APPENDIX A

ANNUAL TREASURY REPORT 2021/22

1. Background

1.1 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).

1.2 Treasury management is defined as: 'The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.'

1.3 Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management strategy.

2.0 Economic Background

2.1 **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 of 4 February 2022 and then to 0.75% in March 2022.

2.2 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.

2.3 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.

2.4 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 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.

2.5 **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 into 2023.

2.6 **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.

Local Context

3.1 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.

3.2 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 cost – the difference between (higher) borrowing costs and (lower) investment returns.

3.3 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.

3.2 The Council's Capital Financing Requirement (CFR) at 31 March 2022 was £137.541m, while usable reserves and working capital which are the underlying resources available for investment were £65.566m.

3.3 The Council has an increasing CFR over the next 2 years of £34m, due to the borrowing requirement of £43.4m (GF £27.4m / HRA £16m) for financing the capital programme over the forecast period, if reserve levels permit internal borrowing will be considered. The CFR reduces when Minimum Revenue Provision (MRP) are made and the repayment of debt, over the forecast period there are two loans due for repayment with a combined total value of £6.5m.

4 Borrowing Strategy

4.1 Borrowing Activity in 2021/22

	Balance 1/4/21 £m	New Borrowing £m	Debt Maturing £m	Balance 31/3/22 £m
CFR	138.162			137.541
Short Term Borrowing	10.211	2.440	2.513	10.138
Long Term Borrowing	85.001	8.500	6.529	86.972
Total Borrowing	**95.212**	**10.940**	**9.042**	**97.110**
Other Long Term Liabilities – Finance Lease Liability	5.510	0	0	5.373
Total External Debt	**100.722**	**10.940**	**9.042**	**102.483**
Increase/(Decrease) in Borrowing £000				1.761

4.2 The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective.

4.3 The Council has an increasing CFR due to the capital programme and an estimated borrowing requirement as determined by the Liability Benchmark, which also takes into account usable reserves and working capital. Having considered the appropriate duration and structure of the Council's borrowing need based on realistic projections, it was decided to take a combination of medium-term borrowing maturity loan during the year, details of which are below.

Long-dated Loans borrowed	Amount £m	Rate %	Term
PWLB	5.000	1.640	50 Years
PWLB	3.500	1.470	49 Years

4.4 **LOBOs**: The Council holds £3.5m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. All of the £3.5m of LOBOS had options during the year, none of which were exercised by the lender.

4.5 **Debt Rescheduling**: The premium charge for early repayment of PWLB debt remained relatively expensive for the loans in the Council's portfolio and therefore unattractive for debt rescheduling activity. No rescheduling activity was undertaken as a consequence.

5 **Investment Activity**

5.1 The Council's investment policy is governed by MHCLG investment guidance, which has been implemented in the annual investment strategy approved by the Council on 9 March 2021. 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, (such as rating outlooks, credit default swaps, bank share prices etc.). During 2021/22 the Council's investment balances have ranged between £49.35 and £81.19 million.

	Balance 1/4/21 £m	**New Investments £m**	**Investments Redeemed £m**	**Balance 31/3/22 £m**
Short Term Investments	39.770	200.180	190.160	49.790
Long Term Investments	7.500	5.000	0	12.500
Total Investments	**47.270**	**205.180**	**190.160**	**62.290**
Increase/(Decrease) in Investments £000				15.020

5.2 Security of capital remained the Council's main objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2021/22.

5.3 Counterparty credit quality is assessed and monitored by Link the Council's treasury advisors, with reference to credit ratings; credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. Link provide recommendations for suitable counterparties and maximum investment periods.

6 **Compliance with Prudential Indicators**

6.1 The Council has complied with its Prudential Indicators for 2021/22, which were set on 9 March 2021 as part of the Council's Treasury Management Strategy Statement.

6.2 **Interest Rate Exposure:** These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates for both borrowing and investments. The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Approved Limit for 2021/22 %	**Maximum during 2021/22 £m**
Fixed Rate		
Borrowing	100%	99.89%
Investments	75%	36.92%
Compliance with Limit		*Yes*
Variable Rate		
Borrowing	20%	0.11%
Investments	100%	63.08%
Compliance with Limit		*Yes*

6.3 **Maturity Structure of Fixed Rate Borrowing.** This indicator is to limit large concentrations of fixed rate debt and control the Council's exposure to refinancing risk.

	Upper Limit %	Fixed Rate Borrowing 31/03/22 £m	Fixed Rate Borrowing 31/3/22 %	Compliance?
Under 12 months	15%	10.000	10.31%	Yes
12 months to 2 years	15%	5.500	5.67%	Yes
2 years to 5 years	30%	11.000	11.34%	Yes
5 years to 10 years	100%	21.970	22.65%	Yes
10 years and above	100%	48.530	50.03%	Yes

6.4 **Principal Sums Invested for over 364 Days.** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments.

Price Risk Indicator	Limit 2021/22	Actual 31/03/22	Compliance?
Limit on principal invested beyond year end	£15m	£12.5m	Yes

6.5 **Authorised Limit and Operational Boundary for External Debt.** The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached. The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit. The s151 Officer confirms that there were no breaches to the Authorised Limit and the Operational Boundary during 2021/22; borrowing at its peak was £104m.

	Approved Operational Boundary 2021/22 £m	Authorised Limit 2021/22 £m	Actual External Debt 31/03/22 £m
Borrowing	160.350	167.550	97.110
Other Long Term Liabilities	6.400	6.600	5.373
Total	**166.750**	**174.150**	**102.483**

6.6 In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary of the treasury management activity during 2021/22. A prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

6.7 The Council also confirms that during 2021/22 it complied with its Treasury Management Policy Statement and Treasury Management Practices.