AUDIT & GOVERNANCE COMMITTEE

DATE	21 July 2022
REPORT OF	Sharon Wroot, Executive Director, Environment, Economy & Resources
SUBJECT	Treasury Outturn 2021-22
STATUS	Open

CONTRIBUTION TO OUR AIMS

Effective treasury management will provide support towards the achievement of Council Plan aims and objectives. Treasury management is an integral part of the Council's finances providing for cash flow management and financing of capital schemes. It therefore underpins all the Council's aims.

EXECUTIVE SUMMARY

The report contains details of treasury management arrangements, activity and performance during the 2021/22 financial year.

During the period covered, 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:

Prudential and Treasury Indicators	31.3.21 Actual £'m	2021/22 Original Forecast £'m	31.3.22 Actual £'m
Capital Expenditure	**51.5**	**54.1**	**31.1**
Capital Financing Requirement	**182.6**	**211.7**	**190.8**
Authorised Borrowing Limit	**290.0**	**290.0**	**290.0**
Operational Boundary	**245.0**	**245.0**	**245.0**
External Borrowing	**149.4**	**167.0**	**154.4**
Investments >365 days	**0.0**	**0.0**	**0.0**

RECOMMENDATIONS

Audit & Governance Committee is requested to:

1) Consider the content of the report and makes any recommendations to Cabinet as necessary in respect of treasury management activity during 2021/22.

REASONS FOR DECISION

The Council's treasury management activity is guided by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year with interim updates on performance against Prudential Indicators reported quarterly. We therefore report in full after Quarter 2 and year end with Prudential Indicators being reported additionally after Quarters 1 and 3 in the Commissioning and Resource Report.

1. BACKGROUND AND ISSUES

1.1. CIPFA has defined treasury management as:

The management of the organisation's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

1.2. The Treasury Management Strategy Statement (TMSS) for 2021/22 was developed in consultation with our treasury management advisors, Link Asset Services Ltd. This statement also incorporates the Investment Strategy.

1.3 Whilst the Council has appointed advisors to support effective treasury management arrangements, the Council is ultimately responsible for its treasury decisions and activity. No treasury activity is without risk. The successful identification, monitoring and control of risk is therefore an important and integral element of treasury management activities.

1.4 The Council has nominated the Audit & Governance Committee as responsible for ensuring effective scrutiny of the treasury management arrangements.

1.5 Key points to note with specific regard to the Treasury Strategy:

- 2022 continued to be driven by the Covid-19 pandemic. As restrictions started to recede and economies began to reopen, persistent supply constraints and spikes in demand created strong inflationary pressures, not just in the UK but in most developed economies. In terms of Treasury, the impacts were seen first in rising gilt rates as the market anticipated a Monetary Policy Committee (MPC) response which duly came in December

2021 with a small rise in Base Rate to 0.25%. Rate expectations then accelerated following the Russian invasion of Ukraine which effectively impelled the Bank of England to act and quell 40 year high inflation. At the time of writing (June 2022) Base Rate stood at 1.25% and we expect there to be further monetary tightening measures through 2022 and beyond, at least until inflationary pressures are brought under control. Given the extreme inflationary factors are largely unaffected by monetary measures there is a non-negligible risk that the joint presence of higher inflation and higher rates causes a 'hard-landing' of the economy (sharp reduction in GDP Growth or technical recession).

- The Treasury Management Strategy covers the Council's treasury aims and principles. The Council also considers direct 'commercial' investments from time-to-time with the aim of generating financial return. Although reference is made to these types of investments in the TMSS' these transactions are guided and limited by the Capital Strategy document.

- A continuing consequence of Covid has been the robustness of higher surplus balances resulting from receipt of Covid support packages and unavoidable delays in Capital Programme delivery. We expect this affect to fall away during 2022-23 particularly as inflation starts to impact those programmes still to be delivered.

- Whilst we regularly monitor performance against data on 80+ other Authorities' activity (as summarised above), in January 2022 Audit and Governance Committee requested that we obtain some additional specific data on what Unitary Authorities (like NELC), are investing in, to ensure we are not 'missing out' on anything those 'peers' are doing. Data was shared with us (confidentially and anonymised) by our Advisors, Link Asset Services. Against this narrower grouping we are even more 'in the bunch' with the only difference being those who have historically lent (sometimes long-term) to other Authorities. We have reviewed the data and considered LA lending but for the time being the S151 Officer has taken the decision not to do so and duly accepts any lost yield.

2. RISKS AND OPPORTUNITIES

2.1 No Treasury activity is without risk. Specific risks include, but are not limited to, Counterparty Credit Risk (the risk of an investment not being repaid), liquidity risk (the risk that the Authority does not have its funds in the right place, at the right time and in the right amount to make it's payments as they fall due), interest rate risk (the risk that future rate movements have a revenue implication for the Authority) and reputational risk (see Section 4 below).

