| | | |
|---|---|---|
| Agenda Item No: | 7 | Fenland CAMBRIDGESHIRE |
| Committee: | Audit and Risk Management Committee | |
| Date: | 4 July 2022 | |
| Report Title: | Treasury Management Annual Review 2021/22 | |

## Cover sheet:

### 1 Purpose / Summary

The purpose of this report is to consider the overall financial and operational performance of the Council's treasury management activity for 2021/22.

### 2 Key issues

- Outstanding loans and finance lease liabilities of £7,905,799 and temporary investments of £31,850,000 as of 31 March 2022.
- The Council invested £4M, split equally, into the Federated Hermes and Patrizia Hanover, Property Unit Trusts, in late March 2022. No distributions were paid in 2021/22 due to the timing of the investments
- No new borrowing was undertaken and the authorised limit was not breached during 2021/22.
- The investment activity during the year conformed to the approved strategy and the Council had no liquidity difficulties.
- Amount received from external investments totalled £52,375 (compared with an estimate of £40,000).
- Overall interest rate achieved from investments 0.1349% (7 day backward looking SONIA uncompounded rate for 2021/22 0.1355%).

### 3 Recommendations

- It is recommended that members note the report.
- It is recommended that Cabinet receive the Treasury Management Annual Report.

| | |
|---|---|
| **Wards Affected** | All |
| **Portfolio Holder(s)** | Cllr Chris Boden, Leader & Portfolio Holder, Finance |
| **Report Originator(s)** | Peter Catchpole, Corporate Director and Chief Finance Officer<br>Mark Saunders, Chief Accountant |
| **Contact Officer(s)** | Peter Catchpole, Corporate Director and Chief Finance Officer<br>Mark Saunders, Chief Accountant |
| **Background Paper(s)** | Treasury Management and Annual Investment Strategy 2021/22 |

## Report:

### 1 Introduction

1.1 The Council is required through 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 Chartered Institute of Public Finance and Accountancy (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 During 2021/22 the minimum reporting requirements were that Council should receive the following reports:

- an annual Treasury Strategy in advance of the year (Council 23/02/2021);
- a mid-year treasury update report (Council 08/12/2021);
- an Annual Review following the end of the year, describing the activity compared to the strategy (this report).

1.3 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

1.4 The 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 Audit and Risk Management Committee before they were reported to Council.

### 2 The Council's Capital Expenditure and Financing

2.1 The Council undertakes capital expenditure on long-term assets. These activities may 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 not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

| | **2020/21 Actual £000** | **2021/22 Revised Estimate £000** | **2021/22 Actual £000** |
|---|---|---|---|
| **Capital expenditure** | **6,678** | **12,816** | **11,583** |
| Financed In Year | 2,775 | 10,804 | 9,936 |
| **Unfinanced capital expenditure** | **3,903** | **2,012** | **1,647** |
| | | | |

## 3 The Council's Overall Borrowing Need

3.1 The Council's underlying need to borrow to finance capital expenditure is termed the capital financing requirement (CFR).

3.2 **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 plus the estimates of any additional capital financing requirement for the current (2022/23) and next two financial years.

3.3 In February 2020 Council allocated £25m in the capital programme to enable the Council to take forward projects linked to its Commercial and Investment Strategy (CIS). At the 31.3.2022 £4.024m has been spent on two acquisitions approved by the Investment Board in accordance with the CIS. This impacts on the Capital Financing Requirement as explained in the table below. Currently both acquisitions have been funded from internal borrowing, i.e. no specific external borrowing to fund the investments has been undertaken, but the Council retains the flexibility to externalise the associated borrowing if it is deemed appropriate to do so.

3.4 The table below highlights the Council's gross borrowing position against the CFR (See Appendix A).

| | **31 March 2021 Actual £000** | **31 March 2022 Revised Estimate £000** | **31 March 2022 Actual £000** |
|---|---|---|---|
| | | | |
| CFR opening balance | 2,274 | 6,177 | 6,177 |
| Capital expenditure – Capital Programme | 553 | 1,682 | 1,322 |
| Capital expenditure – Commercial and Investment Strategy | 3,699 | 330 | 325 |
| Less Minimum Revenue Provision | (349) | (368) | (366) |
| | | | |
| **CFR Closing balance** | **6,177** | **7,821** | **7,458** |
| of which: Capital Programme | 2,478 | 3,802 | 3,444 |
| Commercial and Investment Strategy | 3,699 | 4,019 | 4,014 |
| | | | |
| **Gross Debt (see table at 4.1 below)** | **8,043** | **8,236** | **7,906** |

3.5 The CFR includes finance leases. A finance lease is a commercial arrangement between the Council and a lessor (finance company), where in consideration for a series of payments the Council has the right to use an asset (e.g. refuse vehicle) for the lease duration (typically 7 years). The annual lease payment is made up of a capital and interest repayment.

