Review of Treasury Management Activity 2021/22

Introduction

The council's treasury management activity is underpinned by the Chartered Institute of Public Finance and Accountancy's Codes of Practice on Treasury Management ("the Code") and the related Prudential Code. Authorities are required to produce Prudential Indicators, a Treasury Management Strategy Statement on the financing and investment activity annually which was approved by Full Council on 11 February 2021. CIPFA published its revised Prudential Code for Capital Finance and Treasury Management Code on 20 December 2021 the principles of which came into immediate effect, but the revised reporting requirements are effective from the 2023/24 financial year. The key changes in the two codes relate to the permitted reasons to borrow, requisite professional knowledge and skills, and the management of non-treasury investments.

Investment and borrowing decisions are taken in light of long-term borrowing requirements, the estimated level of reserves and actual and estimated cash-flow. This is in the context of the current and forecast economic condition. Consideration is also given to risks and compliance with Prudential Indicators. Therefore, this report provides commentary on the following factors for 2021/22:

- Economic environment
- Borrowing activity
- Investment activity
- Performance against the Prudential Indicators

Economic Environment During 2021/22

There were a number of major economic issues relevant in 2021/22. Initially, the continuing economic recovery from coronavirus pandemic was a dominant feature but as the year progressed concerns about inflation, the potential for higher interest rates and possibility of a future recession were significant.

The Bank Rate (the benchmark rate set by the Bank of England) was 0.1% at the beginning of the financial year. Although April and May saw the economy gathering momentum as pandemic restrictions were eased, market expectations were that the Bank of England would delay rate rises until 2022. However, the rise in inflation changed the position.

UK Consumer Prices Index (CPI) was 0.7% in March 2021 but thereafter began to steadily increase. Initially driven by energy price effects and by inflation in sectors such as retail and hospitality which were re-opening after the pandemic lockdowns, inflation then was believed to be temporary. However, a combination of rising global costs, strong demand and supply shortages saw large increases in inflation. CPI for February 2022 registered 6.2% year on year, up from 5.5% in the previous month.

As a response to the increase in inflation the Bank of England made the following increases in the Bank Rate:

- December 2021 increase to 0.25%
- February 2022 increase to 0.5%
- March 2022 increase to 0.75%

In its March interest rate announcement, the Bank of England's Monetary Policy Committee noted that the invasion of Ukraine had caused further large increases in energy and other commodity prices, with the expectation that the conflict will worsen supply chain disruptions around the world and push CPI inflation to around 8% later in 2022.

The picture seen in the UK was similar in many of the world economies. Europe and America have seen increases in inflation and in its March 2022 interest rate announcement, the American Federal Reserve raised its interest rate and outlined further increases should be expected in the coming months.

The continuing uncertainty has seen gilt (UK government bond) yields increase. The costs of local authority borrowing from the Public Works Loan Board (PWLB) are related to the bond yields and therefore the cost of borrowing has increased. For example, a 10-year PWLB fixed rate loan taken on the 1 April 2021 was at interest rate of 1.7%, an equivalent loan taken on 31 March 2022 was at 2.81%.

Treasury Holdings 2021/22

In summary the holdings in the year at 31 March 2022, are shown as follows compared to the balances at the end of the previous year:

	31/3/2022	**31/3/2021**
	£m	£m
Long term borrowing	884.6	899.6
Short term borrowing	318.8	481.8
Total borrowing	**1,203.4**	**1,381.4**
Long term investments	549.6	644.5
Short term investments	102.9	117.5
Total investments	**652.5**	**762.0**
Net Borrowing position	**550.9**	**619.4**

Borrowing Activity 2021/22

The Code requires that the council, in the medium term, only borrows for capital purposes (with the underlying need to borrow for capital purposes being measured by the Capital Financing Requirement). Total borrowing in the year was managed within the operational and authorised borrowing limits as approved in the Treasury Management Strategy which reflects the underlying need to borrow for capital purposes.

