TREASURY MANAGEMENT ANNUAL REPORT 2021/22

Finance & Investment Advisory Committee – 6 September 2022

Report of: Deputy Chief Executive and Chief Officer - Finance & Trading

Status: For Decision

Also considered by:

- Cabinet – 20 September 2022

Key Decision: No

Executive Summary: This report provides the customary review of investment and borrowing activity during 2021/22 as required by the Council's Financial Procedure Rules. The report outlines the strategy adopted during the year, shows the position of the investment and debt portfolios at the beginning and the end of the year and gives details of how the investment fund performed in comparison with previous years and against various benchmarks.

This report supports the Key Aim of: efficient management of the Council's resources.

Portfolio Holder: Cllr. Matthew Dickins

Contact Officer: Roy Parsons, Ext. 7204

Recommendation to Finance & Investment Advisory Committee: That Cabinet be asked to approve the Treasury Management Annual Report for 2021/22.

Recommendation to Cabinet: That the Treasury Management Annual Report for 2021/22 be approved.

Reason for recommendations: As required by both the Council's Financial Procedure Rules and the CIPFA Code, an annual report of treasury management activity is to be presented to Members for approval.

Background

1 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 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).

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

- an annual treasury strategy in advance of the year (Council 23/02/2021)
- a mid year (minimum) treasury update report (Finance & Investment Advisory Committee 04/11/2021 & Cabinet 11/11/2021)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

3 The Council's treasury management advisers, Link Asset Services, also provided monthly reviews of our investment performance which were emailed to Members.

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

5 This Council also 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 Finance & Investment Advisory Committee before they were reported to Cabinet or the full Council. Member training was last undertaken on 14 November 2018 in order to support Members' scrutiny role.

Introduction

6 This **annual treasury report** covers:

(a) The Council's capital expenditure and financing;

(b) treasury position at the beginning and end of the financial year

(c) the economy and interest rates;

(d) investment strategy and control of interest rate risk in 2021/22;

(e) borrowing requirement and debt;

(f) borrowing strategy and control of interest rate risk in 2021/22;

(g) borrowing outturn 2021/22;

(h) investment outturn for 2021/22 and performance;

(i) compliance with treasury management limits and prudential indicators; and

(j) other issues (including an update on the Municipal Bonds Agency).

The Council's capital expenditure and financing

7 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.

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

	31/3/21 Actual (£000)	**31/3/22 Actual (£000)**
Capital expenditure	11,635	21,483
Financed in year	(3,641)	(17,950)
Unfinanced capital expenditure	7,994	3,533

The unfinanced capital expenditure was funded by internal borrowing.

Treasury position at the beginning and end of the financial year

9 The Council's treasury position at the beginning and end of the financial year was as follows:

	31/3/21 Principal (£000)	Rate Return (%)	Average Life (Years)	31/3/22 Principal (£000)	Rate Return (%)	Average Life (Years)
Total debt	4,892	2.66	26.5	12,766	2.18	22.5
Capital Financing Requirement (CFR)	35,235	-	-	***	-	-
Over/(under) borrowing	(30,343)	-	-	***	-	-
Total investments	11,050	0.35	-	16,673	0.15	-
Net debt/ (investments)	**(6,158)**	**-**	**-**	**(3,907)**	**-**	**-**

*** Figures unavailable at the time of writing this report.

10 The maturity structure of the debt portfolio was as follows:

	31/3/21 Actual (£000)	31/3/22 Actual (£000)
Under 12 months	-	-
12 months and over and within 20 years	-	8,000
20 years and over and within 30 years	4,892	4,766
30 years and over and within 50 years	-	-

11 The investment portfolio at the beginning and end of the financial year appears at Appendix A, whilst an analysis by maturity and repayment due dates appears at Appendix B.

12 All investments were for periods up to one year in duration.

The economy and interest rates

13 **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.

14 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 Bank of England's Monetary Policy Committee (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.

15 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.

16 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.

17 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.

