normal' year

4.1.3 During the year the average investment balance was £80.908 Million, earning interest of £286,304 and achieving an average interest rate of 0.35%. The comparable rate was 0.14% (Sterling Overnight Index Average (SONIA) rate). This compares with an original budget assumption of £202,910 investment interest based on average investment rate of 0.25%.

4.1.4 The following chart shows UK Bank Rate and SONIA rates in 2021/22. It can be seen that SONIA rates remained below Bank Rate all year.



4.2 TREASURY MANAGEMENT STRATEGY 2021/22

4.2.1 The original 2021/22 Treasury Management strategy had projected Bank Rate of 0.10% for the duration of 2021/22. The actual Bank Rate was 0.10% until February 2022 when it increased to 0.5% and then went to 0.75% during March 2022. The returns achievable on the Council's investments are currently modest based on the low Bank of England base rate and the risk appetite of the TM Strategy, which is compliant with the advice from the Council's treasury advisors, Link Asset Management.

4.2.2 **The Council's Capital Expenditure and Financing 2021/22.**

4.2.2.1 In 2021/22 the Council spent £61.342Million on capital projects (General Fund and Housing Revenue Account). The capital programme was funded from a combination of existing capital resources and an increase in borrowing (General Fund £12.364 Million, HRA £25.487 Million). Table three details capital expenditure and financing used in 2021/22.

Table three : 2021/22 Capital Expenditure and Financing				
	2021/22 Original Estimate £'000	2021/22 Quarter 3 Working Budget £'000	2021/22 Actual £'000	2021/22 Variance Actual to Q3 Working Budget £'000
Capital Expenditure:				
General Fund Capital Expenditure	17,399	28,987	24,121	(4,866)
HRA Capital Expenditure	52,488	43,594	37,221	(6,373)
Total Capital Expenditure	**69,887**	**72,581**	**61,342**	**(11,239)**
Resources Available for Capital Expenditure:				
Capital Receipts	(14,958)	(11,829)	(9,493)	2,336
Capital Grants /Contributions	(9,131)	(9,909)	(8,308)	1,601
Capital Reserves	(1,869)	(802)	0	802
Revenue contributions	(342)	(1,969)	(1,862)	107
Major Repairs Reserve	(11,798)	(8,839)	(3,828)	5,011
Total Resources Available	**(38,097)**	**(33,348)**	**(23,491)**	**9,857**
Capital Expenditure Requiring Borrowing	**(31,790)**	**(39,233)**	**(37,851)**	**(1,382)**