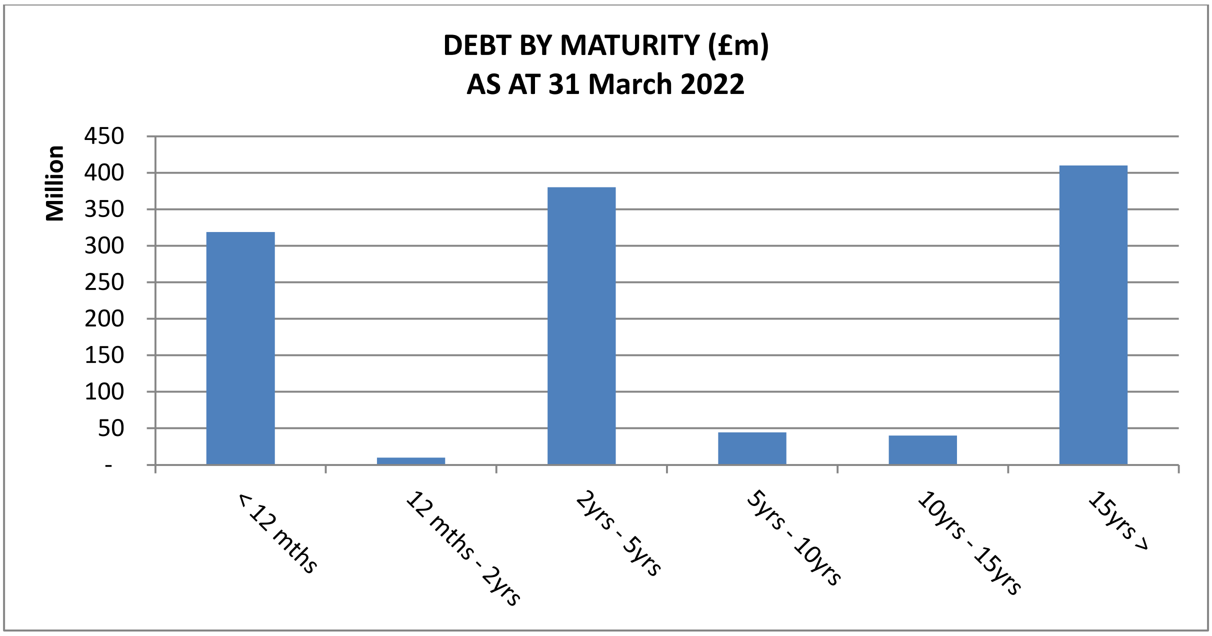
The year saw a fall of £178m in the total borrowing held. This was a planned reduction as reported to this committee on 26 July 2021 as the borrowing held at 31 March 2021 was greater than required due to the council having taken advantage of market conditions to borrow in advance of need to secure lower borrowing rates. The borrowing was undertaken via the issuance of a bond of £250m which also looked to re-balance the debt maturity profile of the portfolio. Debt also included a 15-month PWLB loan of £150m to cover COVID contingencies. It was therefore anticipated that borrowing would fall by 31 March 2022. The PWLB loan was repaid in 2021/22 while no further long-term loans were taken out in year as it is considered a reasonable debt maturity profile had been achieved. The borrowing strategy in the year therefore was to replace maturing short term debt with new short-term loans from local authorities as required.

Despite the moves towards longer term borrowing in previous years the short-term debt is still significant with some £319m of debt at 31 March 2022 due to mature within 12 months. It is also notable that 49.9% of the total debt is now in the forms of bonds.

The following section provides further details on the borrowing during the year.

Analysis of Borrowing

	Debt 31/03/2021		Borrowing	Repayments	Debt 31/03/2022	
	£m	%	£m	£m	£m	%
Fixed Rate Funding						
Public Works Loan Board	439.6	32	0.0	-155.0	284.6	24
Bond	250.0	18	0.0	0.0	250.0	21
Market Borrowing	273.0	20	491.0	-517.0	247.0	20
Total Fixed Rate Funding	**962.6**		**491.0**	**-672.0**	**781.6**	
Variable Rate Funding						
Bond	350.0	25	0.0	0.0	350.0	29
Shared Investment Scheme	68.8	5	529.8	-526.8	71.8	6
Total Variable Rate Funding	**418.8**		**529.8**	**-526.8**	**421.8**	
Total Loan Debt	**1,381.4**	**100**	**1,020.8**	**-1,198.8**	**1,203.4**	**100**



Overall, the average rate of interest paid in 2021/22 on the debt administered by the council was 1.97% per annum compared with an average rate of 1.82% in 2020/21.

