Appendix 8

Annual Report on the Treasury Management Service and Actual Prudential Indicators 2021/22

Purpose
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 Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy 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.

Executive Summary
During 2021/22 the council complied with its legislative and regulatory requirements. The actual prudential indicators for the year along with prior year comparators are as follows:

	2020/21 £'m	2021/22 £'m
Actual Capital Expenditure	**132.616**	**137.800**
Capital Financing Requirement (CFR)		
General Fund	326.715	321.690
HRA	468.374	487.431
Total	**795.089**	**809.121**
Financing Costs as a Proportion of Net Revenue Stream		
General Fund	5.5%	6.1%
Housing Revenue Account	22.6%	22.2%

Other prudential and treasury indicators are to be found in the main body of this report. The Director of Financial also confirms that borrowing was only undertaken for capital purposes and that the statutory borrowing limit (Authorised Limit) was not breached.

At 31 March 2022, the council's external debt was £475.588m (£481.593m at 31 March 2021) and its short-term investments totalled £51.101m (£37.306m at 31 March 2021).

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

Recommendations

The council is recommended to:
- Approve the actual 2021/22 prudential and treasury indicators in this report.
- Note the annual treasury management report for 2021/22.

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

1.1. The council undertakes capital expenditure on long term assets. These activities can 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 to not apply resources, the capital expenditure will give rise to a borrowing need.

1.2. Actual capital expenditure is one of the required prudential indicators. The table below also shows how this expenditure was financed.

	2020/21	2021/22	
	Actual £'m	Estimate £'m	Actual £'m
Capital Expenditure			
General Fund	82.301	94.804	79.523
HRA	50.315	70.808	58.277
Total	**132.616**	**165.612**	**137.800**
Resourced by:			
Capital Receipts	18.869	32.836	18.351
Capital Grants & Contributions	58.737	44.591	53.964
Revenue Contributions	24.107	18.536	25.723
Capital Expenditure Financed from Borrowing	**30.903**	**69.649**	**39.762**

2. The Council's Overall Borrowing Need

2.1. The council's underlying need to borrow for capital expenditure is called the Capital Financing Requirement (CFR).

2.2. **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 2021/22, plus the estimates for 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 table below shows Council has complied with this prudential indicator:

	31 March 21 Actual	31 March 22 Mid Year Indicator	31 March 2022		
			HRA Actual	General Fund Actual	Total
	£'m	£'m	£'m	£'m	£'m
Opening Capital Financing Requirement	**792.260**	**795.089**	**468.374**	**326.715**	**795.089**
add: Capital Expenditure funded from Borrowing	30.903	69.649	30.381	9.381	39.762
less: MRP	-28.074	-25.732	-11.324	-14.406	-25.730
add: Movement on Other Long Term Liabilities	0.000	0.000	0.000	0.000	0.000
adj: Appropriation of Assets	0.000	0.000	0.000	0.000	0.000
Closing Capital Financing Requirement	**795.089**	**839.006**	**487.431**	**321.690**	**809.121**
Gross Borrowing Position	481.593	476.728	336.868	138.720	475.588
Under/(Over) Funding of CFR	**313.496**	**362.278**	**150.563**	**182.970**	**333.533**

The Authorised Limit – This is the 'affordable borrowing limit' required by section 3 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 – This is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is 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 £'m
Original Indicators	
Authorised Limit	809.121
Operational Boundary	557.892
Actual Performance	
Maximum Gross Borrowing Position	498.417
Average Gross Borrowing Position	473.832
Financing Costs as a Proportion of Net Revenue Stream	12.2%

3. Treasury Position at 31 March 2022

3.1. The Council's treasury management debt and investment position is organised by the treasury management service in order 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.

3.2. The figures in this report are based on the principal amounts borrowed and invested and so may differ from those in the final accounts by items such as accrued interest.

3.3. During 2021/22 the Director of Finance managed the debt position to £475.588m; the treasury position at the 31 March 2022 compared with the previous year was:

	31 March 2021				31 March 2022			
	Principal			Average Rate	Principal			Average Rate
	HRA £'m	General Fund £'m	Total £'m	%	HRA £'m	General Fund £'m	Total £'m	%
Actual Borrowing Position								
Fixed Interest Rate Debt	353.950	75.299	429.249	4.43	336.868	90.978	427.846	4.12%
Variable Interest Rate Debt	0.000	52.344	52.344		0.000	47.742	47.742	
Total Debt	**353.950**	**127.643**	**481.593**		**336.868**	**138.720**	**475.588**	
Capital Financing Requirement (CFR)	**468.374**	**326.715**	**795.089**		**487.431**	**321.690**	**809.121**	
Borrowing Above / (Below) CFR	**-114.424**	**-199.072**	**-313.496**		**-150.563**	**-182.970**	**-333.533**	
Investment Position								
Fixed Interest Investments	0.000	0.000	0.000		0.000	0.250	0.250	
Variable Interest Investments	0.000	37.056	37.056		0.000	50.851	50.851	
Total Investments	**0.000**	**37.056**	**37.056**		**0.000**	**51.101**	**51.101**	
Net Borrowing Position	**353.950**	**90.587**	**444.537**		**336.868**	**87.619**	**424.487**	