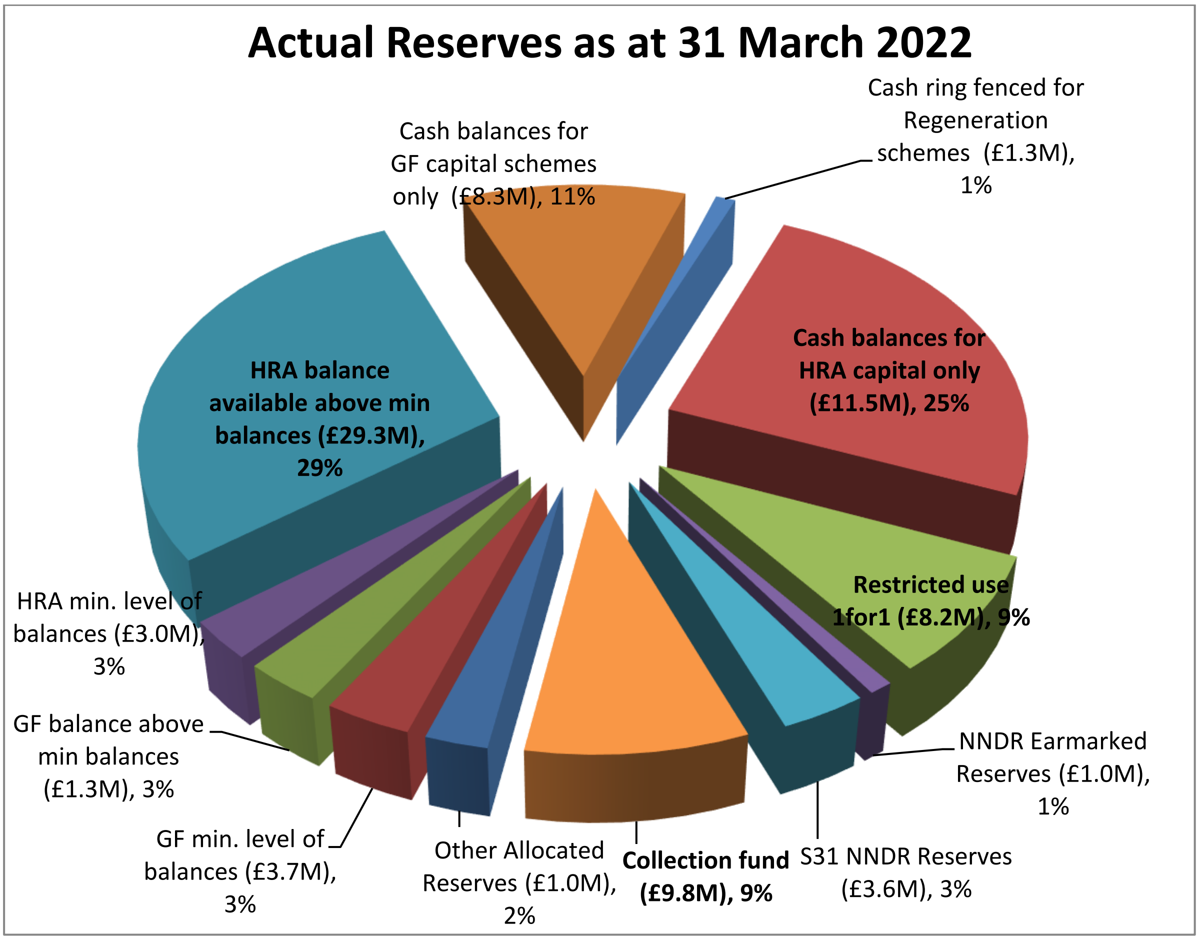
4.2.2.2 The Treasury Management review of 2021/22 and Prudential Indicators have been updated to reflect changes to capital budgets which have been approved throughout the year. The actual capital expenditure for 2021/22 was reported to the Executive on 12 July 2022.

4.2.3 The Council's overall need to borrow and Capital Financing Requirement

4.2.3.1 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). It represents the amount of debt it needs to/has taken out to fund the capital programme (and includes both internal and external borrowing). The CFR is then reduced as debt repayments are made and Minimum Revenue Provisions (MRP – see also section 4.2.4) are made. A separate CFR is calculated for the General Fund and Housing Revenue Account and any transfers of assets (such as land or buildings) between the two accounts will impact on each fund's CFR. The CFR will go up on the fund "receiving" the assets and go down (by the same amount) on the fund "giving" the asset.

4.2.3.2 Cash balances enable the Council to use internal borrowing in line with its Capital Strategy and Treasury Management Strategy. This position is kept under review taking into account future cash balances and forecast borrowing rates. The apportionment of General Fund and HRA cash balances on 31 March 2022 is shown in the following chart, but Members should note that these cash balances relate in part to the restricted use right to buy "one for one" receipts (£9Million) and balances relating to Council Tax and NNDR

(£14Million), which includes the £9Million for the business rate appeals provision, (there are outstanding appeals on the 2010 rating list).



4.2.3.3 As at the 31 March 2022 the Council had total external borrowing of £227.750Million. The debt repayment profile is shown in the following table:

Table four Maturity of Debt Portfolio for 2020/21 and 2021/22		
Time to maturity	**31 March 2021 Actual £'000's**	**31 March 2022 Actual £'000's**
Maturing within one year	263	263
1 year or more and less than 2 years	263	0
2 years or more and less than 5 years	500	8,500
5 years or more and less than 10 years	49,656	57,656
10 years or more	168,284	161,331
Total	**218,966**	**227,750**

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4.2.3.4 The General Fund had external borrowing of £2.019Million with the Public Works Loan Board (PWLB). The HRA had external borrowing of £225.731Million all held with the PWLB, of which £30.820Million relates to the Decent Homes programme, £7.763Million from pre 2012, £4.010Million taken out in 2019/20, £10.0 Million taken out in 2020/21 and new loans of £9.047Million taken out in year. The remainder of £194.911 Million relates to self- finance the payment made to central government in 2012.