The council did not enter into any new other long term liability arrangements in the year. The outstanding Private Finance Initiative liability at 31 March 2022 was £133m.

Investment Activity

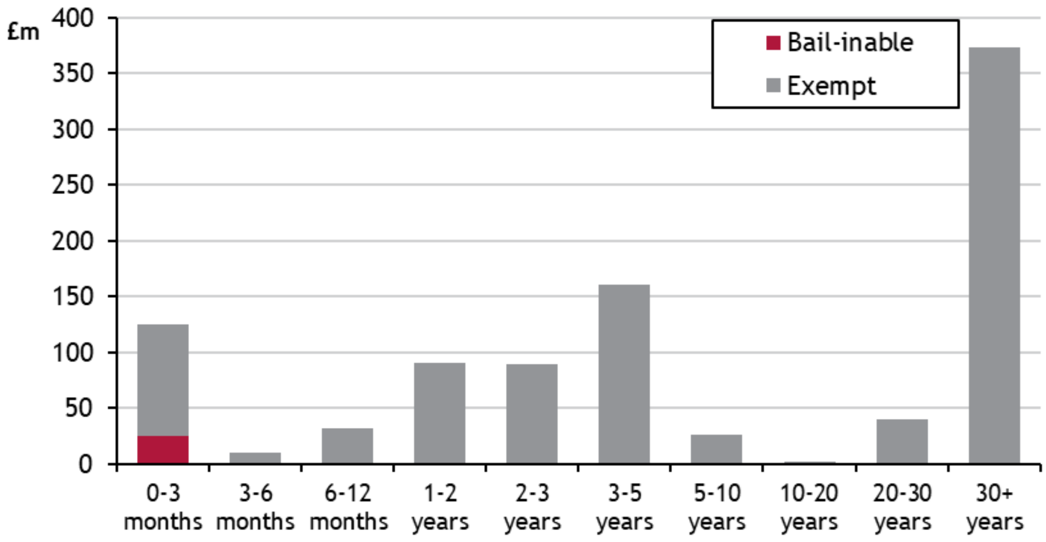
The council invests its reserves and other cash balances. The total value of investments held (excluding fair value adjustment) at 31 March 2022 for treasury management purposes was £652.5m. This is £109.6m lower than at 31 March 2021. The table below shows the investment holdings and the movements during the year:

Maturity Range	Position at 31/3/2021 £m	2021/22 Movement £m	Position at 31/3/2022 £m
Call accounts and under 1 year	117.5	(46.5)	71.0
Bank deposit 1-2 years	0.0	0.0	0.0
Bank & Local Authority Deposits 3-5 years	10.0	0.0	10.0
Local authority bonds	15.2	(6.9)	8.3
UK Government and supranational bonds	619.4	(56.2)	563.2
Total	**762.1**	**(109.6)**	**652.5**

In addition to the investments made for treasury management purposes the non-treasury management investment strategy for 2021/22 enabled the investment in bonds for commercial purposes where cash-flow permits but investments outside the current treasury management credit matrix will only be incurred after agreement with the Director of Finance. Under this arrangement investments have been made in local authority LOBO loans and commercial corporate bonds. As change in market values are charged to the council's revenue accounts for the LOBO loans the council has entered into a short trade which means the council agrees to buy some bonds at a specific price in the future, which aims to offset some of the valuation risk. The net value of the non-treasury management investments at 31 March 2022 was £232.5m (total investments at 31 March 2022 were therefore £885m). In line with the new Prudential Code and the approved treasury management strategy for 2022/23 the council will make no further non-treasury management investments and the existing non-treasury management investments will be managed within the treasury management limits.