18 **USA.** The flurry of comments from Federal Reserve (Fed) officials following the mid-March Federal Open Market Committee (FOMC) meeting – including from Chair Jerome Powell himself - hammering home the hawkish message from the mid-March meeting, has had markets pricing in a further 225bps of interest rate increases in 2022 on top of the initial move to an interest rate range of 0.25% - 0.5%.

19 In addition, the Fed is expected to start to run down its balance sheet. Powell noted that the rundown could come as soon as the next meeting in May.

20 The upward pressure on inflation from higher oil prices and potential knock-on impacts on supply chains all argue for tighter policy (CPI is estimated at 7.8% across Q1), but the hit to real disposable incomes and the additional uncertainty points in the opposite direction.

21 More recently, the inversion of the 10y-2y Treasury yield spread at the end of March led to predictable speculation that the Fed's interest rate hikes would quickly push the US economy into recession. Q1 GDP growth is likely to be only between 1.0% and 1.5% annualised (down from 7% in Q4 2021). But, on a positive note, the economy created more than 550,000 jobs per month in Q1, a number unchanged from the post-pandemic 2021 average. Unemployment is only 3.8%.

22 **EU.** With euro-zone inflation having jumped to 7.5% in March it seems increasingly likely that the European Central Bank (ECB) will accelerate its plans to tighten monetary policy. It is likely to end net asset purchases in June – i.e., earlier than the Q3 date which the ECB targeted in March. And the market is now anticipating possibly three 25bp rate hikes later this year followed by more in 2023. Policymakers have also hinted strongly that they would re-start asset purchases if required. In a recent speech, Christine Lagarde said "we can design and deploy new instruments to secure monetary policy transmission as we move along the path of policy normalisation."

23 While inflation has hit the headlines recently, the risk of recession has also been rising. Among the bigger countries, Germany is most likely to experience a "technical" recession because its GDP contracted in Q4 2021, and its performance has been subdued in Q1 2022. However, overall, Q1 2022 growth for the Eurozone is expected to be 0.3% q/q with the y/y figure posting a healthy 5.2% gain. Finishing on a bright note, unemployment fell to only 6.8% in February.

24 **China.** After a concerted effort to get on top of the virus outbreak in Q1 of 2020, economic recovery was strong in the rest of the year; however, 2021 has seen the economy negatively impacted by political policies that have focussed on constraining digital services, restricting individual freedoms, and re-establishing the power of the One-Party state. With the recent outbreak of Covid-19 in large cities, such as Shanghai, near-term economic performance is likely to be subdued. Official GDP numbers suggest growth of c4% y/y, but other data measures suggest this may be an overstatement.

25 **Japan.** The Japanese economic performance through 2021/22 is best described as tepid. With a succession of local lockdowns throughout the course of the year, GDP is expected to have risen only 0.5% y/y with Q4 seeing a minor contraction. The policy rate has remained at -0.1%, unemployment is currently only 2.7% and inflation is sub 1%, although cost pressures are mounting.