2.2 The attached Appendices define our approach toward mitigating these risks.

2.3 Treasury is an Authority-wide function and its environmental sustainability and equalities implications are the same as for the Council itself.

2.4 The Authority will have regard to the environmental and equality activities of its Counterparties (where reported) but

- Prioritises Security, Liquidity and Yield,
- Recognises that as large, global institutions our high-quality counterparties operate across the full range of marketplaces in which they are legally able to, and such exposures are small parts of their overall business.
- Excluding any one counterparty will likely mean others will similarly have to be avoided and thus impact the Authority's capacity to mitigate risk through diversification.

2.5 **General Data Protection Regulation 2018** – Relationships with external providers covered by the Treasury management Practices are governed by and operated in accordance with the act.

3. OTHER OPTIONS CONSIDERED

3.1 These were set out on Page 28 of the Treasury Management Strategy Statement.

4. REPUTATION AND COMMUNICATIONS CONSIDERATIONS

4.1 As you would expect, with large sums of public money involved, any treasury activity carries a high degree of reputational risk. Any losses have not just financial but also significant, ongoing resource implications for the Council.

5. FINANCIAL CONSIDERATIONS

5.1 As set out in the Appendices.

6. CHILDREN AND YOUNG PEOPLE IMPLICATIONS

6.1. As an Authority-wide corporate function, the immediate impacts of day-to-day Treasury operations on children and young people are the same as for the Council as a whole. However, certain Treasury decisions, most notably those relating to Long-Term Borrowing transactions, will place a greater burden on young residents, over time, relevant to other demographics.

7. CLIMATE CHANGE AND ENVIRONMENTAL IMPLICATIONS

7.1 In line with the Authority's declaration of a Climate Emergency, the S151 Officer will aim to assess and monitor, not just Environmental but all, ESG factors when selecting investment options. Full assessment is however restricted by the fact that, at the time of writing, there is no consistent rating framework with which to measure and benchmark specific counterparty ESG metrics. Until this market data gap is fully resolved, our approach to managing the risks associated with the Environmental activities of our Counterparties is as follows:-

- As the Ratings Agencies headline ratings on our Counterparties now incorporate ESG risk assessments alongside more traditional financial risk metrics and so provide both an holistic risk measure and a proxy for ESG 'scoring' in the absence of anything more robust

- The Council will continue to Prioritise Security, Liquidity and Yield, in that order

- The Council recognises that as large, global institutions our high-quality counterparties operate across the full range of marketplaces in which they are legally able to, and as a result climate change considerations are an increasingly important and heavily-scrutinised part of their overall business.

- Excluding any one counterparty will likely mean others will similarly have to be avoided and thus impact the Authority's capacity to mitigate risk through diversification.

- The Council notes that bonds issued by Supranational institutions offer strong ESG credentials, combined with the explicit underwriting support of all major developed countries. This results in excellent ratings (typically AA+ - AAA) being applied. As such, the Council actively seeks exposure to these assets (commensurate with its investment horizon) and in doing so, contributes to market liquidity and therefore capital raising abilities of these bodies who then deploy that capital in ESG positive schemes.

8. FINANCIAL IMPLICATIONS

8.1 As set out in the appendix.

9. MONITORING COMMENTS

9.1 In the opinion of the author, this report does not contain recommended changes to policy or resources (people, finance or physical assets). As a result no monitoring comments have been sought from the Council's Monitoring Officer (Chief Legal Officer) or Strategic Workforce Lead.

10. BACKGROUND PAPERS

10.1 CIPFA Treasury Management Code and Guidance Notes

11. CONTACT OFFICER(S)

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Councillor Harness
Portfolio Holder for Finance, Resources and Assets

Appendix 1

Treasury Outturn Report 2021/22

Contents

Abbreviations Used In This Report

- **CFR:** capital financing requirement - the council's annual underlying borrowing need to finance capital expenditure and a measure of the council's total outstanding indebtedness.
- **CIPFA:** Chartered Institute of Public Finance and Accountancy – the professional accounting body that oversees and sets standards in local authority finance and treasury management.
- **Gilts:** gilts are bonds issued by the UK Government to borrow money on the financial markets. The yields on Gilts are (usually) fixed and so will change inversely to the price of gilts i.e. a rise in the price of a gilt will mean that its yield will fall.
- **LIBID:** the London Interbank Bid Rate is the rate at which a bank is willing to borrow from other banks.
- **LOBO:** a loan carrying provision for the lender to periodically amend the interest rate applicable. If the lender chooses to exercise this option the borrow then receives the secondary option to choose to repay the loan without penalty.
- **DLUHC:** the Department for Levelling Up, Housing and Communities - the Government department that directs local authorities in England.
- **MRP:** minimum revenue provision - a statutory annual minimum revenue charge to reduce the total outstanding CFR, (the total indebtedness of a local authority).
- **PWLB:** Public Works Loan Board – the section within H.M. Treasury which provides loans to local authorities to finance capital expenditure.
- **S151 Officer:** an Officer appointed under section 151 of the Local Government Act to carry out the duties of 'Responsible Financial Officer' as defined by CIPFA
- **TMSS:** the annual treasury management strategy statement reports that all local authorities are required to submit for approval by the full council before the start of each financial year.