4.2.3.5 In addition to the PWLB borrowing, the General Fund also has loans from the Local Enterprise Partnership (LEP) in relation to regeneration activities. The schedule as at the 31 March 2022 is set out below. Discussions took place with the LEP regarding making these re-investible loans for further regeneration of the town, rather than needing to be repaid on the dates originally agreed. As indicated in the table, the current position is that only £209K of the £7.279Million received to date has been repaid. The remaining balance is repayable - £6.57Million in 2030 and £0.5Million in 2025. The loans are at zero interest.

Table Five: LEP Loans						
Loan Received	**Site Assembly**	**Land Assembly**	**SG1**	**Repaid**	**Total**	**Repayment Date**
2015/16	762,488			(208,795)	553,693	31/03/22
2018/19	416,306				416,306	
2019/20		4,108,709			4,108,709	
2020/21		1,491,291	500,000		1,991,291	
Total	**1,178,794**	**5,600,000**	**500,000**	**(208,795)**	**7,069,999**	

4.2.3.6 The Council's CFR is one of the key prudential indicators and is shown in the following table.

Table Six : Capital Financing Requirement 2020/21 and 2021/22			
CFR Calculation	**31-Mar-21 (£'000)**	**31-Mar-22 (£'000)**	**Movement in Year (£'000)**
Opening Balance	**244,656**	**267,432**	
Closing Capital Financing Requirement (General Fund)	34,338	46,642	12,304
Closing Capital Financing Requirement (Housing Revenue Account)	233,094	258,581	25,487
Closing Balance	**267,432**	**305,223**	**37,791**

Table Six : Capital Financing Requirement 2020/21 and 2021/22			
CFR Calculation	**31-Mar-21 (£'000)**	**31-Mar-22 (£'000)**	**Movement in Year (£'000)**
Increase/ (Decrease)	**22,776**	**37,791**	

4.2.3.7 The CFR for the HRA has increased by £25.487Million, due to increased borrowing requirement to fund major repairs & improvements and new housing.

4.2.3.8 The General Fund's CFR has increased by £12.304Million, due to;

- Borrowing requirement of +£2.154Million
- New Marshgate Ltd loans of +£11.179Million
- less Minimum Revenue Provision (MRP) (see section 4.2.4) of -£195K
- less loan repayments made in year totalling -£834K

4.2.4 Minimum Revenue Provision (MRP)

4.2.4.1 The Prudential Code, by which the Council has to make its borrowing decisions, requires the Council to demonstrate that borrowing is required and affordable. The MRP is a statutory requirement to ensure borrowing is affordable for the General Fund and does not apply to the HRA (the HRA affordability is determined in the HRA BP). The Council is required to make annual MRP based on its policy approved by Council as part of the Treasury Management Strategy. The calculation of MRP is based upon prior years' borrowing requirement (regardless of whether that borrowing was internal or external) and the life of the asset for which the borrowing was required.

4.2.4.2 The MRP charged to the General Fund in 2021/22 was £195,200, of which

- £35,100 is funded from investment property
- £29,400 is funded by the Garage Improvements Programme
- £130,700 is a net cost to the General Fund

4.2.5 Cash Balances and Investment

4.2.5.1 The restrictive use of a proportion of the cash balances set out in paragraph 4.2.3.2, plus the planned use of resources in line with the Council's capital and revenue strategies mean that these resources are not available for new expenditure. The following chart shows the level of balances as at 31st March 2022 and the projected position following the planned use to 2025/26.

