Report to:	**Scrutiny**
Date:	**11 July 2022**
Title:	**Treasury management annual report 2021/22**
Report of:	**Homira Javadi, Chief Finance Officer**
Cabinet member:	**Councillor Stephen Holt, Cabinet member for financial services**
Ward(s):	**All**
Purpose of report:	**To report on the activities and performance of the Treasury Management service during 2021/22**
Decision type:	**Budget and Policy Framework**
Officer recommendation(s) to the Cabinet:	**To recommend to the Full Council:** **(1) Agree the annual Treasury Management report for 2021/22** **(2) Approve the 2021/22 prudential and treasury indicators included.**
Reasons for recommendations:	**Requirement of CIPFA Treasury Management in the Public Sector Code of Practice (the Code) and this has to be reported to Full Council.**
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1 Introduction

1.1 This Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management 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 During 2021/22 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 24 February 2021)
- a mid-year (minimum) treasury briefing.

- an annual report following the year describing the activity compared to the strategy (this report).

1.3 In addition, Treasury Management updates are included in the quarterly performance management reports, considered by both the Cabinet and Scrutiny Committee. Recent changes in the regulatory environment place a much greater responsibility on Members for the review and scrutiny of treasury management policy and activities. This report is 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. This report was considered by the Audit and Governance Committee at its meeting on 12 July 2022 meeting.

1.4 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 Audit & Governance Committee before they were reported to the full Council. Member training on treasury management issues was undertaken on 21 October 2021, which is to support Members' scrutiny role and further training is expected to take place in 2022-23.

1.5 This report summarises:

- Capital programme activities during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement (CFR));
- Reporting of the required prudential and treasury indicators and changes to be approved;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Debt activity and investment activity.
- Economic and Interest Rates

1.6 Treasury Management is an integral part of the Council's overall finances and the performance of this area is very important. Whilst individual years obviously matter, performance is best viewed on a medium / long term basis. The action taken in respect of the debt portfolio in recent years has been extremely beneficial and has resulted in savings. Short term gains might, on occasions, be sacrificed for longer term certainty and stability.

1.7 The criteria for lending to Banks are derived from the list of approved counter parties provided by the Council's Treasury Management advisors, Link Asset Services. The list is amended to reduce the risk to the Council by removing the lowest rated counterparties and reducing the maximum loan duration.

1.8 An economic commentary for the year was provided by the Council's treasury management advisors (Link), this is attached as Appendix C to this report. Bank Rate was 0.1% at the beginning of the year and despite the economy gathering momentum after pandemic restrictions eased, market expectation was for rises to be delayed until 2022. Rising and persistent inflation changed that with Bank Rate rising to 0.75% at the end of the year.

1.9 During 2021 CIPFA published changes to its Prudential Code and Treasury Management Code of Practice. These follow the Public Accounts Committee's recommendation that the prudential framework should be further tightened following continued borrowing by some authorities for investment purposes.

1.10 In addition, HM Treasury issued, in May 2022, updated guidance on PWLB lending to authorities where there is more than a negligible risk of non-repayment. In the same month the Levelling Up and Regeneration Bill announced in the Queens Speech gives government more oversight of the Prudential Framework.

1.11 The main points of these new Codes, PWLB guidance and Levelling Up and Regeneration Bill are summarised at Appendix B.

EBC Capitalisation Direction

1.12 Similar to other local authorities, EBC had discussions with the Department for Levelling Up, Housing and Communities (DLUHC) about Capitalisation Directive to help in dealing with 2020/21 deficit and balance the budget in 2021/22. Other councils that have been harder hit by Covid-19 have also requested support using this means across both years.

