Audit and Governance Committee

Date of meeting:	29 September 2022
Title of Report:	Annual Report on Treasury Management Activities for 2021/22
Lead Member:	Councillor Mark Shayer (Deputy Leader)
Lead Strategic Director:	Brendan Arnold (Service Director for Finance)
Author:	Wendy Eldridge Interim Finance Business Partner (Capital & Treasury Management)
Contact Email:	Wendy.eldridge@plymouth.gov.uk
Your Reference:	Finance/WE
Key Decision:	No
Confidentiality:	Part I - Official

Purpose of Report

In order to comply with the Code of Practice for Treasury Management, the Council is required to formally report on its treasury management activities for the year, providing information on the progress and outcomes against the Treasury Management Strategy. This report covers the treasury management activities for financial year 2021/22 including the final position on the statutory Prudential Indicators.

This report:

a) is prepared in accordance with the CIPFA Treasury Management Code and the Prudential Code;
b) confirms capital financing, borrowing, debt rescheduling and investment transactions for the year 2021/22;
c) provides an update on the risk inherent in the portfolio and outlines actions taken by the Council during the year to minimise risk;
d) gives details of the outturn position on Treasury Management transactions in 2021/22;
e) confirms compliance with treasury limits and Prudential Indicators (PIs) and the outlines the final position on the PI's for the year.

Recommendations and Reasons

1. To note the Treasury Management Annual Report 2021/22
2. Recommend the Treasury Management Annual Report 2021/22 to Full Council for approval

This is to comply with the CIPFA Code of Practice and discharge our statutory requirement.

Alternative options considered and rejected

None - it is requirement to report to Council on the treasury management activities for the year.

Relevance to the Corporate Plan and/or the Plymouth Plan

Effective financial management is fundamental to the delivery of corporate improvement priorities. Treasury Management activity has a significant impact on the Council's activity both in revenue budget terms and capital investment and is a key factor in facilitating the delivery against a number of corporate priorities.

Implications for the Medium Term Financial Plan and Resource Implications:
Into the medium and longer term the Council is facing significant pressures due to the national economic situation, which has led to a reduction in resources for local authorities over the Government's latest spending period. Effective Treasury Management will be essential in ensuring the Council's cash flows are used to effectively support the challenges ahead.

Financial Risks

There is an inherent risk to any Treasury Management activity. The Council continues to manage this risk by ensuring all investments are undertaken in accordance with the approved investment strategy, and keeping the counterparty list under constant review.

Carbon Footprint (Environmental) Implications:
In 2021/22 the Council invested £5m into the Public Sector Social Impact Fund to invest in carbon reduction projects.

Other Implications: e.g. Health and Safety, Risk Management, Child Poverty:
** When considering these proposals members have a responsibility to ensure they give due regard to the Council's duty to promote equality of opportunity, eliminate unlawful discrimination and promote good relations between people who share protected characteristics under the Equalities Act and those who do not.*

Appendices
**Add rows as required to box below*

Ref.	Title of Appendix	**Exemption Paragraph Number** (if applic *If some/all of the information is confidential, you must indi why it is not for publication by virtue of Part 1of Schedule of the Local Government Act 1972 by ticking the relevant*						
		1	2	3	4	5	6	7
A								

Background papers:

Please list all unpublished, background papers relevant to the decision in the table below. Background papers are <u>unpublished</u> works, relied on to a material extent in preparing the report, which disclose facts or matters on which the report or an important part of the work is based.

