Report

Council

Part 1

Date: 19 July 2022

Subject **Outturn Report on Treasury Management for the period 2021/22**

Purpose This report informs Council of treasury activities undertaken in 2021/22 and confirms, (other than interest rate volatility exposure), that all treasury and prudential indicators have been adhered to. Council is asked to note, and comment as needed, on the activities and position reached.

Author Head of Finance / Assistant Head of Finance

Ward All

Summary In line with the agreed Treasury Management Strategy, the Council continues to be both a short-term investor of cash and borrower to manage day-to-day cash flows. Current forecasts indicate that in the future, temporary borrowing will continue to be required to fund normal day-to-day cash flow activities and longer-term borrowing will increase to fund new commitments in the current capital programme as well as the impact of reduced capacity for 'internal borrowing'. However, during 2021/22, and symptomatic in the previous year too, the Council has received a net inflow of extra-ordinary resourcing by way of extra RSG and grant whilst also experiencing a significant slippage in the capital programme spending, to become a net investor of funds in the short term, and this has caused the unusual variance and non-compliance against the performance indicator previously set that monitors exposure to interest rate changes.

During the year the Council's net borrowing decreased by £44.5m from £128.3m at 31 March 2021 to £83.8m at 31 March 22.

The position as described for 2021/22 above with the Council being a net investor and repaying long term borrowing (without the need to re-finance it) is short term and it is expected that the position will return to 'normal' and in line with the Council's position of holding relatively minimal investments and increasing its long term borrowing over the medium term.

Proposal To note the report on treasury management activities for the period 2021-22.

Action by Head of Finance / Assistant Head of Finance

Timetable Immediate

This report was prepared after consultation with:

- Treasury Advisors
- Head of Finance

Signed

Background

1. In June 2009 the Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code) which requires the Authority to approve a treasury management annual report after the end of each financial year.

2. Treasury risk management at the Authority 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) which required the Authority to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report. This report fulfils the Authority's legal obligation to have regard to the CIPFA Code.

3. CIPFA defines 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.

   The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

4. The 2021/22 Treasury Management Strategy was approved by the Council as part of the Capital Strategy in March 2021 and can be viewed via the following link

   https://democracy.newport.gov.uk/documents/s19160/06%20Capital%20Strategy%20and%20Treasury%20Strategy%202021.pdf?LLL=0

5. This report presents the following information:

   - details of capital financing, borrowing, debt rescheduling and investment transactions
   - reports on the risk implications of treasury decisions and transactions
   - details the monitoring position on treasury management transactions
   - confirms compliance with treasury limits set and Prudential Code

   This report was considered by the 'Governance and Audit Committee' in their May meeting who discussed the report and then Cabinet in their June meeting. No issues or observations requiring reporting to Council were made.

BORROWING STRATEGY / ACTIVITY

Short and Long Term Borrowing

1. Whilst the Council has significant long-term borrowing requirements, the Council's current strategy of funding capital expenditure is through the concept of 'internal borrowing' where the Council seeks to use its existing cash balances and reserves to afford its capital expenditure prior to the necessity to take out external borrowing i.e. we defer taking out new long term borrowing and fund capital expenditure from the Council's own cash resources for as long as we can – which it has because of its 'cash-backed' reserves and, to a lesser extent, day to day positive cash-flows. The Council may undertake borrowing early if there is a clear underlying need for future borrowing and it feels it can minimise risk of future interest rate rises while providing value for money. Any such action will be in line with advice from our treasury advisors. Such decisions may be more prevalent into the future as Bank of England has started to increase interest rates as a mechanism to mitigate inflationary pressures.

2. By using an internal borrowing strategy the Council can also minimise cash holding at a time when counterparty risk remains relatively high, especially with the current economic implications of the Covid-19 pandemic. The interest rates achievable on the Council's investments are also significantly lower than the current rates payable on long-term borrowing and this remains a sensible consideration in operating an 'internal borrowing' arrangement.

3. Whilst the strategy minimises investment counterparty risk, the risk of interest rate exposure is increased as the current low longer term borrowing rates may rise in the future. The performance indicator for interest rate exposure is exceeded currently due primarily to the level of recurrent short term investments being undertaken. There has been a conscious choice to keep a larger "cash" balance during the Covid-19 pandemic and there is also an assumption that capital expenditure levels will need to increase significantly to address the levels/budgets approved in capital programme. The market position is being constantly monitored in order to minimise this risk.