1.13 A capitalisation directive permits a Council to capitalise revenue expenditure if it is unable to set a balanced budget, has considered all other options, has limited reserves, and is increasing its Council Tax by the maximum permitted. The direction will only be granted in exceptional circumstances, and only the Secretary of State can permit this action legally

1.14 The Minister of State for Regional Growth and Local Government in a letter (on 2nd February 2021) addressed to the Leader of the Council, states that:

- With respect to the financial year of 2020/21, the Secretary of State is content to approve a total capitalisation direction to fund revenue expenditure not exceeding £6.8m, subject to conditions set out in the capitalisation direction. *Actual revenue expenditure that was capitalised in 2020/21 was £4.6m.*

- With respect to the financial year of 2021/22, the Secretary of State is minded to approve a capitalisation direction of a total not exceeding £6m. Again, such a direction may be subject to conditions, which would be set out in the capitalisation direction. *The 2021/22 expected actual revenue expenditure that will be capitalised is estimated to be £2.5m.*

1.15 These capitalisation figures are yet to be audited and any revisions to this amount will be reported at the future Committee meeting. The capitalisation direction impacts the Council's Capital Expenditure and Financing 2020/21 and 2021/22 (see para 2.2 below).

2 The Council's Capital Expenditure and Financing 2021/22

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.

2.2 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 £m	2021/22 Original Estimate £m	2021/22 Revised Estimate £m	2021/22 Actual £m
General Fund	1.8	8.8	8.2	2.1
Capitalisation Direction	4.6	6.0	4.4	2.5
HRA capital expenditure	3.9	19.8	9.2	6.9
Other Housing & Regeneration	7.0	4.6	15.7	18.2
Total capital expenditure	**17.3**	**39.2**	**37.6**	**29.7**
Resourced by:				
• Capital receipts (including capitalisation direction funding)	4.1	7.4	6.6	6.0
• Capital grants/external funding	2.6	5.2	4.6	3.9
• Capital Reserves	3.1	4.4	6.9	4.9
• Revenue	-	3.1	0.6	0.5
Use of internal balances/ borrowing	**7.5**	**19.1**	**18.9**	**14.4**

3 <u>The Council's overall borrowing need</u>

3.1 The Capital Financing Requirement (CFR) represents the Council's total underlying need to borrow to finance capital expenditure, i.e. capital expenditure that has not been resourced from capital receipts, capital grants and contributions or the use of reserves. Some of this borrowing is from the internal use of cash balances.

3.2 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 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.

3.3 **Reducing the CFR** – the Council's (non 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-Housing Revenue Account 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. 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).

3.4 The Council's 2021/22 MRP Policy (as required by Department for Levelling Up, Housing and Communities Guidance) was approved as part of the Treasury Management Strategy Report for 2021/22 on 10th February 2021. The Council's CFR for the year is shown below and represents a key prudential indicator.

CFR	**31 March 2021 Actual £m**	**1 April 2021 Original Estimate £m**	**31 March 2022 Actual £m**
Opening balance	172.8	180.7	179.0
Add unfinanced capital expenditure (per table 2.0)	7.5	19.1	14.4
Less MRP	(1.3)	(0.8)	(10.2)
Closing balance	**179.0**	**199.0**	**183.2**

Note - the 2021/22 MRP of £10m includes EHIC loan repayment of £9m.

3.5 Under the annuity methodology, MRP will be lower in the early years and increases over time. This is considered a prudent approach as it reflects the time value of money (i.e. the impact of inflation) as well as providing a charge that is better matched to how the benefits of the asset financed by borrowing are consumed over its useful life. That is, a method that reflects the fact that asset deterioration is slower in the early years of an asset and accelerates towards the latter years.

3.6 In the case of all capital spend financed by Prudential Borrowing; this will be subject to annuity methodology. MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction), i.e., where expenditure is capitalised, the Authority shall charge annual Minimum Revenue Provision using the asset life method with a proxy 'asset life' of no more than 20 years.

3.7 The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the Authorised Limit.

Net borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term, the Council's external borrowing net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure.

Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2020/21 plus the expected changes to the CFR over 2021/22 and 2022/23. This indicator allows the Council some flexibility to borrow in advance of its immediate capital need in 2021/22. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2021 Actual £m	**1 April 2021 Original Estimate £m**	**31 March 2022 Actual £m**
GF - Borrowing	54.2	51.9	52.1
HRA - Borrowing	47.8	54.6	48.2
Other Housing and Regeneration	57.4	72.8	59.9
Net borrowing position	**159.4**	**179.3**	**160.2**
CFR – General Fund	73.8	71.6	75.1
CFR – Housing (HRA)	47.8	54.6	48.2
Other Housing and Regeneration	57.4	72.8	59.9
CFR	**179.0**	**199.0**	**183.2**

3.8 **The Authorised limit** - the Authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2020/21 the Council has maintained gross borrowing within its Authorised limit.

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 is acceptable subject to the Authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) against the net revenue stream.

Descriptions	1 April 2021	31 March 2022
Authorised limit	£199m	£199m
Operational boundary	£181m	£181m
Financing costs as a proportion of net revenue stream:		
Non HRA	8.4%	8.4%
HRA	11.1%	11.4%

4 Treasury Position as at 31 March 2022

4.1 The Council's debt and investment position is organised by staff within Financial Services in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities.

4.2 Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2021/22, the Council's treasury position was as follows:

Description	31 March 2021 Principal	Rate/ Return	31 March 2022 Principal	Rate/ Return
Fixed rate funding:				
-PWLB	£122.4m		£119.2m	
-Market	£37.0m		£41.0m	
Total debt	**£159.4m**	**2.10%**	**£160.2m**	**2.01%**
CFR	£179.0m		£183.2m	
Over/ (under) borrowing	(£19.6m)		(£23.0m)	
Total investments (excl. cash)	**£0m**		**£9.5m**	

The Council held cash balances of £6m in current and call accounts which earned an average of 0.11%.

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

	31 March 2021 Actual £m	31 March 2022 Actual £m
Under 12 months	40.21	5.45
12 months and within 24 Mths.	5.45	43.45
24 months and within 5 years	8.12	8.50
5 years and within 10 years	13.60	13.22
10 years and above	92.07	89.62

The exposure to fixed and variable rates was as follows:

	31 March 2021 Actual £m	31 March 2022 Actual £m
Principal - Debt Fixed rate	159.4	160.2
Principal – Investments Variable rate	0	0