Key Messages:

All investment and borrowing transactions were in line with the Approved 2021-22 treasury Strategy.

There were no in-year policy changes to the TMSS; the details in this report update the outturn position set against the updated economic environment and budgetary changes already approved.

Our central case is now for interest rates to continue to rise to a peak of around 2.5 – 3% by mid-2023 but this still has some uncertainty attached and the implications for both investment income and borrowing cost will be closely monitored.

This report covers Treasury and it's related financial transactions. A Capital Strategy is reported separately covering non-treasury related investments.

S151 Officer Overview

The Council operates a balanced budget, which broadly means cash raised during the year will meet its non-capital expenditure, however there will always be timing differences in how funds are received and expenses settled. A fundamental element of treasury management is to ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, whilst retaining adequate liquidity before considering optimising investment return.

Our 2021-22 Treasury Strategy was tailored to allow the Council to manage risks related to cash investments and has, once again, stood up well to the ongoing pressures seen as a result of the Coronavirus Pandemic.

The second main function of the treasury management service is the arrangement of funding for the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending plans as they fall due. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

As 2021-22 progressed the economic focus switched from the negative impact of Covid-19 to the effects of a global unlocking, and then as we approached year end the further inflationary consequences of the Russian invasion of Ukraine. Inflation, especially at the level now being experienced has financial consequences for the Authority on many levels. It drives down the purchasing power of revenue and capital budgets and drives up borrowing costs. We conducted exercises with our Advisors, Link Asset Services, in both November and February to evaluate the benefit of borrowing now versus waiting until funds were required. On both occasions the modelling revealed there was no meaningful value in accepting the additional cost of carry.

We continue to monitor rate paths and develop a borrowing strategy that meets the requirements of the Authority's plans.

Sharon Wroot, Director of Finance

June 2022

Key Messages:

No Treasury activity is without risk. These risks include, but are not limited to, Credit Risk, Liquidity Risk, Interest Rate Risk, Inflation Risk and Reputational Risk.

The Council uses in-house knowledge, advisors (Link Asset Services), treasury management software (Treasury Live) and the CIPFA Treasury Management Code to manage these risks.

Scrutiny of Treasury activity is undertaken by Audit and Governance Committee and reported twice-yearly to Full Council. Going forward, in accordance with Code revisions, updates on Prudential Indicators will also be provided as part of quarterly budget updates Reports.

Introduction and External Context

This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017) to provide a review of treasury management activities and the actual prudential and treasury indicators for 2021/22. This report also references the most recent Revisions to the Code and 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).

This report covers the following:

- An economic update for the 2021/22 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of the Council's investment portfolio in 2021/22;
- A review of the Council's borrowing strategy for 2021/22;
- A review of any debt rescheduling undertaken during 2021/22;
- A review of compliance with Treasury and Prudential Limits for 2021/22.

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.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to the above treasury management report by the Audit Committee before they were reported to the full Council. Member training on treasury management issues was undertaken during 2021/22 in order to support members' scrutiny role.

The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. This report covers treasury activity and the associated monitoring and control of risk.

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Key Messages:

The Council has taken a cautious approach to investing, but is also fully appreciative that the external risk environment is very much shaped by developments in the progression of both the Covid-19 pandemic and inflationary pressures resulting from the joint effects of supply issues and the Russian invasion of Ukraine.

As of June 2022 our advisors, Link Group are forecasting further increases in Bank Rate through to a peak of 2.75% by Mid 2023, although the picture remains somewhat uncertain in terms of path for inflation and the potential for a 'hard-landing' (combined effects of inflation and rates resulting in a dramatic slowdown in growth or even a recession.

Introduction and External Context

Investment returns remained close to zero for much of 2021/22. 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.

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 encouraged governments 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, to hitting an average level of inflation.

The consequential effect was that investment earnings rates indeed 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 7.0% at year end).

The Authority does not typically have sufficient surplus cash balances to be able to place deposits for more than around six months so as to earn higher rates from longer deposits. In a rising rate environment this has the beneficial effect of being able to capture uplifts in rates sooner however.

