ITEM NO	

REPORT TO EXECUTIVE

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PORTFOLIO	Resources and Performance Management
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Annual Treasury Management Report
Review of 2021/2 Activity

PURPOSE

1. To inform members of the Council's treasury management activity during 2021/22.

RECOMMENDATION

2. That the Executive recommends that Full Council note the annual treasury management activity for the year ended 31 March 2022.

REASONS FOR RECOMMENDATION

3. To comply with the regulations issued under the Local Government Act 2003 to produce an annual treasury management report 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). Performance against the approved prudential and treasury indicators are shown in Appendix 1.

During 2021/22 the minimum reporting requirements were that Full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Full Council 24 February 2021)
- a mid-year treasury update report (Full Council 08 December 2021)
- an annual review following the end of the year describing the activity compared to the strategy (this report).

The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. This report is therefore important, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by Members.

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 Full Council. Member training on treasury management issues was undertaken during the year on 25 November 2021 in order to support Members' scrutiny role.

SUMMARY OF KEY POINTS

4. **The Economy and Interest Rates (Provided by Link Asset Services)**

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 16th December 2021, 0.50% at its meeting of 4th February 2022 and then to 0.75% in March 2022.
The UK economy has endured several false dawns through 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 a 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 gilt 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 utilities 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 1st 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.

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, and 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.

World growth. World growth is estimated to have expanded 8.9% in 2021/22 following a contraction of 6.6% in 2020/21.

Deglobalisation. Until recent years, world growth has been boosted by increasing globalisation i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last 30 years, which now accounts for 18% of total world GDP (the USA accounts for 24%), and Russia's recent invasion of Ukraine, has unbalanced the world economy. In addition, after the pandemic exposed how frail extended supply lines were around the world, both factors are now likely to lead to a sharp retrenchment of economies into two blocs of western democracies v. autocracies. It is, therefore, likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China (and to a much lesser extent Russia) to supply products and vice versa. This is likely to reduce world growth rates.

Central banks' monetary policy. During the pandemic, the governments of western countries have provided massive fiscal support to their economies which has resulted in a big increase in total government debt in each country. It is therefore very important that bond yields stay low while debt to GDP ratios slowly subside under the impact of economic growth. This provides governments with a good reason to amend the mandates given to central banks to allow higher average levels of inflation than we have generally seen over the last couple of decades. Both the Fed and Bank of England have already changed their policy towards implementing their existing mandates on inflation, (and full employment), to hitting an average level of inflation. Greater emphasis could also be placed on hitting subsidiary targets e.g. full employment before raising rates. Higher average rates of inflation would also help to erode the real value of government debt more quickly.

5. <u>The Strategy for 2021/22</u>

5.1 Investment Strategy and control of interest rate risk

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 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.

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. Such an approach has also provided benefits in terms of reducing the counterparty risk exposure, by having fewer investments placed in the financial markets.

5.2 Borrowing Strategy and control of interest rate risk

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 very low and minimising counterparty risk on placing investments also needed to be considered.

The policy of avoiding new borrowing by running down spare cash balances has previously been adopted and has served well over the last few years. However, this has been 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.

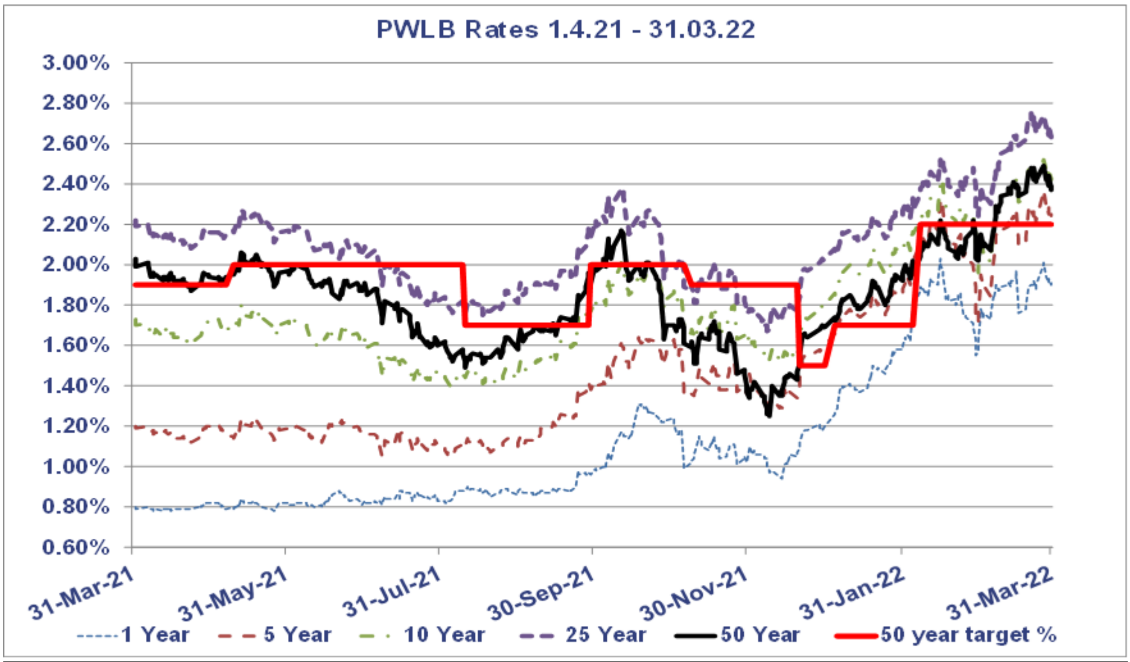
6. The Borrowing Requirement and Debt

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). The table below shows the Council's CFR for 2021/22. The council revised its' CFR in the mid-year report, approved by Full Council on 8 December 2021, due to the significant increase to the capital programme during the year including the acquisition of Charter Walk.