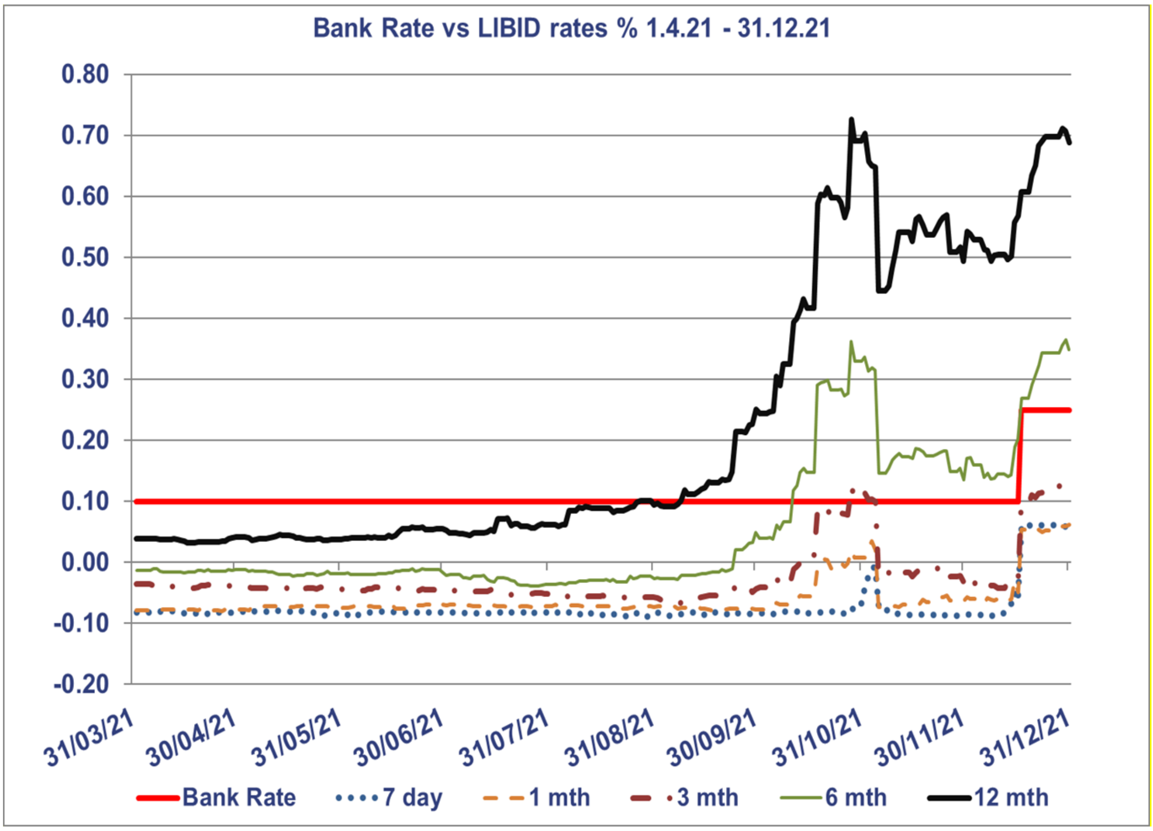
26 **World growth.** World growth is estimated to have expanded 8.9% in 2021/22 following a contraction of 6.6% in 2020/21.

27 **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.

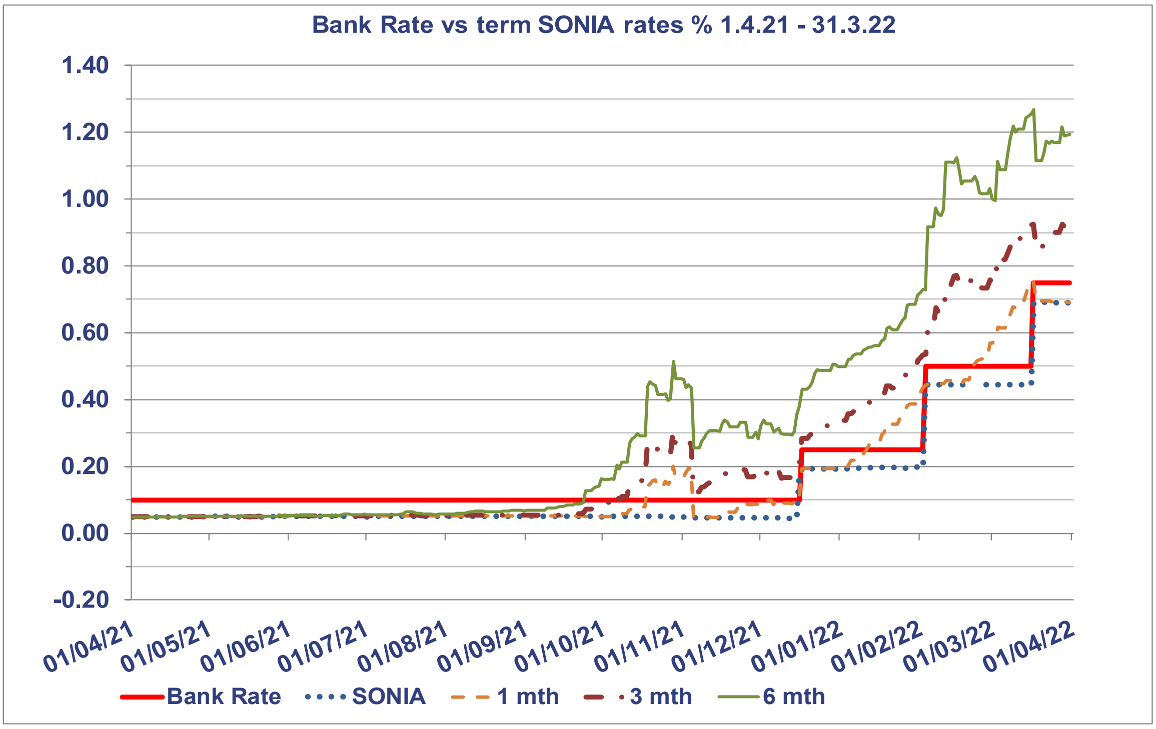
28 **Central banks' monetary policy.** During the pandemic, the governments of western countries have provided massive fiscal support to their economies which has resulted in a big increase in total government debt in each country. It is therefore very important that bond yields stay low while debt to 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.