Investment balances have been boosted by central Government support schemes and temporary loans from other Local Authorities. This allowed debt costs to be managed within budget and for term borrowing to be delayed. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates. Such an approach has also provided benefits in terms of reducing the counterparty risk, by having fewer investments placed in the financial markets.

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 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.

Key Messages:

The Treasury Management Strategy Statement, (TMSS), for 2021/22 was approved by this Council in February 2021. No changes are considered necessary during the year despite the continued uncertainty seen as a result of the Covid-19 pandemic.

The Authority has an increasing CFR over the next four years due to the capital programme, and with reduced investments will therefore need to borrow up to £60m over the next few years. An additional £23m will be required to replace maturing loans.

Since the 2008 financial crisis the Authority has adopted a cautious approach whereby investments are framed by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

Local Context

The Treasury Management Strategy Statement, (TMSS), for 2021/22 was approved by this Council on 18 February 2021.

There were no in-year policy changes to the TMSS – pleasing to note in the face of unprecedented economic circumstances; the Strategy did is job in protecting public funds whilst allowing sufficient flexibility to cope with exceptional operational demands.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council must ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This means that the Council is not borrowing to support revenue expenditure.

The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator and we are on target to achieve the original forecast.

	31 March 2021 Principal	Rate/ Return	Average Life yrs		31 March 2022 Principal	Rate/ Return	Average Life yrs
Total debt	*£149.4m*	*3.30%*	*28.7*		*£154.4m*	*3.17%*	*27.0*
Capital Financing Requirement (CFR)	*£182.6m*				*£190.8m*		
Over / (under) borrowing	*(33.2m)*				*(36.4m)*		
Total investments	*£31.7m*	*0.01*	*0.03*		*£44.7m*	*0.54*	*0.04*
Net debt	£117.7m				£109.7m		

The overall level of investment balances held has remained higher through the Covid-19 pandemic, as the Authority sought additional liquidity and central Government provided additional support. These effects are now expected to reduce and, looking forward, it is anticipated that the Authority will revert to using internal borrowing to both defer more expensive long-term borrowing and reduce it's credit risk exposure.

Key Messages:

When undertaking new borrowing the Council will review both the source and tenure of loans it seeks to take.

At 31/03/2022 the Authority held £154m of loans, (up £5m on 2021) as a result of funding previous years' capital programmes.

The Council's current borrowing portfolio is predominantly of a long-term and fixed nature. Whilst this provides certainty of cost it can restrict flexibility to restructure debts as plans and finances change.

No rescheduling was undertaken during the year as the differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Borrowing Strategy

The first key control over the treasury activity is the CFR, a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if such borrowing proves prudent, meets the CFR criteria above and after due evaluation is believed to represent a Value for Money proposition.

	2021/22 Outturn Original Estimate £m	Mid-year Position 30.9.2021 £m	2021/22 Final Position £m
Borrowing	167.4	155.1	154.4
Other Long Term liabilities	0.0	0.0	0.0
Total debt	167.4	155.1	154.4
CFR (year end position)	211.7		190.8

The structure of our debt portfolio as at 31.3.2022 is shown below

Type of Loan	Amount	% of Portfolio
PWLB Fixed	£72.9m	47%
LOBO	£21.0m	14%
Market Fixed	£42.3m	27%
Short-term Fixed	£18.0m	11%
Variable Rate	£0.2m	1%
Total	£154.4m	

Key Messages:

Affordability and the "cost of carry" remained strong influences on the Authority's borrowing strategy. As short-term interest rates are likely to remain, at least over the forthcoming two years, lower than long-term rates, the Authority determined it was largely more cost effective in the short-term to use its own funds to defer borrowing.

Borrowing short-term from other local authorities provides a useful source of funding below current long-term rates and with the ability to exit loans within a reasonable timeframe.

Importantly however, whilst the above represents the default strategy, there always remains a risk of higher rates in the future. As such, the Authority continues to assess longer term options.

Borrowing Strategy (continued)

- During 2021-22, the Council maintained an under-borrowed position. This means 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 low and minimising counterparty risk on placing investments also needed to be considered.

- The policy of avoiding new borrowing by running down spare cash balances, has served well in recent 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. To actively manage this risk, a new loan of £20m over 30 years was arranged and drawn in April 2020. Due to the increase in PWLB margins this loan was arranged with Nomura International Bank and funded by The Pension Protection Fund. Additional short-term loans were obtained from the Local Authority lending market during 2021/22 (see P11 for details).

- It is anticipated that further borrowing will be undertaken during the 2022/23 financial year.

- Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Director of Finance therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks :

- where there was a significant perceived risk of a sharp FALL in long and short term rates, (e.g. due to a marked increased risk of recession or risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

- if it had been felt that there was a significant risk of a sharp RISE in long and short term rates, perhaps arising from an acceleration in the start date or rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the future.