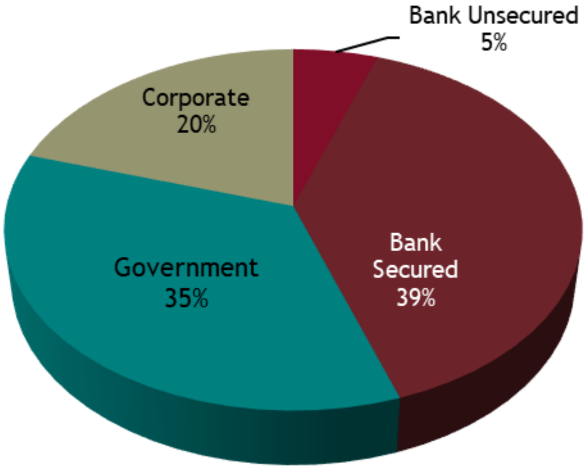
In undertaking investments consideration is given to the risk and liquidity within the portfolio which are affected by the maturity of the investment, asset type, country invested in and the credit rating. This includes those that are deemed to be non- treasury investments. The position of the investment portfolio on these areas are reviewed as follows.

Investments by Maturity

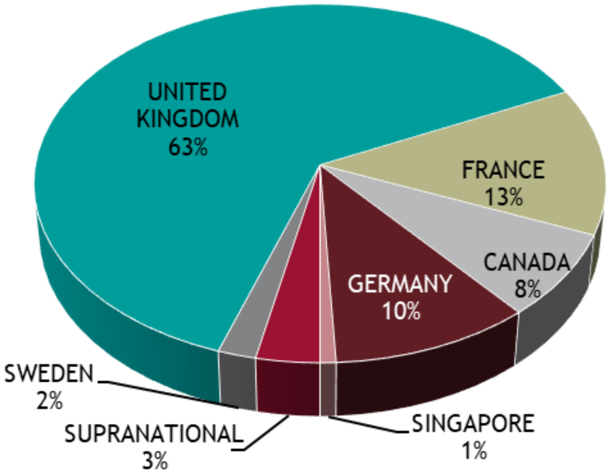


The graph shows the maturity dates of assets along with the exposure to bail-in in the event of a bank default (i.e. the risk that the investment may be lost, or the principal repaid significantly reduced). As can be seen the exposure to bail in is relatively low and arises mainly in the short term with the use of call accounts. The very long-term investments are principally investment in the UK government via gilts. Therefore, the credit risk is considered low. The assets are saleable and do not have to be held to maturity therefore although prices fluctuate the market risk can be managed.

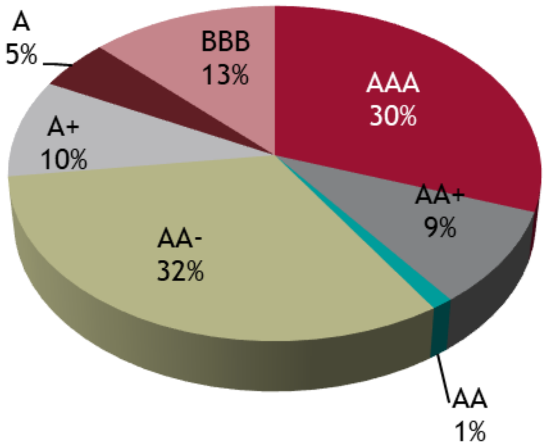
Total Investments Analysed by Asset Type



Total Investments Analysed by Country



Total Investments Analysed by Credit Rating



Security

Security of capital remained the council's main investment objective. This was maintained by following the council's Counterparty Policy, as set out in its Treasury Management Strategy Statement for 2021/22. This defined “high credit quality” organisations as those having a minimum long-term credit rating of A+. In practice the average credit rating in 2021/22 was higher at AA, with the lowest rating being BBB which relates to the holding of bonds issued by the energy company EDF which is largely owned by the French government.

Investments with banks were held in call accounts only. Any longer-term deposits have been restricted to deposits with other local authorities.

Liquidity Management

The council maintained a minimum level of primary liquidity through the use of Call Accounts. The council also has bond portfolios which are available for sale, at current market prices, if needed as 'secondary' liquidity.

The council undertakes cash flow forecasting daily to determine the maximum period for which funds may prudently be committed.

Yield

The rates of return on the council's short-dated money market investments reflect prevailing market conditions and the council's objective of optimising returns commensurate with the principles of security and liquidity.

Overall, the treasury management investment portfolios returned an average rate of 3.41% in 2021/22 which can be attributed to the categories as follows:

Maturity Range	**Average Balance £m**	**Average Rate**
Call and under 1 year	148.6	0.13%
Bank and local authority deposits 3-5 years	10.0	2.95%
Local authority bonds	11.9	4.39%
UK government & other bonds	594.2	4.22%
Total	**764.7**	**3.41%**

In addition, the non-treasury management investments had an average balance of £243.9m which made a net return of 1.84%.