4. The following table compares the borrowing levels at the end of 2021-22 with the equivalent from the end of the previous year. This indicates a net reduction in borrowing of £11m during 2021-22, predominantly through the redemption of short term temporary loan and a PWLB loan at end of September, neither of which has been replaced/refinanced, plus we have a number of loans which are Equal Instalments of Principal (EIP), which pays back principal over the life of the loan, so the borrowing levels decline naturally over the life of the loan as an alternative to maturity based loans where the amount borrowed is only repaid at the end when the loan period expires.

Comparison		21-22	20-21
Public Works Loan Board		97,064,396	101,972,948
Temporary Borrowing			5,000,000
Interest free Borrowing		10,079,672	10,553,464
LOBOS		30,000,000	30,000,000
Ex Lobos		5,000,000	5,000,000
		142,144,068	152,526,412

5. In regards to LOBOs, no loans were called during the period. All £30m outstanding is subject to potential change of interest rates by the lender (which would automatically trigger a right to the Council to repay these loans, at no cost). Should a change of interest rate be requested, then it will be considered in detail and a decision on how we proceed will be made in conjunction with our treasury advisors.

6. These LOBO loans historically used LIBOR as a reference rate for calculating repayment offers. Traditionally LIBOR (the London Interbank Offered Rate) has been used by the financial sector to reflect a series of interest reference rates for a variety of periods, including 'overnight' or longer term periods of one, three, six or twelve months. (Interest rates for periods longer than overnight are often referred to as "term rates"). These reference rates have traditionally underpinned and are used as a basis for calculating many interest rates for financial products.

7. In December 2021 LIBOR was discontinued and has been replaced by an alternative reference rate, SONIA (the Sterling Overnight Index Average). They are broadly comparable when used as LOBO reference rates, and our treasury advisors exhibited no concern in accepting changes to the terms and conditions of these loans to update any reference of LIBOR to SONIA. The change was not regarded as fundamental to introduce a redemption condition unlike if the actual rate of the loan were proposed to change.

INVESTMENTS ACTIVITY / POSITION

8. The Council's strategies in this area of Treasury Management are

   (i) to be a short term and relatively low value investor, consistent with the pursuit of an 'internal borrowing strategy' and

   (ii) investment priorities should follow the priorities of security, liquidity and yield, in that order.

9. The following table compares the investment levels at the end of 2021-22 with the equivalent from the end of the previous year. This indicates a net increase in investment activity of £33.5m during 2021/22

Comparison		21-22	20-21
Investment		- 58,265,000	- 24,780,000

These investments reflect surplus cash invested in financial institutions or organisations to provide a return. Appreciating the ongoing Ukrainian turmoil, (and also, given the global nature of investment markets, the difficulty in tracking ultimate consequences), none of our investments directly involve Russian institutions.

It may be interesting to highlight the current volatility experienced in cash management around the year end. Circa £30m of investments were placed with other Councils in the last 2 weeks of the financial year, symptomatic of the extra cash flowing into the Council through grant funding, extra revenue support grant and capital expenditure being less than predicted by project managers. The majority of this was placed as short term investments of 3-6 weeks.

Due to the continuing pandemic the Authority has continued to keep more cash available at shorter notice than is normal to cover any unexpected calls on cash flow. Currently there is not much demand for very short term borrowing within the market place, and rates on deposits below 14 days with the Debt Management Account Deposit Facility (DMADF) are still very low at 0.5%. The Authority investments with other local authorities are for slightly longer periods and involve interest rates of between 0.57% and 0.62%, which are better but still quite low interest rates. It is anticipated that investments will reduce during 2022/23 as an alternative to borrowing until we reach the balance of £10m, which will remain invested for compliance with MiFID II.

10. As an explanation to new members of Council, January 2018 saw the implementation in the UK of the second Markets in Financial Instruments Directive (MiFID II), where treasury consulting firms were obliged to treat all local authorities as 'retail clients' unless they opted up to 'professional client' status and met certain criteria. Those criteria included holding a minimum of £10m investment balance and employing knowledgeable and experienced staff to carry out investment transactions.