Key Messages:

The Authority's traditional source of long-term borrowing is the Public Works Loan Board (part of HM Treasury).

The rate at which the Authority can borrow is determined by the Gilt Market (the Government's own primary source of borrowing) and fluctuates with market conditions. On top of this 'base rate' PWLB apply a margin, typically 0.8% for NELC.

In the second half of 2021-22 rates began to rise as future hikes in Bank Rates were anticipated by markets. Significantly higher volatility also became a regular feature across the majority of financial markets.

Borrowing Strategy (continued)

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, (certain aspects of) 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.

Revised PWLB Guidance for 2021/22 restored standard and certainty margins but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme.

The current margins over gilt yields 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)
- Local Infrastructure Rate is gilt plus 60bps (G+60bps)

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% but the market had become much more volatile than in previous periods.

There is expected to be only a steady rise in gilt yields and PWLB rates over the next three years as Bank Rate is forecast to rise to 2.75% by mid-2023 as the Bank of England combats high inflation. Gilt markets tend to anticipate these rises, meaning our borrowing rates can change much more quickly.

Borrowing in advance of need

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, so expects to retain access to PWLB.

Key Messages:

Several short-term loans were agreed heading into 2021-22 in order to fix in a large portion of our identified borrowing need at prevailing low market rates and thus deliver in-year debt cost savings of c£0.5m that will be used to support the achievement of a balanced Medium term Financial Plan.

Borrowing Strategy (continued)

Borrowing – the following loans were taken during the period: -

Counterparty	Start Date	Maturity Date	Amount	Rate
Wychavon District Council*	01/04/2021	01/04/2022	£3,000,000	1.70%
Rugby Borough Council*	01/04/2021	01/04/2023	£3,000,000	1.70%
West Midlands Combined Authority	06/04/2021	25/11/2021	£5,000,000	0.20%
West of England Combined Authority	02/06/2021	01/06/2022	£5,000,000	0.25%
Nottinghamshire Police and Crime Commissioner	05/07/2021	04/07/2022	£5,000,000	0.22%
Walsall Metropolitan Borough Council	25/11/2021	25/11/2022	£5,000,000	0.60%

*These loans were arranged using the Authority's accrued internal borrowing position to match prepayment of the Authority's Pension Fund contributions in return for which East Riding Pension Fund offered a discount of 4%.

Key Messages:

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

All other things being equal we would expect to see balances fall each year by the amount of corporately funded capital expenditure less any new borrowing. However, during 2021/22 higher balances were maintained as a result of officers adding liquidity at the outset of the Covid-19 pandemic and subsequent Government support programmes.

Investment Activity

The Authority has held significant invested funds, representing income received in advance of expenditure plus balances and reserves held. As part of its national response to the Coronavirus pandemic the UK Government provided large sums of additional cash resources to local authorities. Some of these funds supported additional burdens experienced by Authorities as a result of the pandemic and others were provided for Authorities to distribute targeted support to the private sector.

During 2021/22 total investment balances ranged between £33.1m and £71.9 million. The average balance maintained was £59m (including central Government support programme monies) with a weighted average maturity of 23 days. During the period our target rate of 7-day LIBID was discontinued as part of a market-wide programme. Up to that point 31 Dec we compared favourably (achieving a positive return of 0.01% vs the benchmark -0.07%). In the final quarter, against LIBID's replacement equivalent (SONIA) we only achieved 0.21% vs 0.40% benchmark. This is partly down to technical differences in the way the new benchmark is calculated and partly down to maturity lag before we could capture rising rates. Comparisons to SONIA will be reported going forward.

Investment Policy – the Council's investment policy is governed by DLUHC guidance, which has been implemented in the annual investment strategy approved by the Council. Investment activity during the year conformed to the Investment Strategy for 2021/22 which aimed to reduce risk by;

- Setting value and term limits for counterparties based on Credit rating, available collateral and sector.
- Utilising data tools available via Treasury Live and Link Asset Services to monitor risk.
- Ensuring a minimum level of liquidity was maintained to allow payments to be made as they fell due

The Council aims to achieve an adequate return (yield) on its investments commensurate with robust levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs using our suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

Creditworthiness – Credit metrics for the financial institutions we interact with have remained remarkably resilient throughout the Covid pandemic and no changes to TMSS limits, or indeed (more restrictive) operational limits were necessary during the period. Even so in a post 'Bail-in' regulatory environment NELC seeks to largely avoid direct bank exposure.

