To: **Council**

On: **30 June 2022**

Report by: **Director of Finance and Resources**

Heading: **Treasury Management Annual Report for 2021/22**

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1. Summary

1.1 It is a requirement of the Local Government Investments (Scotland) Regulations 2010 that a report outlining the treasury management activity undertaken during the year is presented to Council at the end of each financial year.

1.2 This report meets the requirements of these regulations, as well as the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.3 All aspects of the Treasury Policy Statement were complied with in 2021/22.

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2. Recommendations

2.1 It is recommended that the Council approves the Treasury Management Annual Report for 2021/22.

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3. Review of 2021/22 Treasury Activities

3.1 Treasury Portfolio Position at 31 March 2022

The Council's external borrowing position at the beginning and end of the last financial year was as follows:

	Borrowing Position as at 31 March 22		Borrowing Position as at 31 March 21		Change
	£ m (a)	Average Interest Rate	£ m (b)	Average Interest Rate	(a) - (b)
Long-term Borrowings					
Public Work Loans Board (PWLB) Fixed Interest	201.30	3.97%	202.13	3.99%	(0.83)
Market Loans	52.92	4.69%	52.92	4.69%	-
Total Long-term	**254.21**	**4.12%**	**255.05**	**4.13%**	**(0.83)**
Short-term Borrowings					
Common Good Funds	2.35	0.11%	5.43	0.38%	(3.08)
Agencies, Joint Boards	50.82	0.11%	27.27	0.38%	23.55
Total Short-term	**53.17**	**0.11%**	**32.70**	**0.38%**	**20.47**
Total Borrowings	**307.38**	**3.43%**	**287.75**	**3.71%**	**19.64**
Temporary Investments	**215.36**	**0.18%**	**187.72**	**0.18%**	**27.64**

4. Review of Borrowing and Investment Outturn for 2021/22

4.1 Overall, the Council's total external borrowings increased by £19.64m. The main reason for the increase is a result of a higher inter-company balance between the Council and Renfrewshire HSCP which reflects their approved medium-term financial plan and reserves strategy. The balances held by the Council on behalf of the Common Good Funds have reduced by £3.08m. This was due to the transfer in the year of funds (£3.6m) to abrdn plc, who manage investments on behalf of the Common Good Funds.

4.2 Temporary investments held by the Council increased by £27.64 million. The increase in investments is attributable to a number of issues including the re-profiling of substantial elements of the capital programme (where capital expenditure was delayed due to COVID19 lockdowns and social distancing measures); and a number of cash-backed provisions and reserves that the Council has made for specific purposes in closing the 2021/22 accounts.

5. Review of Borrowing Strategy during 2021/22

5.1 The agreed strategy for 2021/22 was approved by Council on 4 March 2021. Based on the Council's planned programme of investments and interest rate forecasts for the year, the Council's borrowing strategy was to firstly use internal cash balances to finance the Capital Investment Programme.

5.2 This strategy was prudent, as investment returns were very low and minimised the risk of placing investments with counterparties. The strategy also avoided a “cost of carry” 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, being the difference between (higher) borrowing costs and (lower) investment returns.

5.3 The policy of avoiding new borrowing by running down excess cash balances has been successful. However, this has been kept under review to avoid incurring higher borrowing costs in the future when the Council may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

6. Review of Investment Strategy and Investment Outturn for 2020/21

6.1 In carrying out investment activities, the Council will have regard to The Local Government Investment (Scotland) Regulations 2010, the accompanying Scottish Government Finance Circular 5/2010 and the CIPFA Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes (“the Treasury Management Code”). The Council’s investment priorities are:

- the security of capital; and
- liquidity of its investments.

The Council’s investment policy was outlined in the Council’s Annual Investment Strategy Report 2021/22 which was approved by Council on 4 March 2021. This policy set out the Council’s approach for choosing investment categories and 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.).

6.2 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 necessary.

6.3 The Bank of England and the Government also maintained various monetary and fiscal measures to support businesses through the worst effects of the pandemic, in many cases via local government.

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 the turn of the year when inflation concerns indicated that the Bank of England would need to lift interest rates to combat the effects of growing levels of inflation (CPI was 6.2% in February).

6.4 During 2021/22, the Council only invested with institutions listed in the Council's approved Counterparty list and in the permitted investment categories. The investment activity during the year conformed to the approved strategy and the Council had no liquidity difficulties.

6.5 The table below shows interest rates achieved by the Council on its temporary investments during the year and, for comparison, the benchmark rate. The benchmark was changed in 2021/22 and is now the 7-day compounded SONIA rate, as the previous measure is now obsolete following the withdrawal of LIBID.