Title of any background paper(s)	**Exemption Paragraph Number** (if applicable) *If some/all of the information is confidential, you must indicate why it is not for publication by virtue of Part 1of Schedule 12A of the Local Government Act 1972 by ticking the relevant box.*						
	1	**2**	**3**	**4**	**5**	**6**	**7**
Treasury Management Strategy report to Council 22 February 2021							

Sign off:

Fin	pl.22.23.223	Leg	EJ/38851/20.9.22/3	Mon Off		HR	Click here to enter text.	Assets	Click here to enter text.	Strat Proc	Click here to enter text.
Originating Senior Leadership Team member: Brendan Arnold											
Please confirm the Strategic Director(s) has agreed the report? Date agreed: 27 September 2022											
Cabinet Member approval: Date approved: 26/9/2022											

Annual Report on Treasury Management Activities for 2021/22

Introduction

1. Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code). This requires the Council to approve a treasury management strategy before the start of each financial year and, as a minimum, a half-year and annual treasury outturn report. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

2. The approval of this report has been delegated to the Governance and Audit Committee to approve.

3. The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 22 February 2021.

Treasury Management Position

4. On 31st March 2022, the Authority had net borrowing of £554m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31/03/21 Actual £m	2021/22 Movement £m	31/03/22 Actual £m
General Fund CFR	807	26	833
Less: Other debt liabilities *	-119	6	-113
Borrowing CFR	**688**	**32**	**720**
Less: Usable reserves	-115	-9	-124
Less: Working capital	-39	-3	-42
Net borrowing	**534**	**20**	**554**

* *finance leases, PFI liabilities and transferred debt that form part of the Council's total debt.*

5. The Council has increasing CFR due to the capital programme and increasing borrowing requirement to £833m. The Authority pursued its strategy of keeping

borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

Borrowing and Investment Activity

6. At 31st March 2022, the Council held £554m of loans, (a decrease of £46m on 31/03/2021 see table 2) as part of its strategy for funding previous years' capital programmes. See table 2 below.

7. Lower official interest rates have lowered the cost of short-term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing at start of year. The Authority pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

8. The Council's main objective when borrowing has been to strike an appropriate balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective. In accordance with this £190m short term borrowing was replaced with long term borrowing for up to 50 years through PWLB, at rates ranging between 1.37% to 2% to mitigate against interest rate risk.

The treasury management position at 31st March 2022 and the change during the year is shown in table 2 and table 3 below.

Table 2: Borrowing Activity

	Balance on 01/04/2021 £m	Movement £m	Balance on 31/03/2022 £m	Avg Rate %
Public Works Loan Board	44	187	231	2.29%
Banks - LOBOs	66	-1	65	4.34%
Other Loans	27	3	30	
Short Term Borrowing	463	-235	228	0.12%
TOTAL BORROWING	600	-46	554	
Other Long Term Liabilities	125	-1	124	-
TOTAL EXTERNAL DEBT	725	-47	678	-
Less Total Investments (see table 3)	-97	-4	-101	
Net Borrowing	628	-51	577	

9. The Council has £228m of short term borrowing which it borrows from other local authorities at a very low rates on 3-12 month terms. The Council has an Interest Rates Risk (the risk that interest rates may go up). If interest rates increase by 1% it would cost the Council £2.280m additional interest on its revenue budget.

10. To Hedge against this risk the Council took out an Interest Rate Swap in April 2020 for £75m at a fixed rates of 0.56% for 20 years using the SONIA (Sterling OverNight Index Average). The Sterling Overnight Interest Rate (SONIA) averaged 0.39% over the quarter therefore the hedge arrangement had no draw down in 2021/22.

11. The Council continues to hold £64m of LOBO loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during the year.

12. Although not classified as borrowing, the Council has other capital finance from Private Finance Initiatives and Finance Leases etc. and as at 31st March 2022 this amounted to £124m. PFI and finance leases are other ways of financing capital however this is quite often more expensive and is paid over a number of years. The Council's current PFI debt will be repaid by 2040.

13. Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the highest rate of return, or yield. The Council'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.

14. At 31 March 2022 the Council held £101m of cash and investments (see table 3) which was an increase of £4m on 2020/21.