Impact of the Treasury Management Strategy on the Council's Revenue Budget

The financing charges budget covered both the treasury management and non-treasury management activities. In total there was a net underspend against budget of £13.5m as shown in the following table.

	21/22 Budget	31 March 2022	Variance
	£m	£m	£m
Minimum Revenue Provision	20.3	21.7	1.4
Interest Paid	27.2	26.5	(0.7)
Interest Received/surplus on sale	(15.9)	(37.2)	(21.3)
Total	**31.6**	**11.0**	**(20.6)**
Contribution to Treasury Management Reserve			7.1
Revised position			**(13.5)**

Income received in the year was £21.3m higher than budgeted. Although investment balances were higher than budget the main reason for the increase was the gains achieved on the sale of gilts. With the markets responding to economic and political events there was volatility in the price of gilts and other bonds however it is extremely difficult to predict the movement in the markets and to assess the potential for gains.

The amount of interest paid was lower than budget due to the actual level of interest rates paid being slightly lower than anticipated in the budget.

Treasury Management and Prudential Indicators 2021/22

The Local Government Act 2003 and supporting regulations require the council to have regard to the Prudential Code and to set prudential indicators to ensure the council's capital investment plans are affordable, prudent and sustainable**.** A comparison of the actual position at 31 March 2022 compared to the 2021/22 indicators set in the Treasury Management Strategy is set out below. All activity in the year complied with the Prudential Indicators and Treasury Management Policy Statement for the year.

Prudential Indicators

Authorised limit for external debt The authorised limit is a prudent estimate of debt which reflects the council's capital expenditure plans and allows sufficient headroom for unusual cash movements.	**2021/22**	**Actual**
	£m	**£m**
Borrowing	1,600	1,203
Other long term liabilities (PFI schemes)	400	133
TOTAL	**2,000**	**1,336**

Operational boundary for external debt The operational boundary is a prudent estimate of debt but has no provision for unusual cash movements. It represents the estimated maximum external debt arising as a consequence of the council's current plans.	**2021/22**	**Actual**
	£m	**£m**
Borrowing	1,200	1,203
Other long term liabilities (PFI schemes)	150	133
TOTAL	**1,350**	**1,336**

Capital Financing Requirement to Gross debt	**2021/22**	**Actual**
	£m	**£m**
Capital Financing Requirement	1,009	1,142
Estimated gross debt	1,088	1,336
Debt to Capital Financing Requirements	108%	117%

The Capital Financing requirement is the underlying need to borrow for capital purposes. This is the cumulative effect of past borrowing decisions and future plans. This is not the same as the actual borrowing requirement on any one day, as day to day borrowing requirements incorporate the effect of cash flow movements relating to both capital and revenue expenditure and income.

Gross debt includes borrowing for premiums, long term debtors and transferred debt. Under the Prudential Code when comparing debt to the Capital Financing Requirement these should be netted off the gross debt. The non-adjusted gross debt is above the Capital Financing Requirement by £194m but once the adjustments are made the borrowing is £112m above Capital Financing Requirement. This largely reflects the on-going impact of borrowing in advance and the issuing of the long-term bond. The amount above the Capital Financing Requirement will be eliminated as debt matures.

Treasury Management Indicators

Interest rate exposure The limit measures the council's exposure to the risk of interest rate movements. The one-year impact indicator calculates the theoretical impact on the revenue account of an immediate 1% rise in all interest rates over the course of one financial year.	**Upper Limit**	**Actual**
	£m	**£m**
1 year impact of a 1% rise	50.0	(11.2)

Maturity structure of debt Limit on the maturity structure of debt helps control refinancing risk.	**Upper Limit %**	**Actual %**
Under 12 months	75	27
12 months and within 2 years	75	1
2 years and within 5 years	75	32
5 years and within 10 years	75	3
10 years and above	75	37

Minimum Average Credit Rating To control credit risk the council requires a very high credit rating from its treasury counterparties.	**Benchmark**	**Actual**
Average counterparty credit rating	A	AA