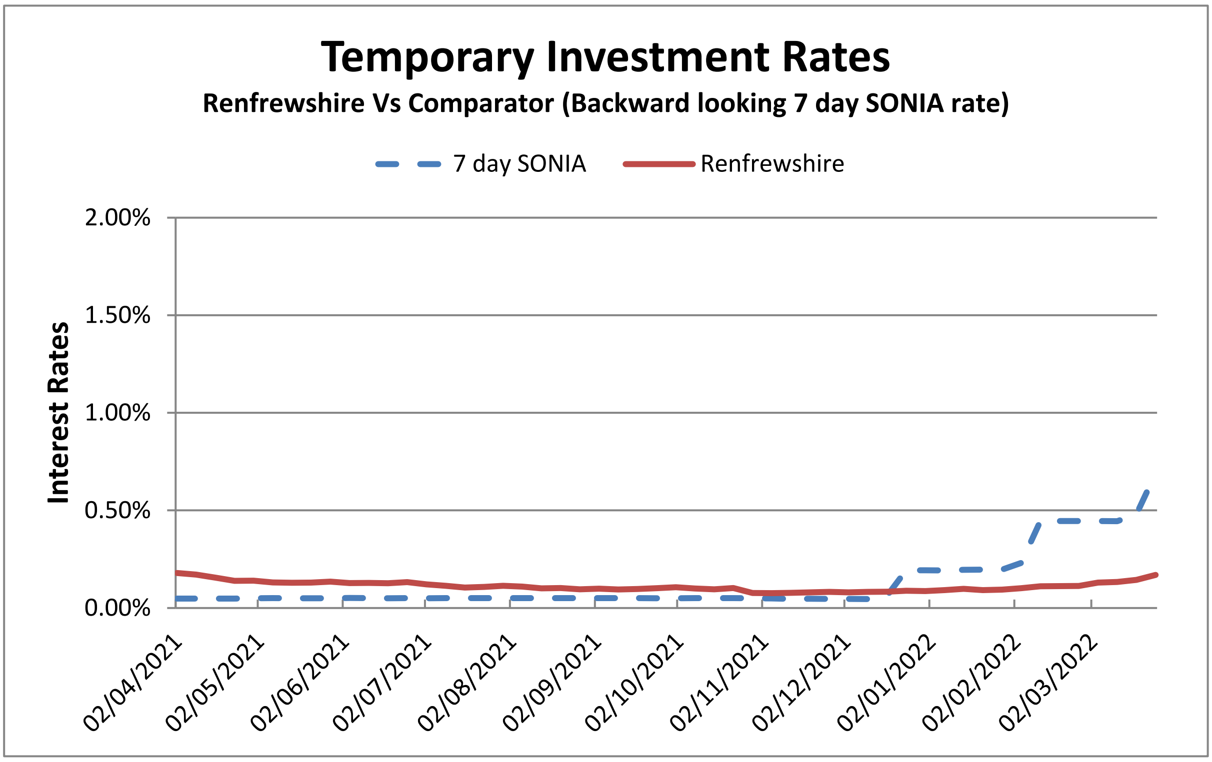
Temporary investments - internally managed	2021/22	2020/21
Average Investment	£236.30m	£160.39m
Actual rate of return	0.11%	0.38%
Benchmark return	0.13%	0.06%

6.6 The graph below shows the trend of interest rates on investments over the course of the year. The Council out-performed the benchmark for much of the year; however, in the current rising investment rate environment the new measure presents higher investment rates than those available to the Council, as many of the Council's current investments commenced earlier in the year.

Throughout the year the Council made use of opportunities where appropriate to invest for longer periods with appropriate counterparties up to one year when better rates were available. These rates offered some value over the year however, deposit rates remained depressed during the year due to the reasons outlined above.

6.7 The current treasury strategy remains appropriate to the Council's ongoing financial, investment and treasury requirements, but is continually reviewed to ensure it remains supportive to the Council's overall financial position, investment priorities and medium-term financial forecasts.

While the strategy was recently approved in March 2022, it is continually being reviewed to ensure as the economic and political landscape changes, and as the Council's financial strategy develops, that borrowing and investments are managed to accommodate both short to medium-term treasury requirements and also to ensure that best value is secured from longer term investment in instruments appropriate for this purpose and consistent with the Council's risk profile.



7. Debt Rescheduling

7.1 No debt rescheduling was undertaken during the year, as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling uneconomical.