Table 3: Investment Activity in 2021/22

Investments	Balance on 01/04/2021 £m	Movement £m	Balance on 30/03/2022 £m	Avg Rate/Yield (%)
Short term Investments (Banks and call accounts)	12	5	17	0.01%
Covered Bonds and Loans	0	0	0	-
Money Market Funds	30	-7	23	0.01%
Other Pooled Funds	55	6	61	2.5%
TOTAL INVESTMENTS	**97**	**4**	**101**	

15. Investment activity included pooled investments with a value of £60.895m (nominal value £55.000m) so had recovered much of the losses sustained through the financial crash and are likely to continue to grow slowly as the economy continues to recover. In addition to the capital value of investment increasing by £6m, externally managed Pooled Funds (bond, equity, multi-asset and property) with the CCLA, Schroder and Fidelity and has generated a total return for the year of £1.976m. Investment income has been used to support services in year.

16. It should be noted that the capital value of the Council's Pooled Investment will fluctuate dependent on market conditions. Any unrealised capital losses will not have an impact on the revenue budget or General Fund. The capital value would only be realised if the funds were sold. The Pooled investments have no defined maturity date, but are available for withdrawal after a notice period. The Council continues to review regularly its investment in these funds together with advice from its Treasury Management advisors.

Treasury Management Outturn 2021/22

17. The Treasury Management budget is a held as a separate budget under the Finance Department of the Council's General Fund. Whilst interest costs are less than the budget there are a number of factors that contribute to the final position. Whilst the Council not only borrows to finance capital expenditure, it also has to maintain a daily net cash surplus position.

18. The Council's Treasury Management Outturn for the year had a £0.490m underspend which has helped the Council balance the budget for 2021/22, see detail in table 4 below. The main savings have come from a dramatic fall in interest rates following the Covid pandemic and the worldwide financial crash. There was also a combination of low interest rates on short term borrowing which averaged 0.12% during 2021/22 offset by transferring debt to PWLB. Provision was made in 2021/22 to fund any financial adjustments required to 2019/20 accounts as a result of external audit which is still ongoing.

19. The Treasury Management Outturn does not include the returns from the Council's investments in the purchasing commercial assets, as this is included in the Place revenue outturn and referred to in Other Non-Treasury Holdings and Activity section below.

20. The continuing impact from the pandemic both on workforce adhering to Covid working restrictions and supply chain issues from Ukrainian conflict slowed the Council's capital programme, therefore reduced the amount of new borrowing that it had expected to take out, and therefore made further savings from loan repayments (Minimum Revenue Provision).

Table 4. Treasury Management Outturn Position 2021/22

	2021/22 Budget	2021/22 Outturn	Year End Variance
	£m	£m	£m
Interest Payable	10.260		
LOBO and other long term loans		4.075	
PWLB (Public Works Loan Board)		3.526	
Temporary loans		0.704	
Other Interest and charges		0.092	
Recharge to Departments for Unsupported Borrowing (in accordance with business cases)	(14.944)	(16.030)	
Total Interest Payable	**(4.684)**	**(7.633)**	**(2.949)**
Interest Receivable	(2.021)		
Pool Funds		(1.976)	
Money Market Fund		(0.031)	
Other Interest		(0.338)	
Total Interest Receivable	**(2.021)**	**(2.345)**	**(0.324)**
Other Payments	0.296	0.305	
Debt Management	0.500	0.257	
Transfer to Reserves	0.000	3.345	
Amortised Premiums	0.650	0.544	
Total Other Charges	**1.446**	**4.451**	**3.005**
Minimum Revenue Provision	**17.115**	**16.893**	**(0.222)**
TOTAL	**11.856**	**11.366**	**(0.490)**

21. Money Market Funds (MMF): Continued downward pressure on short-dated cash rate brought net returns on sterling low volatility net asset value money market funds (LVNAV MMFs) close to zero even after some managers have temporarily lowered their fees.

    Returns have increased as a result of Bank of England increases and MMF investment has been used short-term as the Council converted short term borrowing to PWLB long term fixed arrangements.

22. The costs of borrowing to finance 'invest to save' capital schemes is charged to departments. The figures above include the borrowing implications of decisions to utilise the Property Regeneration Fund, previously known as Asset Investment Fund to acquire assets to earn a revenue return which is accounted for in directorate's budgets.

23. Minimum Revenue Provision (MRP) is a charge to the revenue budget that is made each year for monies to repay the Council's borrowing.
Under regulation 27 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 SI 2003/146, as amended, local authorities are required to charge to their revenue account, for each financial year, MRP for the cost of their unfinanced capital expenditure.