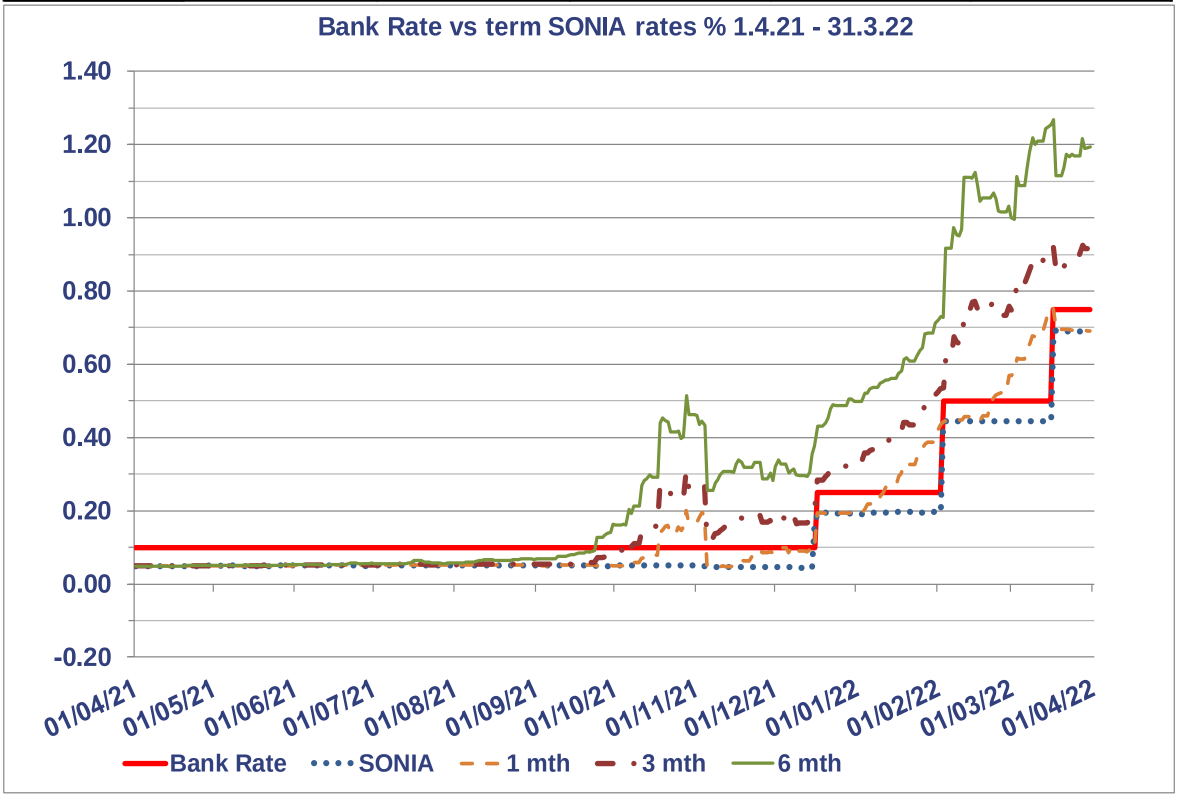
5 The Strategy for 2021/22

5.1 Investment returns plunged during 2021/22 to near zero or even into negative territory. Most local authority lending managed to avoid negative rates and one feature of the year was the growth of inter local authority lending.

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 6.2% in February).

5.3 **Investment strategy and control of interest rate risk**

	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



5.4 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.

5.5 This authority does not have sufficient cash balances to be able to place deposits for more than a month so as to earn higher rates from longer deposits. 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.

Borrowing strategy

5.6 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.

5.7 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.

5.8 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.

6 Borrowing Outturn for 2021/22

6.1 **Treasury Borrowing**.

Borrowing – 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. No new loans were drawn down from PWLB in 2021/22 to fund the net unfinanced capital expenditure and/or to replace maturing loans. Various temporary loans were taken to cover cash flow requirements. All loans drawn were for fixed rate and are detailed in Appendix A.

6.2 In taking this decision, the Council carefully considered achieving best value, the risk of having to borrow at higher rates at a later date, the carrying cost of the difference between interest paid on such debt and interest received from investing funds which would be surplus until used, and that the Council could ensure the security of such funds placed on temporary investment.

- **Rescheduling** – no debt rescheduling was carried out during the year as there was no financial benefit to the Council.
- **Repayment** – £760k of long term PWLB debt was repaid at maturity on 24 March 2022 and £2.45m was an instalment repayment for the repayment (EIP) loans. Various temporary loans were repaid during the year, see Appendix A.
- **Summary of debt transactions** – the overall position of the debt activity resulted in a fall in the average interest rate by 0.2%, representing a saving to the General Fund.

7 Interest Rates in 2021/22

7.1 The tight monetary conditions following the financial crisis continued through 2021/22 with little material movement in the shorter-term deposit rates. With many financial institutions failing to meet the Council's investment criteria, the opportunities for investment returns were limited. The PWLB rates (including the 0.2% reduction for Certainty Rate) at the beginning, average and end of the year are provided below.

Term	Interest Rate March 2021	Average Rate	Interest rate April 2022
1 Year	0.79%	1.12%	1.95%
5 Years	1.18%	1.45%	2.30%
10 Years	1.71%	1.78%	2.46%
25 Years	2.19%	2.10%	2.65%
50 Years	1.99%	1.84%	2.38%

8 Investment Outturn for 2021/22

8.1 **Investment Policy** – the Council's investment policy is governed by DLUHC guidance, which was been implemented in the annual investment strategy approved by the Council on 10 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.).