The maturity structure of the debt portfolio was as follows:

	31 March 2021 Actual %	2021/22 Original %	31 March 2022 Actual %	£'m
Under 12 months	15.29%	10.00%	14.68%	69,824
12 months and within 24 months	1.45%	10.00%	2.49%	11,853
24 months and within 5 years	9.17%	20.00%	8.31%	39,503
5 years and within 10 years	10.29%	20.00%	9.91%	47,136
10 years and above	63.80%	90.00%	64.61%	307,272
	100.00%		**100.00%**	**475,588**

4. The Strategy for 2021/22

4.1 **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).

While the Council has taken a cautious approach to investing, it is also fully appreciative of charges 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.

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.

4.2 **Borrowing**; during 2021/22, the Council maintained an under-borrowed position. This means 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 very 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 costs – 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.

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 in the second half of 2021/22.

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 years 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 growth rates and inflation up from the 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.

Borrowing Outturn

4.1. **Borrowing** – One short term-loans increased by £0.155m, two short-term loans decreased by £4.717m and two new short-term market loans were raised totalling £20.000m in 2021/22 to fund the net unfinanced capital expenditure and naturally maturing debt.

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.

4.2. **Rescheduling** – No rescheduling of debt was undertaken during 2021/22.

4.3. **Repayment** – Two debts matured during 2021/22 (two long-term) totalling £19.228m. Five debts partially matured during 2021-22 (five long term) totalling £2.034m. No early repayment of debt was undertaken during 2021/22.

5. Investment Position

5.1. **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 9 March 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. The investment activity during the year conformed to the approved strategy and the Council had no liquidity difficulties.

5.2. **Resources** – The council's longer-term cash balances comprise primarily revenue and capital resources, although these will be influenced by cash flow considerations. The council's core cash resources include the council's balances, earmarked reserves, provisions and capital receipts.

5.3. **Investments Held by The Council**

Below shows the Council's investment portfolio for 2021/22:

Treasury Portfolio			
	Average Balance 31/03/2022 £'000	**Average Return 31/03/2022 %**	**Balance 31/03/2022 £'000**
Treasury Investments			
Banks	883	0.010%	651
Temporary Deposits	0	0.000%	0
Local Authorities	0	0.000%	0
6 Towns Credit Union	250	1.490%	250
Total Managed In House	**1,133**	**1.500%**	**901**
Money Market Funds	87,280	0.061%	50,200
Total Managed Externally	**87,280**	**0.061%**	**50,200**
Total Treasury Investments	**88,163**	**0.064%**	**51,101**

The council maintained an average balance of £88.163m of internally and externally managed funds. The internally managed funds received an average return of 1.50% and the externally managed funds received an average return of 0.061%. The comparable performance indicator for internally managed funds is the average 7-day backward looking SONIA uncompounded rate as at 31 March 2022, which was 0.1355% and for externally managed funds is the average 7-day backward looking SONIA compounded rate as at 31 March 2022 which was 0.1392%. The SONIA replaced the LIBID rate as a comparable performance indicator in 2021/22.

6. The UK Economy and Interest Rates

6.1. **UK Economy** – 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 16 December 2021, 0.50% at its meeting on 4 February 2022 and then to 0.75% in March 2022.

The UK economy has endured several false dawns through the 2021/22 but with most of the economy now opened up and nearly back 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 6.2% and is likely to exceed 8% in April.

Gilt yields fell towards the back end of 2021 but despite the war in Ukraine gilt yields have shot higher in early 2022. At 1.38%, 2-year yields remain close to their recent 11-year high and 10-year yields of 1.65% are close to their recent six-year high. These rises have been part of global trend as central banks have suggested they will continue to raise interest rates to contain inflation.

Historically a further rise in US Treasury yields will probably drag UK gild yields higher. There is a strong correlation between the two factors however, the squeeze on real household disposable incomes arising from the 54% leap in April utilises prices as well as rises in council tax, water prices, and many phone contract prices, are strong headwinds for any economy to deal with. In addition, from 1 April 2022, employees also pay 1.25% more in National Insurance tax. Consequently, inflation will be a bigger drag on real incomes in 2022 than in any year since records began in 1955.

6.2. **Average inflation targeting** – 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 mantra now seems very dated. Inflation is the “genie” that has escaped the bottle and a perfect storm 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 in 2023.

7. Other Issues

7.1 **IFRS 9 fair value of investments** – following the consultation by the Ministry of Housing, Communities and Local Government [MHCLG] (now renamed the Department of Levelling Up, Housing & Communities) 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 was effective from 1 April 2018. 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.

7.2 **IFRS 16 Leases** HM Treasury and the Financial Reporting Advisory Board (FRAB) have decided that IFRS 16 implementation in the public sector will be deferred for a further two years, to 2024/25.