11. Currently the Council has £10m invested with the CCLA Investment management fund into the medium term to satisfy this requirement. CCLA operates a number of pooled funds consistent with the risk appetite of public and charity sectors, such that it derives a greater level of return both in terms of capital growth and investment returns than traditional deposit investments whilst focussing on lower-risk instruments and liquidity.

IMPACT OF COVID-19 PANDEMIC

12. Since the early days of the pandemic the Council has been monitoring the impact on cash flow closely. In addition to the business grants, the Council saw an increase in Covid-19 related expenditure, a reduction in income across services, and a pressure in the collection of Council Tax and Non-Domestic Rates (NDR) which resulted in extra resourcing for WG in the form of extraordinary settlement funding and the provision of resourcing to assist with taxation relief schemes such as NDR Relief Scheme for retail, leisure and hospitality businesses.

13. All of the above would have had a significant impact on cash flow if not addressed. However, WG continue to have mitigated this impact by reimbursing increased expenditure through the hardship fund and through loss of income claims. WG have also repaid the business grants in a timely manner, as well as providing a grant to support the cash flow of the 100% rate reliefs. Up to this point this has certainly assisted with cash flow and the Council has not been required to undertake additional net borrowing to address cash flow considerations.

14. 2022-23 is potentially going to be more volatile from a cash flow management point of view as the Council's services shift to a more traditional provision with increased emphasis of some services being paid for by customer fees and charges again, as an alternative to receiving Covid 19 hardship and support grants from Welsh Government. However helpfully this may also mean in time that the Council can move to a greater degree of longer term investments as opposed to the current short term strategy.

NON-TREASURY INVESTMENTS

15. The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. This is replicated in the Investment Guidance issued by Ministry of Housing, Communities and Local Government's (MHCLG) and Welsh Government, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

The Authority also held such investments in:

- directly owned property such as office and commercial units of £12.7m
- loans to developers £10.6m
- shareholding in subsidiaries £0.3m (Newport Transport)

Directly held property is subject to annual valuation review which can change the value of the holding. In terms of the financial valuations of these assets, the outbreak of Covid-19 has impacted global financial markets such that less weight can be attached to previous market evidence for comparison purposes, to inform opinions of value. Therefore, the valuations are currently reported on the basis of 'material valuation uncertainty'. Consequently, less certainty and a higher degree of caution should be attached to the valuation of these property investments than would traditionally be the case. The above figure is reflective of 2020-21 Accounts, and is provided as an illustration as the Accounts process for 2021-22 won't have concluded by the time this paper is finalised.

The developer loans activity reflects those regenerative projects that are included within the capital programme to assist developers with cash flow loans on particular projects and which are required to be repaid plus interest. The increase of £5.9m during 2021-22 when compared to previous year reflects the progress experienced in relation to the Indoor Market and Mill Street regeneration schemes predominantly.

OTHER TREASURY CONSIDERATIONS FOR 2021-22

Economic background and Counter Party Update

16. Appendix A outlines the underlying economic environment as provided by the Council's Treasury Management Advisors, Arlingclose. This is very useful context in informing annual strategy and assisting in effective treasury decisions.

17. Our treasury management advisors Arlingclose have completed a recurrent review of its credit advice on unsecured deposits. The outcome of that review included additions to the counterparty list (e.g. NatWest Markets plc) together with the removal of the previous suspensions (e.g. Handelsbanken plc). In addition, the maximum duration for all recommended counterparties was extended to 100 days. Importantly, the long-term rating of Santander UK, (the Council's bankers), remains at A+; above the Council's minimum level of A-. Whilst our CCLA investment of £10m (for MiFiD purposes) is likely to be longer term than most of our other investments, because of its 'on call' nature it generally still wouldn't be considered a long term investment. During 2022-23 as Council services resume to a more traditional pattern and profile, it is intended that an analysis be undertaken whether cash flow movements will allow a degree of short term investments to instead be invested longer term.

Compliance with Prudential Indicators approved by Council

18. The Authority measures and manages its exposures to treasury management risks using various indicators which can be found in Appendix B. There is an exception that the Council is exposed to higher degree of interest rate fluctuation than anticipated in the treasury strategy, the rationale of which is explained in that appendix and reflects primarily the updated interpretation of the Council's LOBO loans as 'variable' interest' loans and volume of net investments being undertaken at the moment. But other than that, the Authority has complied with the Prudential Indicators for 2021/22, set in March 2021 as part of the Treasury Management Strategy. Appendix B sets out more detail here.