3.6 Although legally the Council doesn't own the asset during the lease duration, International Accounting Standards require that the Council capitalise the asset and liability on its balance sheet, much like a loan. Whilst this increases the CFR, the nature of the finance lease agreement doesn't require the Council to separately borrow to fund the asset.

3.7 The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level.

3.8 The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

3.9 Neither the authorised limit nor operational boundary were breached during 2021/22.

## 4 Overall Treasury Position as at 31 March 2022

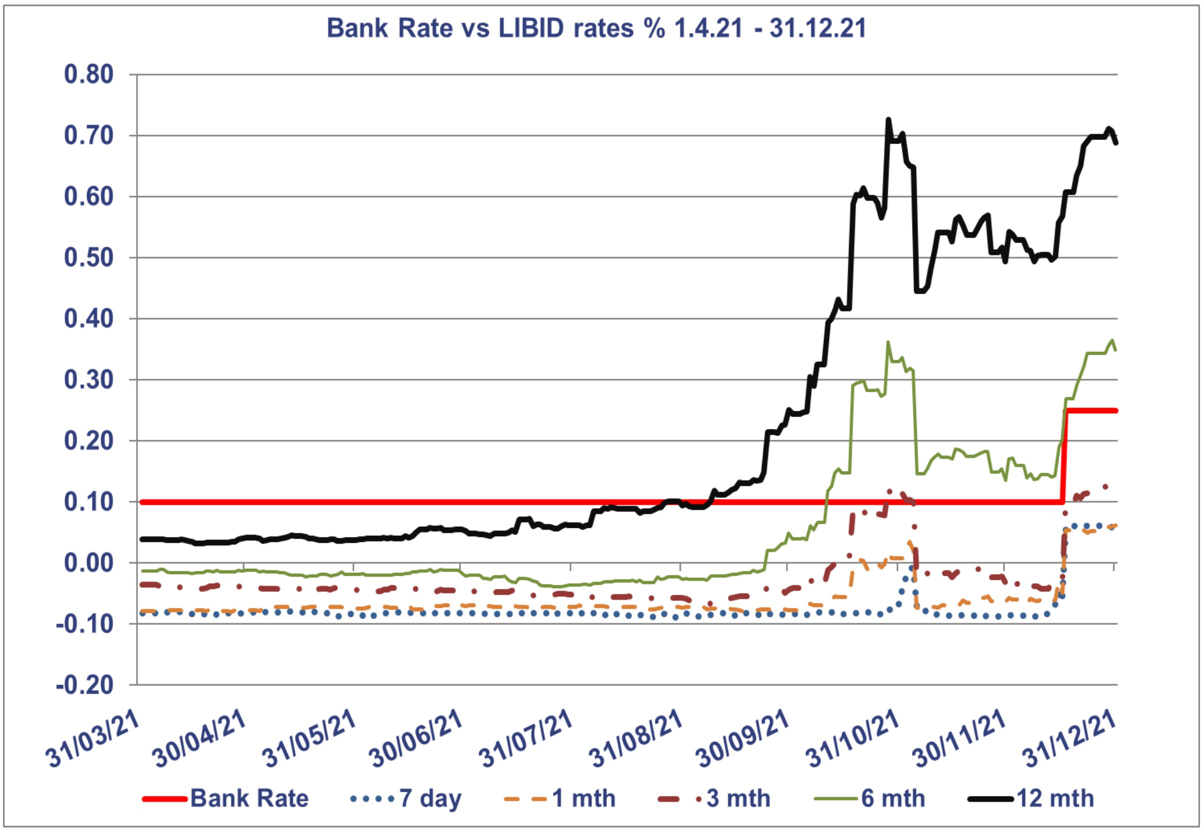
4.1 At the beginning and end of 2021/22, the Council's treasury position was as follows.