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

8.3 **Resources** – the Council's longer-term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations. The Council's core cash resources comprised as follows, and met the expectations of the budget:

Balance Sheet Resources	31 March 2021 £m	31 March 2022 £m
GF Balances	3.23	6.25
Earmarked Reserves	7.35	8.23
HRA Balances	5.45	4.74
Major Repairs Reserve	2.57	2.60
Capital Grants & Contributions	1.44	3.59
Usable Capital Receipts	5.27	1.29
Sub Total	**25.31**	**26.70**
S31 Grant Reserve	10.16	4.14
Total	**35.47**	**30.84**

8.4 **Investments held by the Council** - the Council maintained an average balance of £8.3m of internally managed funds. The internally managed funds earned an average rate of return of 0.11%.

8.5 Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

8.6 Ultra-low short-dated cash rates, which were a feature since March 2020 when Bank Rate was cut to 0.1%, prevailed for much of the 12-month reporting period which resulted in the return on sterling low volatility net asset value (LVNAV) Money Market Funds being at, or close to zero even after some managers have temporarily waived or lowered their fees. However, higher returns on cash instruments followed the increases in Bank Rate in December, February and March. At 31st March, the 1-day return on the Council's MMFs ranged between 0.48% - 0.58% p.a.

8.7 Similarly, deposit rates with the Debt Management Account Deposit Facility (DMADF) initially remained very low with rates ranging from 0% to 0.1% but following the hikes to policy rates increased to between 0.55% and 0.85% depending on the deposit maturity. The average return on the Authority's DMADF deposits in year was 0.08%.

9 Executive Summary and Conclusion

9.1 During 2021/22, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Actual prudential and treasury indicators	**2020/21 Actual £m**	**2021/22 Original Estimate £m**	**2021/22 Actual £m**
Capital expenditure	17.3	39.2	29.7
Total Capital Financing Requirement:			
• General Fund	73.8	71.6	75.1
• HRA	47.8	54.6	48.2
• Other Housing and Regeneration	57.4	72.8	59.9
• Total	179.0	199.0	183.2
Net borrowing	159.4		150.7
External debt	159.4		160.2
Investments (all under 1 year)	-		9.5

9.2 Other prudential and treasury indicators are to be found in the main body of this report. The Chief Finance Officer also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the Authorised limit), was not breached. The financial year 2021/22 continued the challenging environment of previous years; low investment returns, and continuing counterparty risk continued.

10 The Economy and Interest Rates Forecast

10.1 The Council's treasury advisor, Link, provides the *Economy and Interest Rates Forecast, which is attached* as Appendix C.

11 Other

11.1 CIPFA consultations: In February 2021 CIPFA launched two consultations on changes to its Prudential Code and Treasury Management Code of Practice. These follow the Public Accounts Committee's recommendation that the prudential framework should be further tightened following continued borrowing by some authorities for investment purposes. These are principles-based consultations and will be followed by more specific proposals later in the year.

11.2 In the Prudential Code the key area being addressed is the statement that "local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed". Other proposed changes include the sustainability of capital expenditure in accordance with an authority's corporate objectives, i.e., recognising climate, diversity and innovation, commercial investment being proportionate to budgets, expanding the capital strategy section on commercial activities, replacing the "gross debt and the CFR" with the liability benchmark as a graphical prudential indicator.

11.3 Proposed changes to the Treasury Management Code include requiring job specifications and "knowledge and skills" schedules for treasury management roles to be included in the Treasury Management Practices document and formally reviewed, a specific treasury management committee for MiFID II professional clients and a new TMP 13 on Environmental, Social and Governance Risk Management.

11.4 **IFRS 16:** The implementation of the new IFRS 16 Leases accounting standard was due to come into force for local authorities from 1st April 2022. Following a consultation CIFPA/LASAAC announced an optional two-year delay to the implementation of this standard a decision which was confirmed by the Financial Reporting Advisory Board in early April 2022. Authorities can now choose to adopt the new standard on 1st April 2022, 1st April 2023 or 1st April 2024. The Chief Finance Officer intends for the Council to adopt the new standard on 1st April 2024, if resources permit adoption from April 2023 will be considered

12 Investment Consultants

12.1 The Council has recently appointed Link Treasury Services Limited as its Treasury Adviser for an initial two-year term expiring on 30 May 2023, with the Council having the option to extend, if required. The Link Treasury Services has been appointed to support both the Lewes District Council and Eastbourne Borough Council, given that a shared finance team (with treasury management responsibility) has been established.