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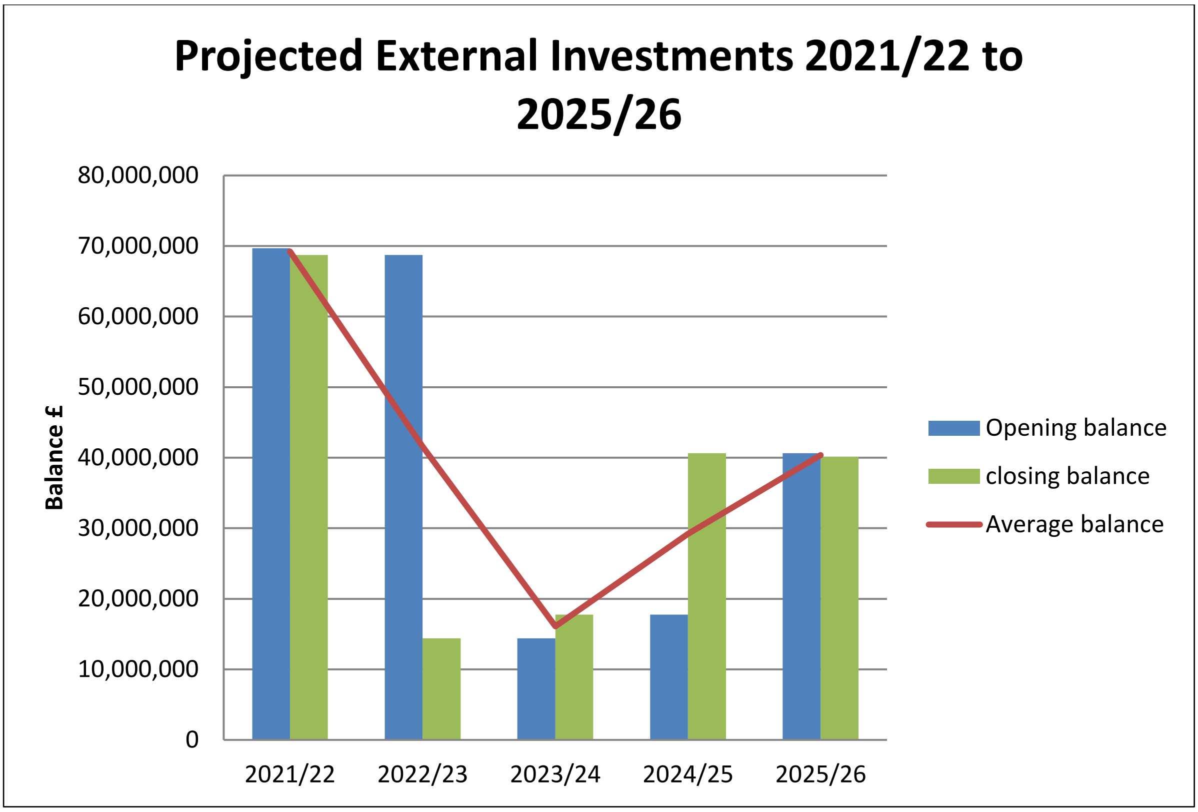
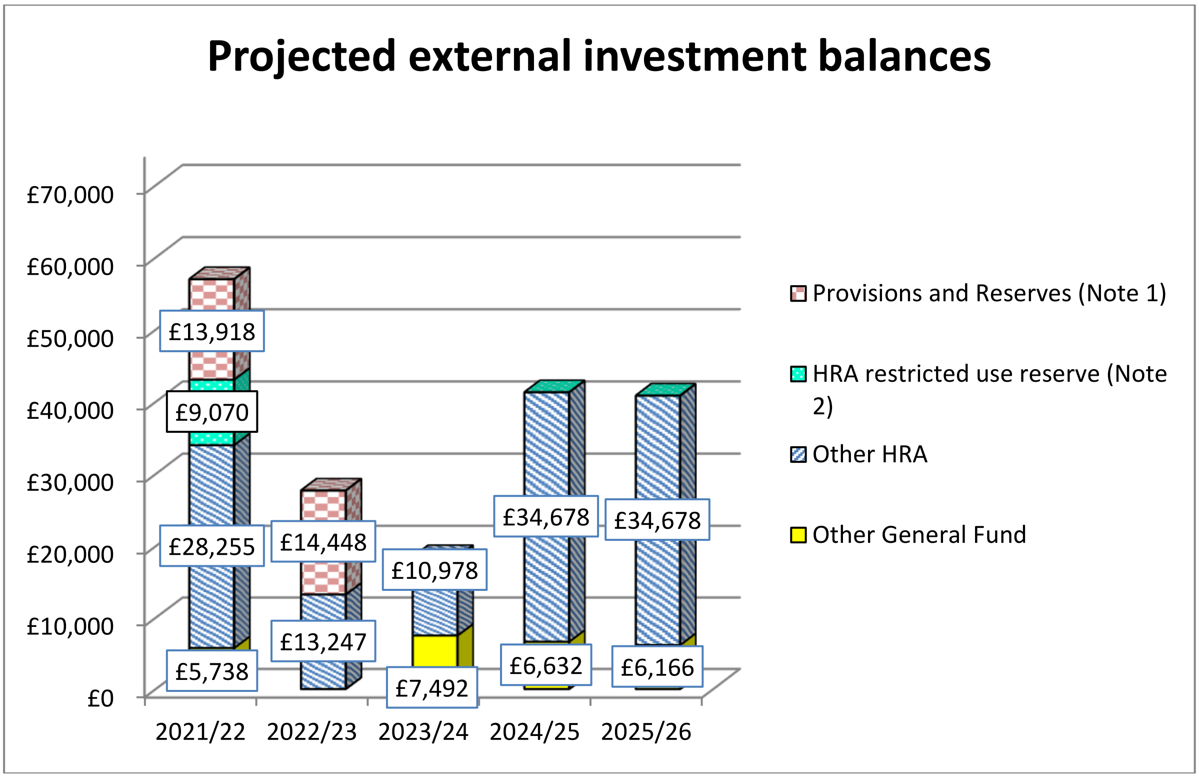