PWLB future lending terms

19. Members will be aware that the Public Works Loan Board (PWLB), the main borrowing institution used by councils, increased interest rates on loans in the autumn of 2019 following concerns about the level of Local Government debt, in particular for commercial activities.

    These have manifested themselves in enhanced PWLB rules being adopted during 2021/22, to preclude advantageous PWLB borrowing rates being used to fund investments primarily for yield. These checks are anticipated to add 2 days to the approval mechanism. The guidelines also allow for sanctions being applied to any counterparty using this funding source erroneously, varying from no longer being able to use PWLB for any of its borrowing, having to unwind specified transactions and/or the application of fines and penalties depending upon the severity of the breach.

Risks

Risk	Impact of Risk if it occurs* (H/M/L)	Probability of risk occurring (H/M/L)	What is the Council doing or what has it done to avoid the risk or reduce its effect	Who is responsible for dealing with the risk?
Investment counterparty not repaying investments	High but depending on investment value	Low	The Council only invests with Institutions with very high credit scores. It employs advisors to monitor money market movements and changes to credit scores and acts immediately should things	Members, Head of Finance, Treasury staff, based on advice

			change adversely. The lower levels of funds available for investment will also alleviate the risk.	from treasury advisors
Interest Rates moving adversely against expectations	Low	Low	Future expectations for higher short term rates are subdued. The Treasury strategy approved allows for the use of short term borrowing once investment funds are exhausted to take advantage of these low rates.	Head of Finance, Treasury staff, treasury advisors

* Taking account of proposed mitigation measures

Links to Council Policies and Priorities

It is the Council's policy to ensure that the security of the capital sums invested is fully recognised and has absolute priority. The Council follows the advice of the Welsh Government that any investment decisions take account of security, liquidity and yield in that order.

Options Available and considered

The Prudential Code and statute requires that, during and at the end of each financial year, reports on these matters are presented to Council for approval.

Preferred Option and Why

The approach required by statute is quite prescriptive, such that there aren't many choices/options. This report is a regular half yearly event. The Governance and Audit Committee acts as the main scrutiny mechanism before a similar report is received by Cabinet/Council.

Comments of Chief Financial Officer

Decisions made on treasury matters will be made with a view to comply with the Treasury Management Strategy, Prudential Indicators, taking advice, where needed, from our Treasury Advisers.

The Council has, to all intent and purpose, complied with its Prudential Indicators with the one 'interest rate exposure' failed indicator being more 'technical' in nature and caused by the unprecedented treasury position the Council (like most others) finds itself in. This is expected to be a short term position and we should see the level of investments fall during 2022/23 and external borrowing increase, in line with requirements, over the medium term. It does not give rise to any concern or heightened risk.

Comments of Monitoring Officer

There are no legal implications. The in year and annual treasury management report is consistent with relevant Chartered Institute of Public Finance and Accountancy Guidance, Treasury Management principles and the Council's investment Strategy.

Comments of Head of People and Business Change

There are no direct HR implications associated with the report.

The Well-being of Future Generations Act requires public bodies to balance short-term needs with the needs to safeguard the ability to meet long-term needs. As stated in this report, the Council continues to be both a short-term investor of cash and borrower to manage day-to-day cash flows but current forecasts indicate that in future temporary borrowing will continue to be required and longer-term borrowing will increase to fund the capital programme. Sound financial management by the Council aligns with the well-being goal of a Prosperous Wales.

Comments of Cabinet Member
The Cabinet Member confirms they have been received this report and has no comment.

Local issues
N/A

Scrutiny Committees
N/A

Fairness and Equality Impact Assessment:
- **Wellbeing of Future Generation (Wales) Act**
- **Equality Act 2010**
- **Socio-economic Duty**
- **Welsh Language (Wales) Measure 2011**

For this report, a full Fairness and Equality Impact Assessment has not been undertaken. This is because this report is not seeking any strategic decisions or policy changes, with its purpose being to update on the treasury management activities for the year retrospectively. However, fairness and equality are considered as part of service delivery and will feature in annual finance reports, such as the Treasury and Capital Strategy.

In terms of the Wellbeing of Future Generations (Wales) Act, and the five ways of working contained within it, this report highlights examples of these being supported. This report is a backwards looking report of the treasury management activities of the Council. It shows that we followed the treasury management strategy and the compliance with prudential code and treasury management indicators. This links into the long-term objectives of the authorities and ensures that the Councils' activities are carried out in an affordable, prudent and sustainable manner.