24. The Council uses the annuity method to calculate its MRP and spreads the cost of the borrowing over the economic life of the assets and this takes into account the time value of money.

External Context affecting 2021/22 Treasury Management activities

25. The continuing economic recovery from coronavirus pandemic, together with the war in Ukraine, higher inflation, and higher interest rates were major issues over the period.

26. The Bank of England (BoE) held Bank Rate was 0.1% at the beginning of the reporting period. April and May saw the economy gathering momentum as the shackles of the pandemic restrictions were eased. Despite the improving outlook, market expectations were that the Bank of England would delay rate rises until 2022. Rising, persistent inflation changed that. Having increased Bank Rate from 0.10% to 0.25% in December, the Bank of England hiked it further to 0.50% in February and 0.75% in March. At the meeting in February, the Monetary Policy Committee (MPC) voted unanimously to start reducing the stock of its asset purchase scheme by ceasing to reinvest the proceeds from maturing bonds as well as starting a programme of selling its corporate bonds.

27. In its March interest rate announcement, the MPC noted that the invasion of Ukraine had caused further large increases in energy and other commodity prices, with the expectation that the conflict will worsen supply chain disruptions around the world and push CPI inflation to around 8% later in 2022, even higher than forecast only a month before in the February Monetary Policy Report. The Committee also noted that although GDP in January was stronger than expected with business confidence holding up and the labour market remaining robust, consumer confidence had fallen due to the squeeze in real household incomes.

28. UK CPI was 0.7% in March 2021 but thereafter began to steadily increase. Initially driven by energy price effects and by inflation in sectors such as retail and hospitality which were re-opening after the pandemic lockdowns, inflation then was believed to be temporary. Thereafter price rises slowly became more widespread, as a combination of rising global costs and strong demand was exacerbated by supply shortages and transport dislocations. The surge in wholesale gas and electricity prices led to elevated inflation expectations.

29. Financial markets: The conflict in Ukraine added further volatility to the already uncertain inflation and interest rate outlook over the period. The Dow Jones started to decline in January but remained above its pre-pandemic level by the end of the

period while the FTSE 250 and FTSE 100 also fell and ended the quarter below their pre-March 2020 levels.

30. Bond yields were similarly volatile as the tension between higher inflation and flight to quality from the war pushed and pulled yields, but with a general upward trend from higher interest rates dominating as yields generally climbed.
The 5-year UK benchmark gilt yield began the quarter at 0.82% before rising to 1.41%. Over the same period the 10-year gilt yield rose from 0.97% to 1.61% and the 20-year yield from 1.20% to 1.82%.

Revised CIPFA Codes, Updated PWLB Lending Facility Guidance

31. 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.

32. 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. Plymouth applied the principles of the Prudential Code which took immediate effect.

33. 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.

34. 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.

Other Non-Treasury Holdings and Activity

35. The Council held £200m of direct property investment under its Property Regeneration Fund. These non-treasury investments generated £2.492m of investment income for the Council after taking account of direct costs, representing a net revenue return of 1.3% after allowing for payment to a void reserve and payment to a lifecycle maintenance reserve. The gross return is higher than the return earned on treasury investments but reflects the additional risks to the Council of holding such investments.

Prudential Indicators 2021/22

36. The Local Government Act 2003 requires the Council to have regard to CIPFA's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

37. This report compares the approved indicators with the outturn position for 2021/22. Actual figures have been taken from or prepared on a basis consistent with, the Council's statement of accounts.

The Council measures and manages its exposures to treasury management risks using the following indicators.

The Section 151 Officer confirms compliance with its Prudential Indicators for 2021/22, which were set in the Treasury Management Strategy 2021/22.

The Following indicators are set and monitored each year:

- Estimates of Capital Expenditure;
- Estimates of Capital Financing Requirement;
- Gross Debt and the Capital Financing Requirement;
- Operation Boundary for External Debt;
- Authorised Limit for External Debt;
- Ratio of Financing Costs to Net Revenue Stream ;
- Incremental Impact of Capital Investment Decisions.

38. Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

	2021/22 Limit	2021/22 Actual	Complied
Upper limit on fixed interest rate exposure	100%	57%	✓
Upper limit on variable interest rate exposure	95%	43%	✓

Fixed rate borrowings are those where the rate of interest is fixed for the whole financial year or more. Instruments that mature during the financial year are classed as variable rate.

39. Maturity Structure of Borrowing: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	Upper Limit	Lower Limit	31.03.2022 Actual	Complied
Under 12 months	90%	10%	43%	✓
12 months and within 24 months	25%	0%	0%	✓
24 months and within 5 years	25%	0%	0%	✓
5 years and within 10 years	25%	0%	5%	✓
10 years and above	95%	5%	52%	✓

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

40. Principal Sums Invested for Periods Longer than 365 days: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end were:

	2021/22	2022/23	2023/24
Limit on principal invested beyond year	£10m	£10m	£10m
Actual	£0m	£0m	£0m
Complied	✓	✓	✓

41. Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

	Target	Actual	Complied
Portfolio average credit rating	A	AA	✓

42. Liquidity: The Council does not keep large amounts of cash in call accounts so that it reduces the cost of carrying excess cash. To mitigate the liquidity risk of not having cash available to meet unexpected payments the Council has access to borrow additional, same day, cash from other local authorities.

43. Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose.

Capital Financing Requirement	31.03.2022 Actual £m
General Fund	**833**
Total CFR	**833**

The CFR increased by £26m to £833m (2021 £807m) from capital expenditure financed by debt outweighs resources put aside for debt repayment. The increase in CFR shows that the Council is increasing its borrowing to pay for capital expenditure in the city.

44. Gross Debt and the Capital Financing Requirement**:** In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

45. The Council's actual debt at 31 March 2022 was as follows:

	31.03.22 Estimate £m	31.03.22 Actual £m	Difference £m
Borrowing	600	554	-46
PFI liabilities & other Finance leases	125	124	-16
Total Debt	**725**	**725**	**3**

The actual debt levels are monitored against the Operational Boundary and Authorised Limit for External Debt below.

46. The operational boundary is based on the Council's estimate of most likely (i.e. prudent, but not worst case) scenario for external debt. It links directly to the Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the Council's debt.

Operational Boundary	31.03.22 Boundary £m	31.03.22 Actual Debt £m	Complied
Borrowing	935	554	✓
Other long-term liabilities	130	124	✓
Total Debt	**1065**	**678**	✓

47 Authorised Limit for External Debt: The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003.
It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	31.03.22 Boundary £m	31.03.22 Actual Debt £m	Complied
Borrowing	980	554	✓
Other long-term liabilities	135	124	✓
Total Debt	**1115**	**678**	✓

Other

48. IFRS 16: CIPFA/LASAAC confirmed in April 2022 that there will be a deferral of the implementation of IFRS 16 Leases to 1 April 2024, however early adoption is permitted for 1 April 2022.

Investment Training

49. Officers have undergone the following training during the year all of which have been online and provided by Arlingclose.

Outlook for the remainder of 2022/23

50. Inflationary pressures in the UK and Europe have intensified significantly with UK CPI inflation is expected to rise further and peak at just over 13% in 2022 Q 4 overwhelmingly reflecting the sharp increase in gas prices since May. Larger wage settlements are feeding into inflation. Domestic inflationary pressures are projected to remain strong in the near term before dissipating.

51. Arlingclose expects Bank Rate to rise by 50 basis points at the next MPC meeting in September 2022 and a further 25 basis points at both subsequent MPC meetings in November and December 2022. Therefore see Bank Rate peaking at 2.75%.
The projected rise to 3.25% in December 2022 will require a further 1.5% of Bank Rate hikes, suggesting 0.5% at each of the next three meetings.

Recommendations

1. To note the Treasury Management Annual Report 2021/22
2. Recommend the Treasury Management Annual Report 2021/22 to Full Council for approval