13 Reporting and Training

13.1 The Chief Finance Officer reported the details of treasury management activity to each regular meeting of the Audit and Standards Committee and Cabinet held in 2021/22. A mid-term summary report was issued in November 2021.

13.2 The training needs of the Council's treasury management staff were reviewed as part of the annual corporate staff appraisal/training needs assessment process for all Council employees. Members of staff attended, where appropriate, Links workshops alongside colleagues from other local authorities during 2021/22. In 2021/22, Link Asset Services continue to meet with Council officers to explain developments within the sector, as well as review the Council's own investment and debt portfolios.

14 Corporate plan and council policies

14.1 The priority themes were considered as part of the overall Capital Programme which forms part of the Treasury Management Strategy.

15 Financial appraisal

15.1 Financial appraisals were considered as part of the overall Capital Programme which forms part of the Treasury Management Strategy.

16 Legal implications

16.1 Comment from the Legal Services Team is not necessary for this routine monitoring report.

17 Risk management implications

17.1 Risks relating to the timing of borrowing and terms of borrowing are considered and advice is provided by Link. Risk management is considered for each of the schemes within the Capital Programme.

18 Equality analysis

18.1 Equality issues are considered

19 Appendices

19.1

- Appendix A – Temporary loans taken during 2021/22.
- Appendix B - Revised CIPFA Codes, Updated PWLB Lending Facility Guidance
- Appendix C - The Economy and Interest Rates
- Appendix D – Glossary - Local Authority Treasury Management Terms

20 Background papers

20.1 The Background Papers used in compiling this report were as follows:

- CIPFA Treasury Management in the Public Services code of Practice (the Code)
- Cross-sectorial Guidance Notes
- CIPFA Prudential Code
- Treasury Management Strategy and Treasury Management Practices.
- Link Asset Services Citywatch and interest rate forecasts

Appendix A

Temporary loans taken during 2021/22

Lender - Temp Debt	£m	Start Date	End Date	Rate
West Midlands Combined Authority	10	21-May-21	21 Jan 22	0.07%
Northern Ireland Housing Executive	7.0	20-Sep-21	20-Jun-22	0.07%
Middlesbrough Teeside Pension Fund	5.0	22-Nov-21	23-May-22	0.04%
West Midlands Combined Authority	10.0	21-Jan-22	20-Jan-23	0.25%
Hyndburn BC	2.0	28-Feb-22	27-Feb-23	0.70%
Swansea City & County	5.0	01-Mar-22	24-Jun-22	0.57%
Rotherham MBC	2.0	16-Mar-22	16-Jun-22	0.75%
Middlesbrough Council	5.0	11-Mar-22	29-Jul-22	0.79%
Greater Manchester Pension Fund	5.0	21-Mar-22	22-Aug-22	0.70%

Long Term Loans taken during 2021/22

Lender - Long Term Debt	£m	Start Date	End Date	Rate
None				

Maturity loans – repayment is due in full at maturity.
EIP loans – loans are repaid over the term of the loan in equal instalments paid half yearly.

Appendix B

Revised CIPFA Codes, Updated PWLB Lending Facility Guidance

In August 2021 HM Treasury significantly revised guidance for the PWLB lending facility with more detail and 12 examples of permitted and prohibited use of PWLB loans. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

CIPFA published its revised Prudential Code for Capital Finance and Treasury Management Code on 20th December 2021. The key changes in the two codes are around permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments.