| | | | | | | |
|---|---|---|---|---|---|---|
| | **31 March 2022 Principal £000** | Rate / Return | Average Life years | **31 March 2021 Principal £000** | Rate / Return | Average Life years |
| Fixed rate funding | | | | | | |
| • PWLB | **4,500** | 7.29% | 8.40 yrs | **4,500** | 7.29% | 9.40 yrs |
| • Market | **3,300** | 4.70% | 31.96 yrs | **3,300** | 4.70% | 32.96 yrs |
| • Finance Leases | **106** | 3.59% | 1.14 yrs | **243** | 3.71% | 1.56 yrs |
| Total debt | **7,906** | | | **8,043** | | |
| | | | | | | |
| Investments | | | | | | |
| • Banks/Building Societies | **(31,850)** | 0.13% | | **(24,000)** | 0.25% | |
| • Property Funds | **(4,066)** | N/A | | **0** | | |
| Total Investments | **(35,916)** | | | **(24,000)** | | |
| | | | | | | |
| Net debt /(Investments) | **(28,010)** | | | **(15,957)** | | |
| | | | | | | |

4.2 In line with the Treasury Management Strategy and Annual Investment Strategy approved by Council on 23 February 2021, the Council invested £4M, split equally, into the Federated Hermes and Patrizia Hanover, Property Unit Trusts, in late March 2022. No distributions were paid in 2021/22 due to the timing of the investments.

4.3 All other investments held at 31 March 2022 are fixed term or callable deposits due for repayment within the next twelve months.

**5 The Strategy for 2021/22**




**Investment Strategy**

5.1 Investment returns remained close to zero for much of 2021/22. Most local authority lending managed to avoid negative rates. 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.

5.2 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 9% in April).

5.3 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.

5.4 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 the counterparty risk exposure, by having fewer investments placed in the financial markets.

**Borrowing Strategy**

5.5 The Council was 'over borrowed' during 2021/22 the Council's gross debt exceeded its CFR, as has been the case since 2007 when the Council decided not to repay £7.8m of PWLB debt, following the Council's stock transfer.

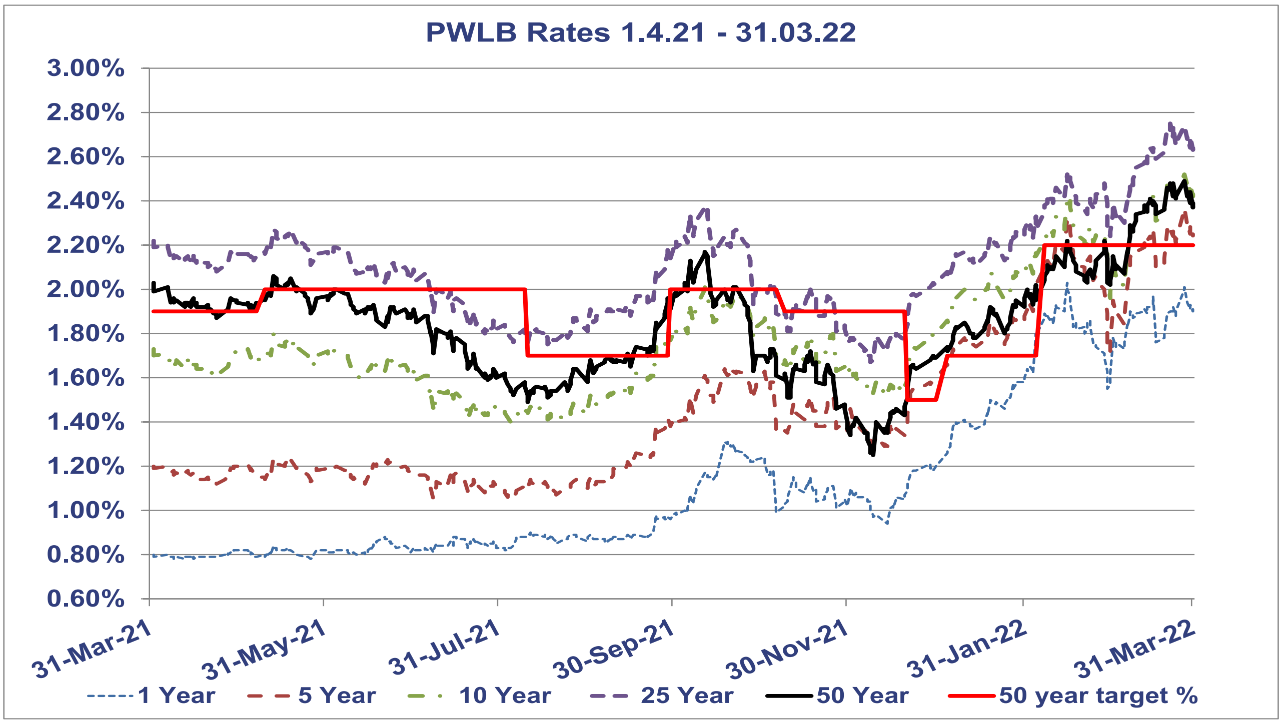
5.6 Therefore, as opposed to taking on additional loan debt to fund capital expenditure in 2021/22, the Council followed a strategy of using cash, supporting the Council's reserves, balances and cash flow as an interim measure. The strategy was prudent as investment returns were low and to reduce counterparty risk on placing investments.