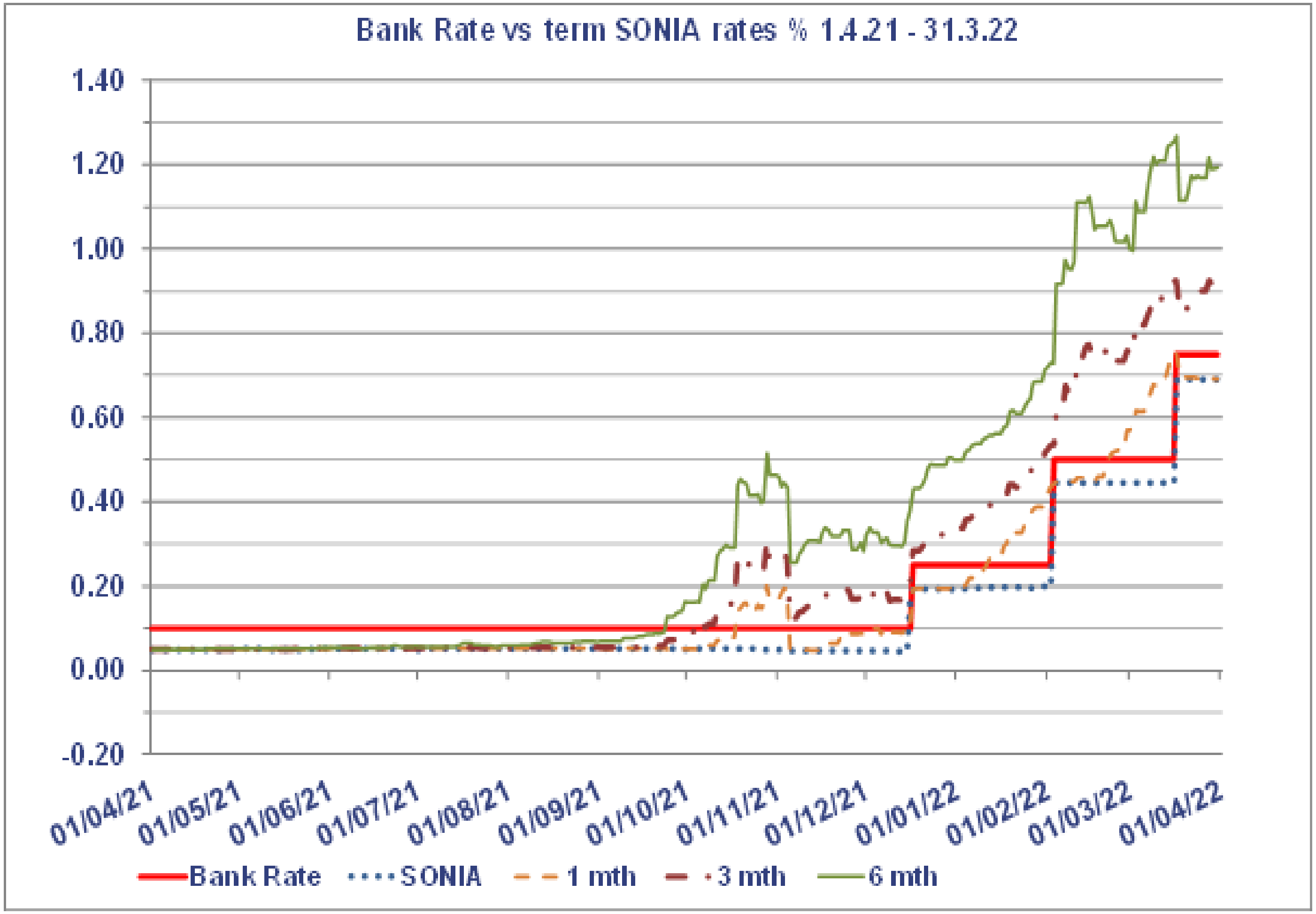
Key Messages:

Investment returns which had been near zero or even negative during 2020/21 remained so for most of 2021/22 whilst the Bank of England (BoE) stuck to its 'transitory' inflation narrative. The Russian invasion of Ukraine brought a new dynamic to inflation projections and the BoE found itself having to make consecutive rate hikes into period end.

The Chart shown here clearly demonstrates how the BoE's new urgency to fighting inflation affected short-term rates.

Total investment income was therefore lower than anticipated at £0.042m compared to an annual budget expectation of £0.050m. However, savings on the debt side far outweighed this lower income.

Short-Term Investment Rates



Key Messages:

Counterparty credit quality is assessed and monitored with reference to credit ratings (the Authority's minimum long-term counterparty rating for institutions defined as having "high credit quality" is A-); credit default swap prices, financial statements, and reports from quality financial news feeds.

The higher average balances were a result of a combination of an active strategy to maintain liquidity during the uncertainty around Covid-19 crisis and subsequent central government assistance schemes.