£m	31 March 2021 Actual	31 March 2022 Budget	31 March 2022 Actual
CFR General Fund	41.7	71.4	63.9

7. Borrowing Rates in 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 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.



8. **Borrowing Outturn for 2021/22**

Borrowing – The following PWLB loans were taken during the year to fund the net unfinanced capital expenditure and loans that have matured and been repaid in year.

Date	Lender	Principal	Type	Interest Rate	Duration
14/10/21	PWLB	£18m	Annuity	2.15%	30 years
10/2/22	PWLB	£4.7m	Annuity	2.22%	30 years
10/2/22	PWLB	£2m	Maturity	1.93%	50 years
10/2/22	PWLB	£2m	Maturity	1.94%	49 years

This compares to a budget assumption of borrowing at an interest rate between 2.1 and 2.15%.

9. **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.

10. **Repayments** – The following PWLB loans were repaid during the year, as scheduled:

Date	Lender	Principal	Balance at Repayment	Type	Interest Rate	Duration
31/3/22	PWLB	£1.0m	£1.0m	Maturity	5.13%	22.5 years
31/3/22	PWLB	£0.2m	£0.2m	Maturity	4.88%	21.5 years

Investment Rates in 2021/22

The Council operates a deposit account with its' bank, HSBC, which pays an interest rate of 0.09% below Bank Rate. There was an average daily total of £18.7m being invested within the HSBC "sweep" deposit account in 2021/22. This was higher than the usual level of deposit due to the large amount of government funding being made available for distribution to businesses during the pandemic.

Investment Outturn for 2021/22

Investment Policy – the Council's investment policy is governed by DLUHC investment guidance, which has been implemented in the annual investment strategy approved by Full Council on 24 February 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. This guidance is enhanced by advice from Link Asset Services.

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

Investments held by the Council - the Council maintained a daily average balance of £31.3m of internally managed funds during 2021/22.These investments earned an average rate of return of 0.20%.

There was a total of 7 market investments made during the financial year, totalling £20m. The table below shows the amount deposited, and the rate of return against the market benchmark.

Counterparties	Date of Investment	Investment Made £m	Return	Benchmark
Goldman Sachs (6 mth fixed)	10/09/2021	2.0	0.145%	0.33%
Goldman Sachs (6 mth fixed)	02/11/2021	2.0	0.41%	0.33%
Standard Chartered Sustainable (1 mth fixed)	17/02/2022	4.0	0.37%	0.0796%
Lloyds Bank Corporate Markets (3 mth fixed)	17/02/2022	4.0	0.65%	0.17%
Goldman Sachs (6 mth fixed)	10/03/22	2.0	1.16%	0.33%
Standard Chartered Sustainable (1 mth fixed)	16/03/22	4.0	0.71%	0.0796%
Burnley College (15 yr fixed)	28/03/22	2.0	4.45%	N/A

All investments were for one year or under, with the exception of a fixed loan of £2m over 15 years, made to Burnley College for the purpose of the development of its' campus.

The table below shows the maximum amount invested with any of the counterparties at any one time during the period April 2021 to the end of March 2022 against the maximum limits approved in the 2021/22 Treasury Management Strategy.

Counterparties	Maximum Limits £m	Highest level of Investment 2021/22 (£m)
HSBC	50.0	44.4
Standard Chartered Sustainable	4.0	4.0
Goldman Sachs	4.0	4.0
Santander UK plc	4.0	4.0
Lloyds Bank Corporate Markets	4.0	4.0
Burnley College	4.0	2.0
Moray Council	2.0	2.0

11. **<u>Interest payable on External Borrowing / Interest Receivable on Investments</u>**

The total PWLB interest payable on external borrowing for 2021/22 was £1,281,297 compared to the annual budget of £1,497,407.

The total interest receivable on temporary investments in 2021/22 amounted to £59,642 compared to the revised annual budget of £124k. The shortfall in interest received was due to sustained low interest rates throughout the year, and a delay in completion of the Burnley College loan to the end of March.

12. **<u>Property Fund Investments, & dividends received</u>**

The Council continues to invest £2m in property funds with CCLA and Hermes. Dividends receivable amounted to £68,136 compared to a budget of £60,000.

The aim of the Property Fund investments is to provide high levels of income and long-term capital appreciation. During the pandemic, the UK economy and commercial property market have proved to be more resilient than many initial forecasts. The UK economy outlook and business confidence have been improving following positive outcomes from the vaccination programme and a gradual lifting of lockdown restrictions. Whilst the long-term social, economic, and political risks associated with the current pandemic and the war in Ukraine are still unknown, there are signs that the impact to occupier and investor confidence in certain property market segments is starting to ease.

Valuations of both property funds exceeded the initial investment at the end of March 2022. (CCLA £1.057m, Hermes £1.067m)

FINANCIAL IMPLICATIONS AND BUDGET PROVISION

13. None arising as a direct result of this report.

POLICY IMPLICATIONS

14. All transactions are in accordance with the Council's approved Treasury Policy Statement

DETAILS OF CONSULTATION

15. None

BACKGROUND PAPERS

16. None.

FURTHER INFORMATION PLEASE CONTACT:	**Howard Hamilton-Smith,** **Head of Finance & Property**