Investment strategy and control of interest rate risk in 2021/22

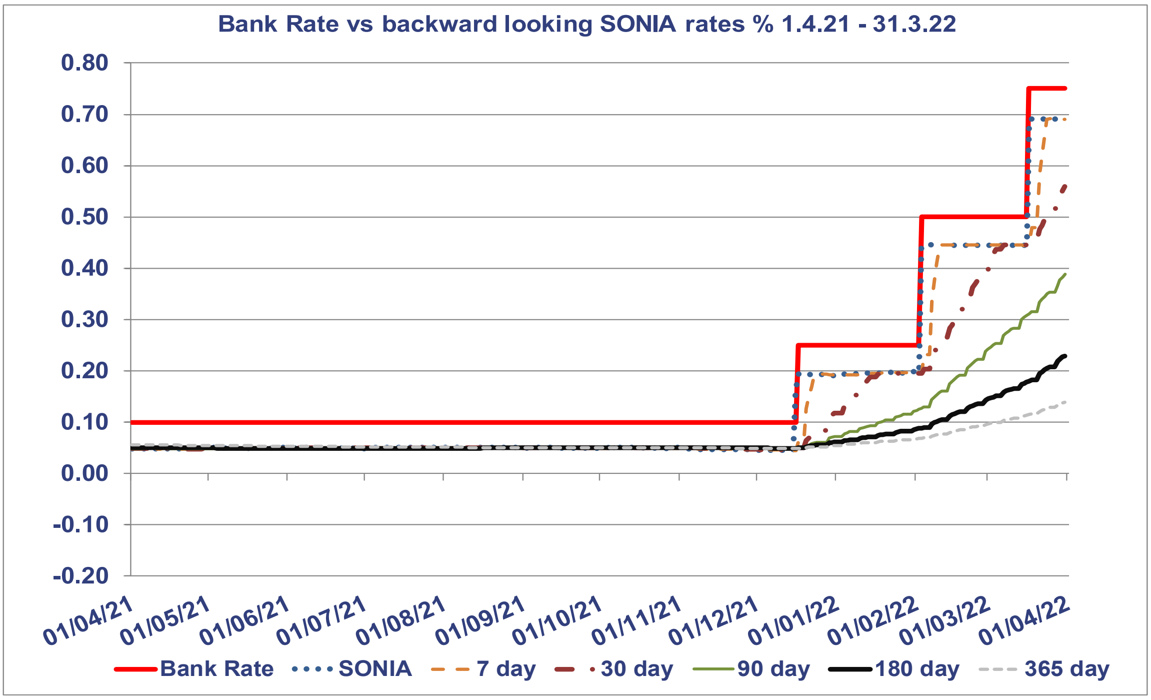
29 The benchmark LIBID rates were replaced by SONIA rates from January 2022. For the purpose of consistency, and for comparatives, the LIBID data to 31 December 2021 and the SONIA data for the whole of 2021/22 were as follows: -