5.7 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.

5.8 Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Chief Finance Officer therefore monitored interest rates in financial markets and adopted a pragmatic strategy based on managing interest rate risk, if it had been felt that there was a significant risk of a much sharper rise in long and short term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

5.9 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 to the second half of 2021/22. Financial estimates were based on the interest rate forecasts in the table below.

| Link Group Interest Rate View 20.12.21 | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Dec-21 | Mar-22 | Jun-22 | Sep-22 | Dec-22 | Mar-23 | Jun-23 | Sep-23 | Dec-23 | Mar-24 | Jun-24 | Sep-24 | Dec-24 | Mar-25 |
| BANK RATE | 0.25 | 0.25 | 0.50 | 0.50 | 0.50 | 0.75 | 0.75 | 0.75 | 0.75 | 1.00 | 1.00 | 1.00 | 1.00 | 1.25 |
| 3 month ave earnings | 0.20 | 0.30 | 0.50 | 0.50 | 0.60 | 0.70 | 0.80 | 0.90 | 0.90 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| 6 month ave earnings | 0.40 | 0.50 | 0.60 | 0.60 | 0.70 | 0.80 | 0.90 | 1.00 | 1.00 | 1.10 | 1.10 | 1.10 | 1.10 | 1.10 |
| 12 month ave earnings | 0.70 | 0.70 | 0.70 | 0.70 | 0.80 | 0.90 | 1.00 | 1.10 | 1.10 | 1.20 | 1.20 | 1.20 | 1.20 | 1.20 |
| 5 yr PWLB | 1.40 | 1.50 | 1.50 | 1.60 | 1.60 | 1.70 | 1.80 | 1.80 | 1.80 | 1.90 | 1.90 | 1.90 | 2.00 | 2.00 |
| 10 yr PWLB | 1.60 | 1.70 | 1.80 | 1.80 | 1.90 | 1.90 | 2.00 | 2.00 | 2.00 | 2.10 | 2.10 | 2.10 | 2.20 | 2.30 |
| 25 yr PWLB | 1.80 | 1.90 | 2.00 | 2.10 | 2.10 | 2.20 | 2.20 | 2.20 | 2.30 | 2.30 | 2.40 | 2.40 | 2.50 | 2.50 |
| 50 yr PWLB | 1.50 | 1.70 | 1.80 | 1.90 | 1.90 | 2.00 | 2.00 | 2.00 | 2.10 | 2.10 | 2.20 | 2.20 | 2.30 | 2.30 |




5.10 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

5.11 Gilt yields fell sharply from the spring of 2021 through to September and then spiked back up before falling again through December. However, by January sentiment had well and truly changed, as markets became focussed on the embedded nature of inflation, spurred on by a broader opening of economies post the pandemic, and rising commodity and food prices resulting from the Russian invasion of Ukraine.

5.12 At the close of the day on 31 March 2022, all gilt yields from 1 to 5 years were between 1.11% – 1.45% while the 10-year and 25-year yields were at 1.63% and 1.84%.