Investment Activity

Investments	Balance on 31/03/2021 £m	Investments Made £m	Maturities/ Investments Sold £m	Balance on 31/03/2022 £m	Avg Rate/Yield (%) and Avg Life (years)
UK Government: - DMADF - Treasury Bills	21.5 -	594.8 17.6	(588.7) (11.1)	27.6 6.5	0.06% 16 days 0.29% 34 days
Bonds issued by Multilateral Development Banks	-	1.5	(1.5)	0	0.07% 116 days
Direct Unsecured Investments (call accounts, deposits) with financial institutions - rated A- or higher - rated below A-	3.3 -	57.3	(60.4)	0.2	0.17% at Call
Tradable Investments with Financial institutions Corporates (CDs) rated A- or higher	-	2.0	-	2.0	0.72% 77 days
Money Market Funds	6.9	8.4	(6.9)	8.4	0.06% at Call
TOTAL INVESTMENTS	31.7	681.6	(668.6)	44.7	0.06% 23 days
Increase/ (Decrease) in Investments £m				13.0	

Given the increased risk and continued low returns from short-term unsecured bank investments, but having no funds available for longer-term investment, the Authority is unable to simply diversify into more secure and/or higher yielding asset classes such as repurchase agreements or covered bonds which are secured on financial assets. Eliminating Credit Risk by running down balances whilst still maintaining adequate liquidity therefore remains a key strand of operational activity.

Key Messages:

Figuratively the Authority's risk profile remained fairly steady for most of the year, (with a narrow set of counterparties our risk profile primarily moves with UK sovereign rating where there were no changes during the period).

Investment Activity (contd.)

Credit Risk

Counterparty credit quality as measured by credit ratings is summarised below:

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating
31/03/2021	3.50	AA-
30/06/2021	3.46	AA
30/09/2021	3.51	AA-
31/12/2021	3.64	AA-
31/03/2022	3.45	AA

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 26
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

As previously stated balances have remained higher than in the years prior to the onset of the Covid_19 pandemic due a combination of a desire for greater liquidity in uncertain times and large scale central Government support programmes (both for LAs directly and for passporting to targeted private sector entities). It has therefore been important to ensure that this larger surplus did not automatically translate into a change in risk profile. As can be seen above this has been successfully managed.

Key Messages:

In an environment where direct unsecured bank deposits present increased risk but low return NELC has sought to avoid this imbalance by utilising UK Government based investments and diversified funds.

Ultimately we seek to minimise counterparty risk by limiting our cash levels whilst still maintaining adequate liquidity.

There was one operational breach of the limits set in the TMSS. Guidance procedures have been amended to prevent a recurrence.

Investment Activity (contd.)

Benchmarking

- Comparisons are made to other Authorities using the Treasury Live database which looks at over £8Bn of local Authority investments. As at the outturn date this shows that other Authorities:-

    – Hold more cash than NELC. Average balance £107m (estimated) vs £45m at NELC
    – Invest for longer periods. 121 days on average vs only 14 days at NELC
    – Take more risk than us collectively.
    – Deliver similar return to us. 0.55% vs 0.54%

- Whilst the above shows greater return can be generated by term premiums the Council has been able to take advantage of rising rates more quickly due to its shorter average investment term. NELC is of the view that, in a post Bail-in environment elimination of credit risk through lower balances is worth potential lower overall return. To ensure this strategy does not replace credit risk with liquidity risk NELC maintains a liquid balance at least £10m.

- Whilst we regularly monitor performance against data on 80+ other Authorities' activity (as summarised above), in January 2022 Audit and Governance Committee requested that we obtain some additional specific data on what Unitary Authorities (like NELC), are investing in, to ensure we are not 'missing out' on anything those 'peers' are doing. Data was shared with us (confidentially and anonymised) by our Advisors, Link Asset Services. Against this narrower grouping we are even more 'in the bunch' with the only difference being those who have historically lent (sometimes long-term) to other Authorities. We have reviewed the data and considered LA lending but for the time being the S151 Officer has taken the decision not to do so.

Operational Breaches

- The Gross value of investments transacted during 2021/22 was £0.635Bn.

- There was one breach of limits set within the TMSS during that period. On 8th October an investment was made which included an element of uncleared cheques. This resulted in our account with Barclays being £0.240m overdrawn overnight. The position was corrected the next day and interest payable to Barclays of £41.42. Operational guidance notes have been updated to ensure all involved understand the different reporting balances to prevent any recurrence.

Key Messages:

The Authority confirms compliance with its Prudential Indicators for 2021/22, which were set in February 2021 as part of the Authority's Treasury Management Strategy Statement.