In the case of the Welsh Language, the service will continue to ensure that, wherever possible, services or information is available in the medium of Welsh.

The Equality Act 2010 contains a Public Sector Equality Duty, which came into force on 06 April 2011. The Act identifies a number of 'protected characteristics', namely age; disability; gender reassignment; pregnancy and maternity; race; religion or belief; sex; sexual orientation; marriage and civil partnership. The new single duty aims to integrate consideration of equality and good relations into the regular business of public authorities. Compliance with the duty is a legal obligation and is intended to result in better-informed decision-making and policy development and services that are more effective for users. Nothing in this report is considered to have a direct equality impact.

Consultation
N/A

Background Papers
Report to Council March 2021: Capital Strategy and Treasury Strategy.

Dated: 19th July 2022

APPENDIX A

External Context – Provided by Council's Treasury Advisors

Economic background: 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.

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.

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. CPI for February 2022 registered 6.2% year on year, up from 5.5% in the previous month and the highest reading in the National Statistic series. Core inflation, which excludes the more volatile components, rose to 5.2% y/y from 4.4%.

The government's jobs furlough scheme insulated the labour market from the worst effects of the pandemic. The labour market began to tighten and demand for workers grew strongly as employers found it increasingly difficult to find workers to fill vacant jobs. Having peaked at 5.2% in December 2020, unemployment continued to fall and the most recent labour market data for the three months to January 2022 showed the unemployment rate at 3.9% while the employment rate rose to 75.6%. Headline 3-month average annual growth rate for wages were 4.8% for total pay and 3.8% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 0.1% while regular pay fell by 1.0%.

With the fading of lockdown – and, briefly, the 'pingdemic' – restraints, activity in consumer-facing sectors improved substantially as did sectors such as oil and mining with the reopening of oil rigs but materials shortages and the reduction in the real spending power of households and businesses dampened some of the growth momentum. Gross domestic product (GDP) grew by an upwardly revised 1.3% in the fourth calendar quarter of 2021 according to the final estimate (initial estimate 1.0%) and took UK GDP to just 0.1% below where it was before the pandemic. The annual growth rate was revised down slightly to 7.4% (from 7.5%) following a revised 9.3% fall in 2020.

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.

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.

GDP growth in the euro zone increased by 0.3% in calendar Q4 2021 following a gain of 2.3% in the third quarter and 2.2% in the second. Headline inflation remains high, with CPI registering a record 7.5% year-on-year in March, the ninth successive month of rising inflation. Core CPI inflation was 3.0% y/y in March, was well above the European Central Bank's target of 'below, but close to 2%', putting further pressure on its long-term stance of holding its main interest rate of 0%.

The US economy expanded at a downwardly revised annualised rate of 6.9% in Q4 2021, a sharp in increase from a gain of 2.3% in the previous quarter. In its March 2022 interest rate announcement, the Federal Reserve raised the Fed Funds rate to between 0.25% and 0.50% and outlined further increases should be expected in the coming months. The Fed also repeated it plan to reduce its asset purchase programme which could start by May 2022.

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.

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%.

The Sterling Overnight Rate (SONIA) averaged 0.39% over the quarter.

Credit review: In the first half of FY 2021-22 credit default swap (CDS) spreads were flat over most of period and are broadly in line with their pre-pandemic levels. In September spreads rose by a few basis points due to concerns around Chinese property developer Evergrande defaulting but then fell back. Fitch and Moody's revised upward the outlook on a number of UK banks and building societies on the Authority's counterparty to 'stable', recognising their improved capital positions compared to 2020 and better economic growth prospects in the UK.

Fitch also revised the outlook for Nordea, Svenska Handelsbanken and Handelsbanken plc to stable. The agency considered the improved economic prospects in the Nordic region to have reduced the baseline downside risks it previously assigned to the lenders.

The successful vaccine rollout programme was credit positive for the financial services sector in general and the improved economic outlook meant some institutions were able to reduce provisions for bad loans. However, in 2022, the uncertainty engendered by Russia's invasion of Ukraine pushed CDS prices modestly higher over the first calendar quarter, but only to levels slightly above their 2021 averages, illustrating the general resilience of the banking sector.