5.13 There is likely to be a further rise in short dated gilt yields and PWLB rates over the next three years as Bank Rate is forecast to continue to increase throughout 2022. Medium to long dated yields are driven primarily by inflation concerns and the Bank of England has said it wouldn't decide to sell down its gilt holdings, whereby the Bank's £895bn stock of gilt and corporate bonds will be sold back into the market over several years, until after its August MPC meeting. The impact this policy will have on the market pricing of gilts, while issuance is markedly increasing, is an unknown at the time of writing.

## 6 Borrowing Outturn

6.1 No long term or temporary borrowing was taken during 2021/22. The approach during the year was to use cash balances to finance new capital expenditure, so as to run down cash balances that were earning low investment returns and to minimise counterparty risk incurred on investments.Additionally, it is important to note that Council had abnormally high cash balances due to the receipt of significant funds from government in respect of both schemes to support businesses to recover from the economic impact of the pandemic and funding received in advance to enable the Council to deliver grant-funded schemes included in its capital programme.

6.2 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.

6.3 No rescheduling was completed during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates and the penalty position which can arise from early repayment of debt, made rescheduling unviable.

## 7 Investment Outturn

7.1 The Council's investment policy is governed by the Department for Levelling Up, Housing and Communities investment guidance, which has been implemented in the annual investment strategy approved by Council on 23 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 (such as rating outlooks, credit default swaps and bank share prices etc).

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

7.3 The Council maintained an average balance of £32.183m of internally managed funds. The internally managed funds earned an average rate of return of 0.1349% (£52,375). The comparable performance indicator is the average 7-day backward looking SONIA rate, which was 0.1355%.

7.4 In line with the Treasury Management Strategy and Annual Investment Strategy approved by Council on 23 February 2021. Officers, in conjunction with Link Group, its external treasury advisors, carried out a detailed, financial and qualitative review into a number of property funds, before selecting the Federated Hermes and Patrizia Hanover, Property Unit Trusts, in late March 2022. £4m was invested, split equally, between these two funds. No distributions were paid in 2021/22 due to the timing of the investments.

7.5 Updates on the performance of these funds will be provided to the Audit and Risk Management Committee as part of future reporting. It is important to note investment in property funds is a long-term investment so the value of the Council's underlying investment may increase and decrease over the period the Council maintains its investment. The benefit to the Council of investing in property funds is that it will receive a quarterly cash distribution reflecting rental income collected by the fund manager from tenants and the potential for capital growth should the value of the Council's holding exceed the amount the Council originally invested.

## 8 Prudential and Treasury Indicators

During 2021/22 the Council complied with its legislative and regulatory requirements.

## Appendix A - Prudential Indicators

| | Prudential Indicators | 2020/21 Actual £000 | 2021/22 Revised Estimate £000 | **2021/22 Actual £000** |
|---|---|---|---|---|
| 1 | **Capital Expenditure (including Commercial and Investment Strategy)** | 6,678 | 12,816 | **11,583** |
| 2 | **Ratio of Financing Costs to Net Revenue Stream (borrowing costs – investment income)** | 7.03% | 8.27% | **8.13%** |
| 3 | **Gross Borrowing and the Capital Financing Requirement** | | | |
| | Gross Debt | 8,043 | 8,236 | **7,906** |
| | CFR | 6,177 | 7,821 | **7,458** |

| | Treasury Management Indicators | 2020/21 Actual £000 | 2021/22 Revised Estimate £000 | **2021/22 Actual £000** |
|---|---|---|---|---|
| 4 | **Authorised Limit for External Debt** | | | |
| | Borrowing | 17,000 | 17,000 | **17,000** |
| | Other Long-Term Liabilities | 1,000 | 1,000 | **1,000** |
| | Commercial Activities | 25,000 | 21,302 | **21,302** |
| | Total | 43,000 | 39,302 | **39,302** |
| 5 | **Operational Boundary for External debt** | | | |
| | Borrowing | 12,000 | 12,000 | **12,000** |
| | Other Long-Term Liabilities | 1,000 | 1,000 | **1,000** |
| | Commercial Activities | 25,000 | 21,302 | **21,302** |
| | Total | 38,000 | 34,302 | **34,302** |
| 6 | **Actual External debt (as at 31 March)** | | | |
| | Borrowing | 7,800 | 8,130 | **7,800** |
| | Other Long-Term Liabilities | 243 | 106 | **106** |
| | Total | 8,043 | 8,236 | **7,906** |