4.2.5.2 The chart below shows the breakdown of the projected external investment balances, showing what the external investments are held to fund.



1) Council Tax & NNDR held for bad debts and appeals and collection fund reserves.
2) 1-4-1 new build

4.2.5.3 In accordance with the Treasury Management Strategy approved by Council on 24 February 2021, the Council invests it surplus cash balances, that are committed for future approved spending. The 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 and counterparty limits dependant on level of cash balances held.

4.2.5.4 There were no breaches to this policy in 2021/22 with the investment activity during the year conforming to the approved strategy. The Council had no liquidity difficulties and no funds were placed with the Debt Management Office (DMO) during 2021/22, demonstrating that counterparty limits and availability for placing funds approved in the TM Strategy were working effectively. It is possible that surplus funds borrowed during 2022/23 will be placed in the DMO temporarily, if PWLB borrowing rates are advantageous and cash balances due to the timing of taking out new loans would breach other counterparty limits.

4.2.5.5 The Specified and Non-Specified Investment Criteria (Appendix C) have been reviewed and updated in the Treasury Management Strategy 2022/23 agreed at Full Council in February 2022. Appendix C reflects the strategy in place for 2021/22. No further amendments are proposed at this stage.

4.2.6 **Other Prudential Indicators**

4.2.6.1 The treasury management indicators for 2021/22 onwards have been updated based on the updated Capital Strategy approved by Council in February 2022 and subsequently updated in the 3rd quarter capital update reported to Executive in March 2022 and the 4th quarter (Outturn) capital update reported to Executive in July 2022.

4.2.6.2 The **net borrowing position** for the Council as at 31 March 2022 was **£159Million** (total external borrowings/loans of £227.750Million less total investments held of £68.750Million).

4.2.6.3 The **operational boundary** and **authorised limit** refers to the borrowing limits within which the treasury team operate. A temporary breach of the operational boundary is permissible for short term cash flow purposes however a breach of the authorised limit would require a report to Council. **There were no breaches of either limit in 2021/22.**

4.2.6.4 The **ratio of financing costs** to net revenue stream is equal to General Fund interest costs divided by the General Fund net revenue income from Council tax, Revenue Support Grant and retained business rates. The 2021/22 indicator is **2.10%.**

4.2.6.5 The full list of treasury prudential indicators is shown in Appendix A and has been updated for the 2021/22 outturn position.

4.3 OTHER ISSUES

4.3.1 **Operational and Authorised Borrowing Limits**

4.3.1.1 General Fund limits will be reviewed if necessary in the Mid-Year 2022/23 Treasury Management Strategy, due to go to Executive and Audit Committee in November 2022 and Council in December 2022.