	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
High	0.25	0.06	0.06	0.14	0.36	0.73
High Date	17/12/2021	29/12/2021	31/12/2021	31/12/2021	30/12/2021	28/10/2021
Low	0.10	-0.09	-0.08	-0.07	-0.04	0.04
Low Date	01/07/2021	27/08/2021	17/09/2021	08/09/2021	27/07/2021	08/07/2021
Average	0.11	-0.07	-0.05	-0.01	0.09	0.31
Spread	0.15	0.15	0.14	0.20	0.40	0.68



	Bank Rate	SONIA	1 mth	3 mth	6 mth
High	0.75	0.69	0.75	0.93	1.27
High Date	17/03/2022	18/03/2022	16/03/2022	28/03/2022	17/03/2022
Low	0.10	0.05	0.05	0.05	0.05
Low Date	01/04/2021	15/12/2021	10/11/2021	14/04/2021	09/04/2021
Average	0.19	0.14	0.17	0.24	0.34
Spread	0.65	0.65	0.71	0.88	1.22



	Bank Rate	SONIA	7 day	30 day	90 day	180 day	365 day
High	0.75	0.69	0.69	0.56	0.39	0.23	0.14
High Date	17/03/2022	18/03/2022	25/03/2022	31/03/2022	31/03/2022	31/03/2022	31/03/2022
Low	0.10	0.05	0.05	0.05	0.05	0.05	0.05
Low Date	01/04/2021	15/12/2021	16/12/2021	16/12/2021	16/12/2021	07/06/2021	13/12/2021
Average	0.19	0.14	0.13	0.12	0.09	0.07	0.06
Spread	0.65	0.65	0.65	0.51	0.34	0.18	0.09

30 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.

31 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).

32 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.

33 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.

The borrowing requirement and debt

34 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2021/22 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

35 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies, (such as the Government, through the Public Works Loan Board (PWLB), or the money markets), or utilising temporary cash resources within the Council.

36 Reducing the CFR – the Council's non-Housing Revenue Account (HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the non-HRA borrowing need, (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

37 The total CFR can also be reduced by:

- the application of additional capital financing resources, (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

38 The Council's 2021/22 MRP Policy, (as required by DLUHC Guidance), was approved as part of the Treasury Management Strategy Report for 2021/22 on 23 February 2021.

39 The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes PFI and leasing schemes on the balance sheet, which increase the Council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract (if applicable).

40 Borrowing activity is constrained by prudential indicators for gross borrowing and the CFR, and by the authorised limit.

41 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 of 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 Council has complied with this prudential indicator.

	31/3/21 Actual (£000)	**31/3/22 Actual (£000)**
CFR General Fund	35,235	***
Gross borrowing position	4,892	12,766
Over/(under) funding of CFR	(30,343)	***

*** Figures unavailable at the time of writing this report.

42 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. The table below demonstrates that during 2021/22 the Council has maintained gross borrowing within its authorised limit.

43 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.

44 “Actual financing costs as a proportion of net revenue stream” is an indicator identifying 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 (£000)
Authorised limit	35,533
Maximum gross borrowing position during the year	12,766
Operational boundary	30,533
Average gross borrowing position	6,813
Financing costs as a proportion of net revenue stream	0.83%

Borrowing strategy and control of interest rate risk in 2021/22

45 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 is known as internal borrowing. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

46 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.

47 The policy of avoiding new borrowing by running down spare cash balances, has served the Council 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.

48 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. Forecasts from our treasury management advisors, Link Asset Services, together with historical rates appear below.