Compliance with Prudential Indicators

Treasury Management Indicators
The Authority measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures: This indicator is set to control the Authority'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	2022/23	2023/24
Upper limit on fixed interest rate exposure	£290m	£290m	£290m
Actual*	£140m	£167m (est)	£184m (est)
Upper limit on variable interest rate exposure	£70m	£70m	£70m
Actual*	£15m	£35m (est)	£35m (est)

*= Peak position for 2021/22

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

	Upper	Lower	Actual
Under 12 months	60%	0%	27%
12 months and within 24 months	30%	0%	3%
24 months and within 5 years	50%	0%	5%
5 years and within 10 years	50%	0%	11%
10 years and within 20 years	75%	0%	8%
20 years and within 30 years	75%	0%	17%
Over 30 years	90%	0%	29%

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. Note: LOBO option dates are included as potential repayment dates.

Key Messages:

For 2021-22 a minimum cash level of £10m was targeted and there were no breaches of this, or other Indicators.

Compliance with Prudential Indicators (contd.)

Principal Sums Invested for Periods Longer than 365 days: The purpose of this indicator is to control the Authority'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 will be:

	2021/22	2022/23	2023/24
Limit on principal invested beyond year end	£21m	£21m	£21m
Actual	£0m	£0m	£0m

Security: The Authority 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
Portfolio average credit rating	A	AA-

Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

	Target	Actual (Low)
Total cash available within 1 month	£10m	£33m*

*includes Business Support Grant balances held during the period for the purpose of dispersal to local businesses.

Key Messages:

Borrowing remains comfortably below control levels as a result of continued internal borrowing support for the Capital Programme.

Borrowing levels were projected to be £167m at the end of 2021/22 when the TMSS was set in Feb 2021. The actual position as at 31.3.2022 was £154m. The difference was represented by cash and Reserves at the period end and was expected to be utilised to fund Capital Spend during 2022/23.

Compliance with Prudential Indicators (contd.)

Other Prudential Indicators

The following prudential indicators are relevant to the treasury function as they concern limits on borrowing and the adoption of the CIPFA Treasury Management Code.

Operational Boundary for External Debt: The operational boundary is based on the Authority's estimate of most likely, i.e. prudent, but not worst-case scenario for external debt.

Operational Boundary	2021/22 £m	2022/23 £m	2023/24 £m
Borrowing	£215m	£215m	£215m
Other long-term liabilities	£30m	£30m	£25m
Boundary for Total Debt	£245m	£245m	£245m

Authorised Limit for External Debt: The authorised limit is "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 2020-21 the Council has maintained gross borrowing within its authorised limit.

Authorised Limit	2021/22 £m	2022/23 £m	2023/24 £m
Borrowing Limit	£250m	£250m	£250m
Other long-term liabilities	£40m	£40m	£40m
Total Debt Limit	£290m	£290m	£290m
Actual/projected Peak Debt levels	£155m	£187m (est)	£205m (est)

Adoption of the CIPFA Treasury Management Code: The Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition in February 2018.

Key Messages:

The Local Government Act 2003 requires the Authority 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 Authority confirms compliance with its Capital Finance Prudential Indicators for 2021/22, which were set in February 2021 as part of the Authority's Treasury Management Strategy Statement.

Changes to the 2022/23 and later programmes may occur as these are progressed in the coming months.

Compliance with Capital Finance Prudential Indicators

The Local Government Act 2003 requires the Authority 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 Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure

The Authority's planned capital expenditure and financing as at 31.3.2022 may be summarised as follows.

Capital Expenditure and Financing	2021/22 Original £m	2021/22 Changes £m	2021/22 Draft Outturn £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Total Expenditure	54.1	-23.0	31.1	84.0	62.7	23.3
Capital Receipts	0.5	0.0	0.5	0.4	0.4	0.0
Government Grants	26.7	-6.3	20.4	42.4	31.8	9.4
Ring-fenced External Funding	0.1	-0.1	0.0	0.2	5.0	0.0
Borrowing	26.8	-16.6	10.2	41.0	25.5	13.9
Total Financing	54.1	-23.0	31.1	84.0	62.7	23.3

Key Messages:

The percentage of the Council's income required to service it's debt came in below projections due to a combination of slippage in the capital programme and the effect of using short-term lenders which offered lower interest rates and delivered in-year cost-savings.

Compliance with Capital Finance Prudential Indicators (contd.)

Ratio of Financing Costs to Net Revenue Stream

This is a voluntary indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2021/22 Original Estimate %	2021/22 Outturn %	2022/23 Estimate %	2023/24 Estimate %	2024/25 Estimate %
General Fund	7.6	6.9	8.0	9.9	10.3

There are a range of factors that affect these future estimates, some internal such as what the capital investment delivers, and others an impact of interest rate changes. Any future borrowing must be in accordance with prudential borrowing principles. Borrowing must be affordable, sustainable and prudent.