Having completed its full review of its credit advice on unsecured deposits, in September Arlingclose extended the maximum duration limit for UK bank entities on its recommended lending list from 35 days to 100 days; a similar extension was advised in December for the non-UK banks on this list. As ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remains under constant review.

Revised CIPFA Codes, Updated PWLB Lending Facility Guidance

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

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

The principles of the Prudential Code took immediate effect.
To comply with the Prudential Code, authorities must not borrow to invest primarily for financial return. This Code also states that it is not prudent for local authorities to make investment or spending decision that will increase the CFR unless directly and primarily related to the functions of the authority. Existing commercial investments are not required to be sold; however, authorities with existing commercial investments who expect to need to borrow should review the options for exiting these investments.

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

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

Appendix B - 2021-22 Treasury Activities and Indicators

Local Context

On 31st March 2021, the Authority had net borrowing of £128.3m 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. Whilst work on the 2021-22 Statement of Accounts remains a work in progress, a comparative draft illustration is provided in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.22 Draft/budgeted £m	**31.3.21 Actual £m**
General Fund CFR	295	281
Less: *Other debt liabilities	-39	-41
Loans CFR	**256**	**240**
Less: Usable reserves	-168	-108
Less: Working capital	-4	-4
Net borrowing	**84**	**128**

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

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. The Authority pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk.

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

Table 2: Treasury Management Summary

	31.3.21 Balance £m	**Movement £m**	**31.3.22 Balance £m**	**31.3.22 Rate**
Long-term borrowing	136.9	-4.9	132.0	3.9%
Long term interest free borrowing	10.6	-0.5	10.1	0%
Short-term borrowing (inc. accrued interest £0.6k)	5.6	-5.6	0	N/A
Total borrowing	**153.1**	**-11**	**142.1**	
Long-term investments				
Short-term investments	-5.0	-31.0	-36.0	0.57%
Cash and cash equivalents	-19.8	-2.5	-22.3	0.71%
Total investments	**-24.8**	**-33.5**	**-58.3**	
Net borrowing	**128.3**	**44.5**	**83.8**	

Borrowing Update

Local authorities can borrow from the PWLB provided they can confirm they are not planning to purchase 'investment assets primarily for yield' in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 Officer. 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.

Competitive market alternatives may be available for authorities with or without access to the PWLB. However, the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders.

The Authority is not planning to purchase any investment assets primarily for yield within the next three years and so is able fully access the PWLB

Borrowing Strategy during the period

At 31st March 2022 the Authority held £142.1m of loans, (a decrease of £11m against 31st March 2021, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 31st March are summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.21 Balance £m	Net Movement £m	31.3.22 Balance £m	31.3.22 Weighted Average Rate %	31.3.22 Weighted Average Maturity (years)
Public Works Loan Board	102.0	-5.0	97.0	3.7	16.0
Banks (LOBO)	30.0	0	30.0	4.4	32.3
Banks (fixed-term)	5.0	0	5.0	3.8	56.0
Local authorities (long-term)	0	0	0	N/a	N/a
Local authorities (short-term)	5.0	-5.0	0	N/a	N/a
Other WG loans	10.6	-0.5	10.1	0%	8.1
Accrued interest	0.6	-0.6	0	N/a	N/a
Total borrowing	**153.1**	**-11.0**	**142.1**		

The Authority's chief objective when borrowing has been to strike an appropriately low risk 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 Authority's long-term plans change being a secondary objective.

In keeping with these objectives, no new borrowing was undertaken, while £11m of existing loans allowed to mature without replacement. This strategy enabled the Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

With short-term interest rates remaining much lower than long-term rates and with surplus of liquidity continuing to feature in the LA to LA market, the Authority considered it to be more cost effective in the near term to use internal resources or borrowed rolling temporary / short-term loans instead. The net movement in temporary / short-term loans is shown in table 3 above.

The Authority continues to hold £30m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Authority 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.

Other Debt Activity

Although not classed as borrowing, the Authority previously raised capital finance previously to afford Glan Usk School and the Southern Distributor Road. The Accounts for 2021-22 are still be being prepared at the time this report is finalised, but as an illustration the 2020-21 Statement of Accounts indicated an outstanding liability of £39m to pay to the operator.

Treasury Investment Activity

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances ranged between £17.9 and £58.2 million due to timing differences between income and expenditure. The investment position is shown in Table 4 below.