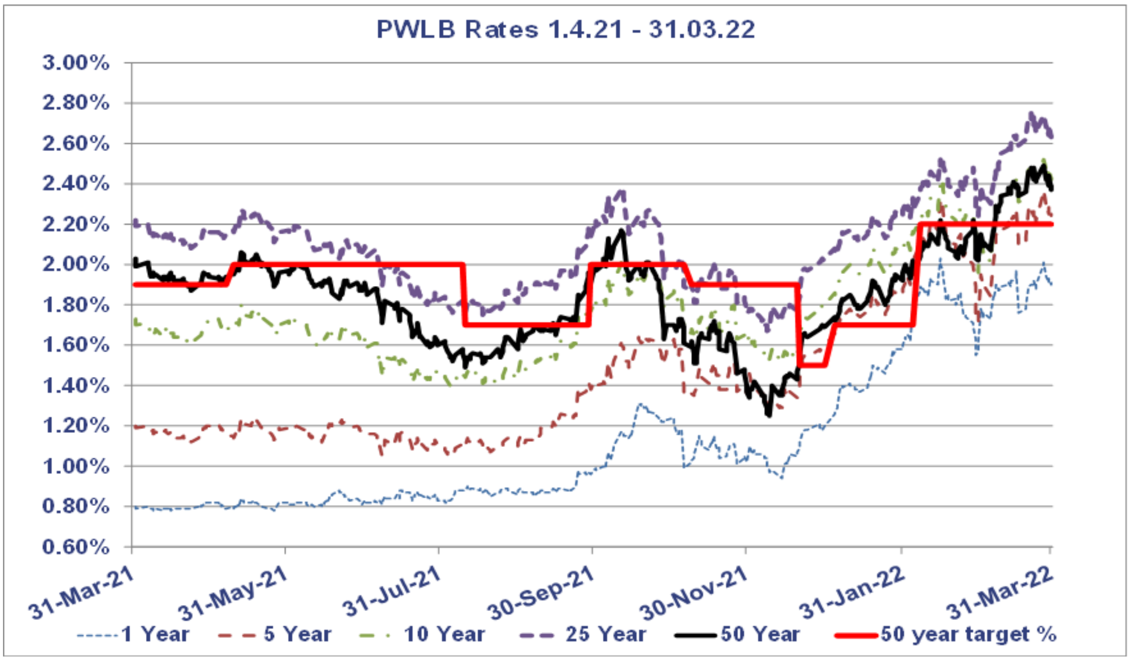
Forecast at the time of approval of 2021/22 Treasury Management Strategy:-

Link Group Interest Rate View	9.11.20													
	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	1.80	1.80	1.80	1.80	1.80	1.90	1.90	1.90	1.90	1.90	2.00	2.00	2.00	2.00
10 yr PWLB	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30	2.30	2.30	2.30	2.30
25 yr PWLB	2.50	2.50	2.60	2.60	2.60	2.60	2.70	2.70	2.70	2.70	2.80	2.80	2.80	2.80
50 yr PWLB	2.30	2.30	2.40	2.40	2.40	2.40	2.50	2.50	2.50	2.50	2.60	2.60	2.60	2.60

Forecast at year end:-

Link Group Interest Rate View	7.2.22												
	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	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
3 month av. earnings	0.80	1.00	1.00	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20
6 month av. earnings	1.00	1.10	1.20	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30
12 month av. earnings	1.40	1.50	1.60	1.70	1.70	1.60	1.60	1.50	1.40	1.40	1.40	1.40	1.40
5 yr PWLB	2.20	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30
10 yr PWLB	2.30	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40
25 yr PWLB	2.40	2.50	2.50	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60
50 yr PWLB	2.20	2.30	2.30	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40

PWLB rates in 2021/22:-



	1 Year	5 Year	10 Year	25 Year	50 Year
01/04/2021	0.80%	1.20%	1.73%	2.22%	2.03%
31/03/2022	1.91%	2.25%	2.43%	2.64%	2.39%
Low	0.78%	1.05%	1.39%	1.67%	1.25%
Low date	08/04/2021	08/07/2021	05/08/2021	08/12/2021	09/12/2021
High	2.03%	2.37%	2.52%	2.75%	2.49%
High date	15/02/2022	28/03/2022	28/03/2022	23/03/2022	28/03/2022
Average	1.13%	1.45%	1.78%	2.10%	1.85%
Spread	1.25%	1.32%	1.13%	1.08%	1.24%

49 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.

50 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.

51 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%.