The principles of the Prudential Code took immediate effect although local authorities could defer introducing the revised reporting requirements and the Council will implement the new Code fully commencing from the 2023/24 financial year. To comply with the Prudential Code, authorities must not borrow to invest primarily for financial return. This Code also states that it is not prudent for local authorities to make investment or spending decision that will increase the CFR unless directly and primarily related to the functions of the authority. Existing commercial investments are not required to be sold; however, authorities with existing commercial investments who expect to need to borrow should review the options for exiting these investments.

Borrowing is permitted for cashflow management, interest rate risk management, to refinance current borrowing and to adjust levels of internal borrowing. Borrowing to refinance capital expenditure primarily related to the delivery of a local authority's function but where a financial return is also expected is allowed, provided that financial return is not the primary reason for the expenditure. The changes align the CIPFA Prudential Code with the PWLB lending rules.

Unlike the Prudential Code, there is no mention of the date of initial application in the Treasury Management Code. The TM Code now includes extensive additional requirements for service and commercial investments, far beyond those in the 2017 version.

The Council will follow the same process as the Prudential Code, i.e. delaying changes in reporting requirements to the 2023/24 strategy year.

Public Works Loan Board (PWLB) – updated guidance for applicants

On 12th May 2022 HM Treasury issued an update to PWLB lending guidance, addressing lending to authorities where there is more than a negligible risk of non-repayment. The update states that where HM Treasury considers that a local authority may be at risk of being unable to repay PWLB lending, it will engage with that local authority to establish the extent of the risk of non-repayment. **Loans will not generally be advanced where there is a more than negligible risk of non-repayment.**

HM Treasury will generally consider that where a local authority is actively and constructively engaged with Government on addressing financial risk, that local authority is sufficiently managing risk of non-repayment. This includes where a local authority is working with the government as part of ongoing financial support measures. In such cases, HM Treasury will work with the relevant department to assess any risks to the PWLB.

The Department for Levelling Up, Housing and Communities (DLUHC) has announced plans to bring forward measures to provide the government with appropriate powers to directly address excessive risk arising from local government investing and borrowing practices. Where DLUHC believes it to be probable that a local authority would fall within the scope of the powers, it will be engaging with them immediately to get a better understanding of their risk positions in advance of the powers coming into force and to reach agreement on any actions needed to address government concerns.

Levelling Up and Regeneration Bill

The Levelling Up and Regeneration Bill that was included in the Queen's Speech in May 2022 proposes to introduce new powers into the Local Government Act 2003 for capital finance risk management. The proposals would represent an increase in the Government's oversight of the Prudential Framework and its ability to intervene.

Under the proposals, the Secretary of State would be able to issue risk mitigating directions to an authority if a trigger event has occurred. A direction will be able to place borrowing limits on an authority or require it to take specified action, which could include disposing of an identified asset.

One such trigger event is if a risk threshold is breached. For the assessment of risk thresholds, there will be a range of capital risk metrics, whose basis of calculation will be specified, as will the thresholds against which breaches are to be measured. The metrics specified in the Bill are:

- the total debt (including credit arrangements) as compared to the financial resources of the authority
- the proportion of the total capital assets which are investments made, or held, wholly or mainly to generate financial return
- the proportion of the total debt (including credit arrangements) in relation to which the counterparty is not central government or a local authority
- the amount of minimum revenue provision charged to a revenue account for a financial year
- any other metric specified by regulations.

The Secretary of State will have the power to appoint an independent expert to review the level of an authority's financial risk. Authorities will be required to co-operate with the expert in any way that they consider necessary or expedient for the purposes of the conduct of the review, as far as this is practicable.

Appendix C

The Economy and Interest Rates by Link Treasury Services Limited

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. 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.