Table 4: Treasury Investment Position

	31.3.21 Balance £m	Net Movement £m	31.3.22 Balance £m	Income Return %	Weighted Average Maturity days
Banks & building societies (unsecured)	9.8	-7.5	2.3	0.2	-
Government (incl. local authorities and money market fund)	15.0	41.0	56.0	0.6	-
Total investments	**24.8**	**33.5**	**58.3**		**-**

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

Ultra-low short-dated cash rates which have been a feature since March 2020 when Bank Rate was cut to 0.1% have resulted in the return on sterling low volatility net asset value money market funds (LVNAV MMFs) being close to zero even after some managers have temporarily waived or lowered their fees. At this stage net negative returns are not the central case of most MMF managers over the short-term, and fee cuts or waivers should result in MMF net yields having a floor of zero, but the possibility cannot be ruled out.

Deposit rates with the Debt Management Account Deposit Facility (DMADF) are also largely around zero.

In the Treasury Management Strategy, it was agreed that the Authority will move into higher risk/higher yield investments such as pooled funds. In December 21, the Council invested £10m in a CCLA money market fund which is a pooled fund.

Non-Treasury Investments

The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. This is replicated in the Investment Guidance issued by the Ministry of Housing, Communities and Local Government (MHCLG) and Welsh Government, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

The Authority also held investments in

- directly owned property such as office and commercial units of £12.7m
- loans to developers £10.6m
- shareholding in subsidiaries £0.3m

Treasury Performance

The Authority measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in Table 6 below.

Compliance

The Head of Finance reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management strategy. Compliance with specific investment limits is demonstrated in Table 5 below.

Compliance with the authorised limit and operational boundary for external debt is demonstrated in Table 7 below.

Table 5: Debt Limits

	2021/22 Peak Debt	2021/22 Operational Boundary	31.3.22 Actual	2021/22 Authorised Limit	Complied? Yes/No
Borrowing	146.5	187	142.1	255	Y
PFI and Finance Leases	**39**	**42**	**39**	**42**	Y
Total debt	**185.5**	**229**	**181.1**	**297**	Y

Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow. This has not been necessary, but it would not be counted as a compliance failure anyway.

As part of Treasury Strategy, the Council agreed the following counterparty limits and appetite towards investment risk. None of these indicators were breached during 2021-22.

Table 8: Investment Limits

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£20m	Unlimited
Secured investments *	20 years	£10m	Unlimited
Banks (unsecured) *	13 months	£5m	Unlimited
Building societies (unsecured) *	13 months	£5m	£10m
Registered providers (unsecured) *	5 years	£5m	£25m
Money market funds *	n/a	£10m	Unlimited
Strategic pooled funds	n/a	£10 m	£25m

Real estate investment trusts	n/a	£10m	£25m
Other investments *	5 years	£5m	£5m

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£5m 5 years	£10m 20 years	£10m 50 years	£5m 20 years	£5m 20 years
AA+	£5m 5 years	£10m 10 years	£10m 25 years	£5m 10 years	£5m 10 years
AA	£5m 4 years	£10m 5 years	£10m 15 years	£5m 5 years	£5m 10 years
AA-	£5m 3 years	£10m 4 years	£10m 10 years	£5m 4 years	£5m 10 years
A+	£5m 2 years	£10m 3 years	£5m 5 years	£5m 3 years	£5m 5 years
A	£5m 13 months	£10m 2 years	£5m 5 years	£5m 2 years	£5m 5 years
A-	£5m 6 months	£5m 13 months	£5m 5 years	£5m 13 months	£5m 5 years
None	£1m 6 months	n/a	£10m 25 years	Not Applicable	£5m 5 years
Pooled funds and real estate investment trusts	£10m per fund or trust				

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 the one-year revenue impact of a 1% rise or fall in interests was:

Interest rate risk indicator	31.3.22 Actual	2021/22 Limit	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates (borrowing)	£300,000	£200,000	N
Upper limit on one-year revenue impact of a 1% fall in interest rates (investments)	(£362,000)	(£100,000)	N

Whilst both borrowing and investment sensitivity to interest rates is higher than level anticipated in the Treasury Strategy, this shouldn't be regarded as introducing a risk that requires specific mitigation, due to the following explanation.