52 Regarding PWLB borrowing rates, the various margins attributed to their pricing are as follows:-

- **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
- **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

53 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 rise from 0.75% in March 2022 to 1.25% later this year, with upside risk likely if the economy proves resilient in the light of the cost-of-living squeeze. Medium to long dated yields are driven primarily by inflation concerns but the Bank of England is also embarking on a process of Quantitative Tightening when Bank Rate hits 1%, whereby the Bank's £895bn stock of gilt and corporate bonds will be sold back into the market over several years. 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.

Borrowing outturn for 2021/22

54 One new loan was drawn during the year. The loans outstanding are as follows:-

Lender	Principal	Type	Interest Rate	Maturity
PWLB	£5.25m	Fixed interest rate - Annuity	2.66%	30 years to 3/11/2047
PWLB	£8m	Fixed interest rate - Annuity	1.70%	20 years to 25/11/2041

55 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.

56 There were no repayments or rescheduling of debt during 2021/22.

Investment outturn for 2021/22 and performance

57 The Council's investment policy is governed by Department for Levelling Up, Housing & Communities (DLUHC) guidance, which has been implemented in the annual investment strategy approved by the 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, bank share prices etc).

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

59 Appendix C shows the performance of the fund during 2021/22 both in table and graphical form. The table shows the average percentage return on the fund, both monthly and for the whole year and compares them with the average 7-day and 3-month London Interbank Bid (LIBID) rates and the corresponding SONIA rates. The average return achieved by each broker is only a very basic measure of performance, because returns will depend on the number and length of each investment he/she is asked to carry out. If a particular broker is only asked to place short term investments, he/she may well not achieve the same overall rate as a broker who predominantly handles longer term investments for us.

60 The graph shows actual monthly receipts for 2019/20, 2020/21 and 2021/22 plus budgeted monthly receipts for 2021/22. The monthly interest budget has been profiled in line with the previous year's monthly weighted average principal.

61 Over the course of the year interest receipts amounted to £40,400 compared with a budget of £188,000. The fall in income reflects the ultra-low returns on short duration deposits (up to 12 months) available in the market during the year. Rates declined throughout 2021/22 in response to the realisation that recovery from the economic impacts of Covid-19 is going to be with us for some time to come. They only started to recover in response to increases in Bank Rate brought about by measures to control inflation. Balances available for investment were significantly reduced during the year owing to the demands of the property investment strategy and the funding of the capital programme. The planned diversification into longer-term pooled investment vehicles such as multi-asset income funds was commenced with a view to placing such investments in the early part of 2022/23. These funds have the potential for greater revenue income, but also have the potential for capital loss as well as capital growth. For these reasons, they are viewed

with a minimum 5 year investment horizon which, in theory, evens out capital loss and growth.

62 In 2021/22 the average return on the Council's investments was roughly in line with that of our neighbouring authorities. Our overall rate of return was 0.15% compared with 0.62% for Tonbridge & Malling Borough Council and 0.28% for Gravesham Borough Council. It should be noted that investment returns are notoriously difficult to compare as they have often been compiled on a different basis (for example, whether or not interest has been compounded, whether or not cashflow generated balances have been included, whether or not externally managed funds have been included and whether or not the figures are net of borrowings). Our balances available for investment are significantly lower and mainly required for cash flow purposes, which means that there is less scope for us to invest for longer periods at potentially more attractive rates. Note that this Council has also invested in property which is not included in this report.

63 Our treasury management advisers recommend the 3-month LIBID / SONIA figures as a benchmark. The 3-month rate reflects a more realistic neutral investment position for core investments with a medium term horizon and a rate which is more stable with less fluctuation caused by market liquidity. Historically (but not in 2021/22), this rate has been slightly higher than the 7-day rate and therefore more challenging a comparator, but one which does not necessitate a significantly increased level of risk. The figures calculated by our advisers for these benchmarks are as follows:

- 7-day SONA compounded 0.1392%
- 90-day SONIA compounded 0.1286%
- 3-month LIBID compounded -0.0436%

64 The above comparators are somewhat different to those shown in Appendix C because LIBID rates were replaced by SONIA rates in January 2022 and the figures for the year shown in Appendix C are the average of the two.