4.3.1.2 HRA limits will be revisited as part of the HRA BP review to be reported to Executive in December 2022.

4.3.2 **Property Funds and Commercial Strategy.** As reported in the most recent Treasury Management Strategy, approved by Council in February 2022, Commercial investments (including investment properties), which are entered into primarily for gain by earning a positive net financial return are no longer permitted in the Capital Strategy, in order to access PWLB rates. Therefore this activity, and the borrowing requirement for it, is no longer included in the Prudential Indicators set out in Appendix A.

4.3.3 **UK Sovereign rating and investment criteria**. The UK sovereign rating could come under continued pressure from the impact of COVID and / or following the post-Brexit trade agreements agreed and their impact on the UK economy. The Council's investment criteria only use countries with a rating of AA- or above. Moody's UK Sovereign rating is Aa3 (AA-equivalent), the same as Fitch, while Standard & Poor's has it rated at AA. The UK rating remains exempt from the sovereign rating investment criteria so in this event if it were to result in the UK being downgraded below AA- it would not impact on the Council's ability to invest with UK institutions. Other investment criteria will be considered in this event to ensure security of funds for the Council.

5 IMPLICATIONS

5.1 Financial Implications

5.1.1 This report is of a financial nature and reviews the treasury management function for 2021/22. Any consequential financial impacts identified in the Capital strategy and Revenue budget monitoring reports have been incorporated into this report.

5.1.2 During the financial year Officers operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

5.2 Legal Implications

5.2.1 Approval of the Prudential Code Indicators and the Treasury Management Strategy are intended to ensure that the Council complies with relevant legislation and best practice.

5.2.2 The changes to PWLB borrowing arrangements as per paragraph 4.3.2, prohibiting access to PWLB where Council's retain commercial investments within their Capital Strategy, have been addressed and these activities removed.

5.3 Risk Implications

5.3.1 The current policy of minimising external borrowing only remains financially viable while cash balances are high and the differentials between investment income and borrowing rates remain. Should these conditions change the Council may need to take borrowing at higher rates which would increase revenue costs.

5.3.2 There remains uncertainty on the long-term implications of exiting the EU on the UK economy and borrowing rates. Officers monitor interest rate forecasts to inform the timing of borrowing decisions.

5.3.3 The Council's Treasury Management Strategy is based on limits for counterparties to reduce risk of investing with only a small number of institutions.

5.3.4 The thresholds and time limits set for investments in the Strategy are based on the relative ratings of investment vehicles and counter parties. These are designed to take into account the relative risk of investments and also to preclude certain grades of investments and counterparties to prevent loss of income to the Council.

5.3.5 There is a risk to the HRA BP's ability to fund the approved 30 year spending plans if interest rates continue to rise, this will included in the revision to the BP in November 2022.

5.4 Equalities and Diversity Implications

5.4.1 This report is technical in nature and there are no implications associated with equalities and diversity within this report. In addition to remaining within agreed counterparty rules, the council retains the discretion not to invest in countries that meet the minimum rating but where there are concerns over human rights issues. Counterparty rules will also be overlaid by any other ethical considerations from time to time as appropriate.

5.4.2 The Treasury Management Policy does not have the potential to discriminate against people on grounds of age; disability; gender; ethnicity; sexual orientation; religion/belief; or by way of financial exclusion. As such a detailed Equality Impact Assessment has not been undertaken.

5.5 Climate Change Implications

5.5.1 The council's investment portfolio is sterling investments and not directly in companies. However the TM team continue to review the use of Money Market funds to ensure, where possible, money market funds that invest in environmentally sustainable companies are used. In this way the TM team aligns with the Councils ambition to attempt to be carbon neutral by 2030.

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BACKGROUND PAPERS

- BD1 Treasury Management Strategy including Prudential Code Indicators 2021/22 (Council 24 February 2021)
- BD2 Mid-year Treasury update (Council 15 December 2021)

APPENDICES

- Appendix A Prudential Indicators
- Appendix B Investment and Borrowing Portfolio
- Appendix C Specified and Non-Specified Investment Criteria