Appendix D

GLOSSARY

Local Authority Treasury Management Terms

Terms	Descriptions
Bond	A certificate of long-term debt issued by a company, government, or other institution, which is tradable on financial markets
Borrowing	Usually refers to the stock of outstanding loans owed, and bonds issued.
CFR	Capital Financing Requirement. A council's underlying need to hold debt for capital purposes, representing the cumulative capital expenditure that has been incurred but not yet financed. The CFR increases with capital expenditure and decreases with capital finance and MRP.
Capital gain or loss	An increase or decrease in the capital value of an investment, for example through movements in its market price.
Collective investment scheme	Scheme in which multiple investors collectively hold units or shares. The investment assets in the fund are not held directly by each investor, but as part of a pool (hence these funds are also referred to as 'pooled funds').
Cost of carry	When a loan is borrowed in advance of need, the difference between the interest payable on the loan and the income earned from investing the cash in the interim.
Counterparty	The other party to a loan, investment or other contract.
Counterparty limit	The maximum amount an investor is willing to lend to a counterparty, in order to manage credit risk.
Covered bond	Bond issued by a financial institution that is secured on that institution's assets, usually residential mortgages, and is therefore lower risk than unsecured bonds.
CPI	Consumer Price Index - the measure of inflation targeted by the Monetary Policy Committee.
Deposit	A regulated placing of cash with a financial institution. Deposits are not tradable on financial markets.
Diversified income fund	A collective investment scheme that invests in a range of bonds, equity and property in order to minimise price risk, and also focuses on investments that pay income.
Dividend	Income paid to investors in shares and collective investment schemes. Dividends are not contractual, and the amount is therefore not known in advance.

Terms	Descriptions
DMADF	Debt Management Account Deposit Facility – a facility offered by the DMO enabling councils to deposit cash at very low credit risk. Not available in Northern Ireland.
DLUHC	Department for Levelling Up, Housing and Communities (*formerly known as Ministry of Housing, Communities & Local Government - MHCLG*).
DMO	Debt Management Office – an executive agency of HM Treasury that deals with central government's debt and investments.
Equity	An investment which usually confers ownership and voting rights
Floating rate note (FRN)	Bond where the interest rate changes at set intervals linked to a market variable, most commonly 3-month LIBOR or SONIA
FTSE	Financial Times stock exchange – a series of indices on the London Stock Exchange. The FTSE 100 is the index of the largest 100 companies on the exchange, the FTSE 250 is the next largest 250 and the FTSE 350 combines the two
GDP	Gross domestic product – the value of the national aggregate production of goods and services in the economy. Increasing GDP is known as economic growth.
Income Return	Return on investment from dividends, interest and rent but excluding capital gains and losses.
GILT	Bond issued by the UK Government, taking its name from the gilt-edged paper they were originally printed on.
LIBID	London interbank bid rate - the benchmark interest rate at which banks bid to borrow cash from other banks, traditionally 0.125% lower than LIBOR.
LIBOR	London interbank offer rate - the benchmark interest rate at which banks offer to lend cash to other banks. Published every London working day at 11am for various currencies and terms. Due to be phased out by 2022.
LOBO	Lender's Option Borrower's option
MMF	Money Market Funds. A collective investment scheme which invests in a range of short-term assets providing high credit quality and high liquidity. Usually refers to Constant Net Asset Value (CNAV) and Low Volatility Net Asset Value (LVNAV) funds with a Weighted Average Maturity (WAM) under 60 days which offer instant access, but the European Union definition extends to include cash plus funds
Pooled Fund	Scheme in which multiple investors hold units or shares. The investment assets in the fund are not held directly by each investor, but as part of a pool (hence these funds are also referred to as 'pooled funds').

Terms	Descriptions
PWLB	Public Works Loan Board – a statutory body operating within the Debt Management Office (DMO) that lends money from the National Loans Fund to councils and other prescribed bodies and collects the repayments. Not available in Northern Ireland.
Quantitative easing (QE)	Process by which central banks directly increase the quantity of money in the economy to promote GDP growth and prevent deflation. Normally achieved by the central bank buying government bonds in exchange for newly created money.
SONIA	Sterling overnight interest average – a benchmark interest rate for overnight deposits.
Short-dated	Usually means less than one year
Total return	The overall return on an investment, including interest, dividends, rent, fees and capital gains and losses.