Compliance with treasury management limits and prudential indicators

65 The Council operates to approved prudential indicators for treasury management as contained in the Treasury Management Strategy Statement (TMSS). The TMSS for 2021/22 was part of the annual treasury strategy reported to Council on 23 February 2021. The approved limits exist to regulate short-term borrowing for operational cash flow fluctuations, as well as long-term borrowing for financing capital investments. Additionally, the limits aim is to mitigate against fluctuations in interest rates.

Other issues

Update on the Municipal Bonds Agency

66 During 2014/15, the Council invested £50,000 to become an equity shareholder in the Local Capital Finance Company, which was set up by the Local Government Association under the name of the Municipal Bonds Agency (MBA). This was a 'Policy Investment' and does not form part of the treasury management strategy. The purpose of the agency is to facilitate borrowing by local authorities at rates that are expected to be more competitive than those of the Public Works Loan Board (PWLB). There are 56 shareholder councils.

67 In 2021 the Company engaged with a number of local authorities amongst its shareholders and others with respect to their debt finance requirements and supported authorities in their due diligence process. As part of this work the Company adopted an Environmental, Social and Governance (ESG)/"Green" Bond Framework to enable issuance of debt financing to support local authorities' projects that can be classified as ''green'' and/or sustainable. The Company is now working to assemble several Green bond transactions across the range of instruments including fixed rate notes of various maturity, rate locks and commercial.

68 The Company also engaged with local authorities to assemble a number of councils with borrowing demand for a pooled bond transaction. Subsequently, the focus of the Company will be to market the Company's activities within the local authority sector and build its volume of lending, in a manner consistent with its high credit standards. In this, the Company would note the continued demand from local authorities for high quality funding to invest in local services, economic development, housing and infrastructure.

69 The MBA is an option for any future borrowing requirement, but the Council will first need to ensure that it has thoroughly scrutinised the legal terms and conditions of the arrangement and is satisfied with them.

Non-treasury management investments

70 Members will be aware that significant property purchases have been carried out in recent years which are regarded as non-treasury investments. Further details are contained within Property Investment Strategy reports that are submitted to Members separately.

Key Implications

Financial

The management of the Council's investment portfolio and cash-flow generated balances plays an important part in the financial planning of the authority. The security of its capital and liquidity of its investments is of paramount importance.

Legal Implications and Risk Assessment Statement

Under Section 151 of the Local Government Act 1972, the Section 151 Officer has statutory duties in relation to the financial administration and stewardship of the authority, including securing effective arrangements for treasury management.

This annual review report fulfils the requirements of The Chartered Institute of Public Finance & Accountancy's Code of Practice on Treasury Management 2017.

Treasury management has two main risks:

- Fluctuations in interest rates can result in a reduction in income from investments; and

- A counterparty to which the Council has lent money fails to repay the loan at the required time.

Consideration of risk is integral in our approach to treasury management. However, this particular report has no specific risk implications as it is not proposing any new actions, but merely reporting performance over the last year.

Equality Assessment

The decisions recommended through this paper have a remote or low relevance to the substance of the Equality Act. There is no perceived impact on end users.

Net Zero Implications

The decisions recommended through this paper have a remote or low relevance to the council's ambition to be Net Zero by 2030. There is no perceived impact regarding either an increase or decrease in carbon emissions in the district, or supporting the resilience of the natural environment.

Conclusions

The overall return on the Council's investments was below budget in 2021/22 by more than £147,000 but the percentage return exceeded the recognised benchmarks. Inflation continues to outpace investment returns, leading to the gradual erosion of capital in real terms.

The economic situation both globally and within the Eurozone remains volatile, and this will have consequences for the UK economy. Treasury management in the past financial year was conducted against this background and with a cautious investment approach.

Appendices:	Appendix A – Investment portfolio at start and end of financial year
	Appendix B – Analysis of investment portfolio by maturity and repayment due dates

	Appendix C - Investment performance in 2021/22
Background Papers:	Treasury Management Strategy for 2021/22 - Council 23 February 2021

Adrian Rowbotham
Deputy Chief Executive and Chief Officer Finance & Trading