Borrowing:
The only element of Council borrowing that is subject to interest rate volatility are LOBO loans. We have historically not assessed these as variable rate loans and in that circumstance, 100% of the Council's loans were fixed with no interest rate risk therefore possible. The limit was simply used here for any new in-year loans we might have taken out with a variable rate.

We have re-appraised the above position and assesses these now as variable rate loans; or more correctly, as "semi-fixed" as the Council has the choice to redeem the loan should an interest rate change be advocated without penalty. The effect of a 1% variance interest rate on these is calculated above. The non-compliance therefore predominantly arises due to a change in interpretation and therefore the basis of the target and the actual here as opposed to a true non-compliant issue. . Indeed, traditional replacement fixed rate loan finance is currently available at lower rate than the existing LOBO rates and therefore in the event that the Council were notified of an increase here, we would not suffer any actual budget pressure.

Investment:
In calculating the limit here, an estimate on amounts invested was made when setting this as that is a key component of any financial impact of a change in interest rates. In working out a limit in the treasury strategy, the investment interest sensitivity set would not have presumed that the Council would have £58m invested at the end of financial year. This is a key reason in understanding why this limit is non-compliant. The indicator here is a 'blunt tool' in reality as it also makes no reference to the budgeted/expected amount of interest income resulting from investments. In the event of a 1% decrease in rates, the budget would still have been achieved because the quantum of investments was so much higher than the base budget was based on.

In order to mitigate risk of both interest volatility and security of investments, £36m of this has been placed with other local authorities or government agencies at fixed rates so exclusive of interest rate risk. However these are short term in nature and will need to be reinvested at maturity. It is anticipated to use similar fixed rate arrangements and similar entities mitigating interest rates volatility exposure, however this isn't certain, so prudently this has been included in the calculation above. The Council also has £22m investments on call which would be more subject to variable interest rate volatility. £10m of that £22m relates to the Council's longer term investment in the CCLA fund, to satisfy MiFiD II requirements. The annual interest receivable relating to on call investments is £157k currently (including in the above table), reflective of 0.2% collective returns, these investments are priced very prudently, so it is unlikely that adverse interest rate fluctuations would be as great as 1%. Base rate increases introduced by Bank of England also mean that volatility indications are more skewed to affecting the borrowing line in above table than investments.

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 all borrowing were:

	31.3.22 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	1%	60%	0%	Y
12 months and within 24 months	1%	40%	0%	Y
24 months and within 5 years	23%	40%	0%	Y
5 years and within 10 years	3%	40%	0%	Y
10 years and within 20 years	19%	30%	0%	Y
20 years and within 30 years	16%	20%	0%	Y
30 years and within 40 years	21%	20%	0%	N
40 years and within 50 years	9%	20%	0%	Y
50 years and above	7%	20%	0%	Y

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. *For presentational purposes LOBO option dates are treated as potential repayment dates.*

Please note that borrowing arranged to mature between 30 and 40 years hence shows a 1% compliance deficiency against the limit set. This is not because any new borrowing was arranged for this period during 2021-22 but instead more the consequence of £30m for that period now being more significant against a lower total borrowing. It is not cost effective to arrange early redemption of some of these loans to better comply with limits, particularly as borrowing levels can be expected to rise as Council addresses the backlog in capital programme expenditure.

Principal Sums Invested for Periods Longer than a year: 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 long-term principal sum invested to final maturities beyond the period end were:

	2022/23	2023/24	2024/25
Actual principal invested beyond year end	0	0	0
Limit on principal invested beyond year end	£10m	£10m	£10m
Complied?	Y	Y	Y

NB. Any "on call" investments are treated as less than 12 months investments as they can be redeemed at any time.

<u>Other</u>

IFRS 16: The implementation of the new IFRS 16 Leases accounting standard was due to come into for force for local authorities from 1st April 2022. Following a consultation CIFPA/LASAAC announced an optional two year delay to the implementation of this standard a decision which was confirmed by the Financial Reporting Advisory Board in early April 2022. Authorities can now choose to adopt the new standard on 1st April 2022, 1st April 2023 or 1st April 2024. A straw poll amongst other Welsh authorities suggest a 2024 implementation date being most common, and there is sense in councils being consistent, but this will need to be ratified by Council explicitly. At the moment, Accountancy is working through the ramifications, particularly its impact upon the capital financing requirement to be able to advise members accordingly.