8. Compliance with Treasury Limits

8.1 The Prudential Code for Capital Finance in Local Authorities came into force on 1 April 2004 and replaced the previous system of Section 94 Government controls over capital investment and borrowing. The Prudential Code allows greater local flexibility for investment decisions that are informed and supported by a basket of performance indicators. The 2021/22 indicators were approved by Council on 4 March 2021, and refreshed on 10 November 2021.

8.2 The Council’s overall performance against the basket of these indicators provides a firm basis for the monitoring and control of capital investment and borrowing and for determining that it is affordable. Certain headline indicators are sub-divided per recommended best practice into two programmes: housing and non-housing.

8.3 The key performance indicators for Treasury are:

- An “Operational Boundary” for the Council’s external borrowing (the upper limit for the aggregate external borrowing needed) plus an “Authorised Limit” for the Council’s external borrowing (the upper limit of aggregate external borrowing that is affordable and prudent).
- A ratio of financing costs to net revenue stream (an affordability measure for debt repayments).
- An upper limit for fixed rate borrowing maturing within the short, medium and long-term (to ensure that the Council is not exposed to a significant re-financing requirement in the short to medium term).

In addition, it is a requirement of the Council's Treasury Policy Statement that the maximum amount of long-term borrowings maturing in any one year will be no more than 15% and the maximum amount of long-term borrowings maturing in any five year period will be no more than 50%. The objective of these limits is to ensure that the Council is not exposed to a significant re-financing requirement over a short period when interest rates could be relatively high.

8.4 The main source of the Council’s borrowing is from the Public Works Loan Board (PWLB). The borrowing rates are based on, and are determined by, the yield on UK Government bonds (gilts). The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields. The overall level of interest rates and bond yields has fallen over the last 30 years as central banks have been successful in lowering inflation also the high level of borrowing by consumers has meant that central banks do not need to raise rates by much to have a major impact on consumer spending/inflation.

8.5 Gilt yields fell sharply from May 2021 to September and then spiked up again before falling through December. However, by January 2022 views changed as markets began to focus on increasing inflation caused by the opening of economies following the pandemic and the rising energy and food prices connected to the Russian invasion of Ukraine.

8.6 At 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% respectively. For PWLB rates, the various margins for borrowing 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)

8.7 There is likely to be a further rise in short-dated gilt yields and PWLB rates over the next three years as the Bank Rate is forecast to rise from 0.75% in March 2022 to 1.25% later this year. This will be more likely if the economy proves resilient in the light of the cost of living crisis.

8.8 External Borrowing at the Year-end

The Council's aggregate external debt was contained within both the Operational Boundary and the Authorised Limit. The outturn compared to the prudential limits is as follows:

2020/21 Outturn £m		**2021/22 Borrowing Limits £m**	**2021/22 Outturn £m**
323.94	Aggregate external debt of the Council at 31 March 2022		320.51
393	Operational Boundary	375	
409	Authorised Limit	390	

8.9 Ratio of Financing Costs to Net Revenue Stream

This indicator is expressed as a proportion. Both the Housing and Non-housing programme were within estimate.

2020/21 Outturn %		**2021/22 Estimated Ratio %**	**2021/22 Outturn %**
51.4	Housing	39.91	43.13
4.7	Non-Housing	3.92	3.11

The higher than forecast outturn on the Housing Revenue Account was due to voluntary accelerated repayment of loans fund debt of £2.3m. Non-Housing borrowing costs were lower than estimated due to less borrowing taking place than originally forecast.

8.10 <u>Fixed Rate Borrowing Maturing within the Short, Medium and Long-term</u>

This indicator is expressed as a proportion of the total debt of the Council. The maturity profile of the Council's external debt is well within the approved limits. The outturn compared to the estimate is as follows:

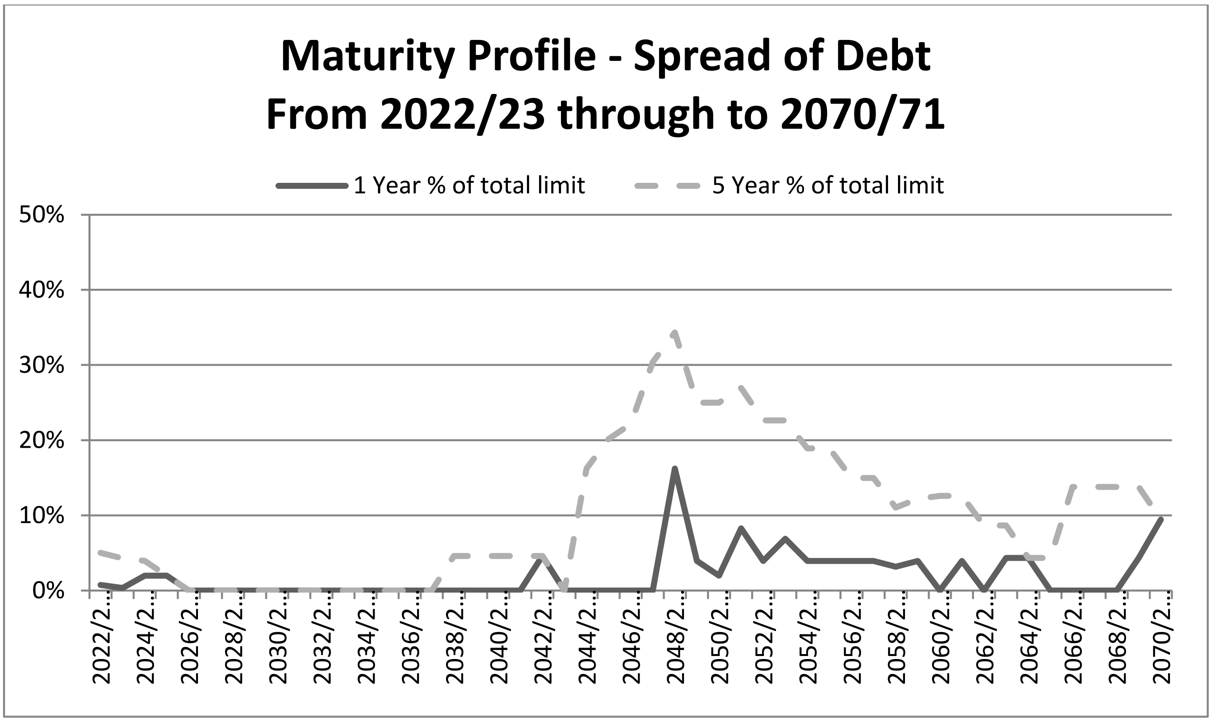
2020/21 Outturn %		2021/22 Approved Upper Limits %	2021/22 Outturn %
	Short-term		
0.33	Under 12 months	15	0.73
	Medium term		
0.73	12 months and within 24 months	15	0.33
4.26	24 months and within 5 years	15	3.95
0.01	5 years and within 10 years	50	0.01
	Long-term		
94.67	10 years and above	100	94.98

8.11 <u>Long-Term Borrowing Maturity Profile</u>

During the financial year, the Council operated within the treasury limits set out in the Council's Treasury Policy Statement and Treasury Strategy Statement. The Council's debt maturity profile at 31 March 2022 was within these limits, with the exception of the debt maturing in the year 2048/49.

The debt maturing in the year 2048/49 is 16.23% of the portfolio as compared to a target of 15%. This marginal breach on the 15% target emerged as a consequence of a change implemented in 2007/08, in the way Lender Option/Borrower Option (LOBO) loans are treated in calculating the Council's maturity profile. Previously the next option date was used as a "potential" maturity date for each loan and this has been changed to the actual maturity end date for each loan. This better reflects the maturity risk in relation to these loans and although it does marginally breach our 15% target in 2048/49, it is expected that the debt will be subject to re-profiling well in advance of the 2048/49 maturity date.

The table below shows the "maturity profile" of the Council's long-term borrowing. The heavy black line shows the debt maturing, and therefore requiring to be replaced, during each year up to 2071. The lighter broken line shows the debt maturing in the five-year period for each year up to 2064. All years are below 40% and well within our policy limit of 50%.



Implications of the Report

1. **Financial** - As described in this report
2. **HR & Organisational Development** - None
3. **Community Planning** – None
4. **Legal** - None
5. **Property/Assets** None
6. **Information Technology** – None
7. **Equality & Human Rights** – The Recommendations contained within this report have been assessed in relation to their impact on equalities and human rights. No negative impacts on equality groups or potential for infringement of individuals' human rights have been identified arising from the recommendations contained in the report because it is for noting only. If required following implementation, the actual impact of the recommendations and the mitigating actions will be reviewed and monitored, and the results of the assessment will be published on the Council's website.
8. **Health & Safety** None
9. **Procurement** – None

10. **Risk** – the report outlines a range of measures taken during the course of 2021/22 to manage treasury risks and the risk issues associated with the investment regulations in respect to borrowing and investment activity of the Council and the proposals for managing these risks.

11. **Privacy Impact** – None

12. **COSLA implications -** None

13. **Climate risk -** None

List of Background Papers: Non Housing Capital Investment Programme, Prudential Framework and Treasury Management Strategy, and Capital Strategy 2021/22 – 2025/26, Council 4 March 2021

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