

Treasury Management Annual Report 2021/22

Summary:	This report sets out the Treasury Management activities actually undertaken during 2021/22 compared with the Treasury Management Strategy for the year.
Options considered:	This report must be prepared to ensure the Council complies with the CIPFA Treasury Management and Prudential Codes.
Conclusions:	Treasury activities for the year have been carried out in accordance with the CIPFA Code and the Council's Treasury Strategy.
Recommendations:	That Council be asked to resolve that the Treasury Management Annual Report for 2021/22 is approved.
Reasons for Recommendations:	Approval by Council demonstrates compliance with the CIPFA Codes.

Cabinet Member(s) Cllr Eric Seward	Ward(s) affected
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1. Introduction

- 1.1 The Authority has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports.

The Authority's treasury management strategy for 2021/22 was approved at a meeting on 24th February 2021. 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. The successful identification, monitoring and control of risk remains central to the Authority's treasury management strategy.

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 (the CIPFA Code) which requires 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.

The Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 24th February 2021.

Treasury risk management at the Authority is conducted within the framework of the TM Code. This Code now also includes extensive additional requirements for service and commercial investments, far beyond those in the 2017 version

2. Main body of report

External Context

Economic background: Following Russia's invasion of Ukraine in February, global inflationary pressures have intensified sharply, leading to a sizeable deterioration in the outlook for world and UK growth.

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 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 its 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 although local authorities

could defer introducing the revised reporting requirements until the 2023/24 financial year if they wish.

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

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

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

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

Local Context

On 31st March 2021, the Authority had net investments of £34.81m 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.

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 and keep interest costs low

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

Treasury Management Summary

	31.3.21 Balance £m	Movement £m	31.3.22 Balance £m	31.3.22 Rate %
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Long-term borrowing	0.000	0.000	0.000	0.00
Short-term borrowing	7.000	6.000	13.000	0.36
Total borrowing	7.000	6.000	13.000	
Long-term investments	32.000	0.000	32.000	2.92
Short-term investments	9.810	0.960	10.770	0.06
Total investments	41.810	0.960	42.770	
Net Investments	34.810	0.960	29.770	

There was an increased amount of borrowing at the end of the financial year to fund a £8.6m repayment to central government on the 8th March 2022 to repay part of the first tranche of COVID business grants.

Borrowing Update

The Authority has not planned any borrowing to invest primarily for commercial return and so is unaffected by the changes to the Prudential Code.

The Council mainly sources its borrowing through brokers to borrow only from other local government authorities/police services/fire services/pension funds. The Council takes measures to ensure no money is borrowed from authorities deemed to be at financial risk.

Borrowing strategy

At 31st March 2022 the Authority held £13m of short-term loans, an increase of £6m to the 31st March 2021, as part of its strategy for funding current years' capital programmes. Outstanding short-term loans on 31st March are summarised in the table below.

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)
Local authorities (short-term)	7.00	4.00	11.00	0.36	<1
Fire & Rescue authorities (short-term)	0.00	2.00	2.00	0.36	<1
Total borrowing	7.00	6.00	13.00		

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.

With short-term interest rates remaining much lower than long-term rates, the Authority considered it 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 the table above.

The Authority has an increasing CFR due to the capital programme and an estimated borrowing requirement as determined by the Liability Benchmark which also takes into account usable reserves and working capital. Having considered the appropriate duration and structure of the borrowing need based on realistic projections, it was decided to take short-term borrowing to fulfil any funding requirements. The Authority borrowed no medium/long term loans as long term loans.

PWLB funding margins have lurched quite substantially and there remains a strong argument for diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields + 0.80%. The Authority will evaluate and pursue these lower cost solutions and opportunities with its advisor Arlingclose.

Treasury Investment Activity

CIPFA published a revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes on 20th December 2021. These define treasury management investments as investments that arise from the organisation's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

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 £35.623 and £71.748 million due to timing differences between income and expenditure. The investment position is shown in the table below.

On 6th April 2021 the Authority received central government funding to support small and medium businesses during the coronavirus pandemic through grant schemes. £26.166m was received, temporarily invested in short-dated, liquid instruments such as call accounts and Money Market Funds

Treasury Investment Position

	31.3.21 Balance £m	Net Movement £m	31.3.22 Balance £m	31.3.22 Income Return %
Money market Funds			10.770	

Other Pooled Funds.	9.810	0.960	3.000	0.06
- <i>Cash plus funds</i>	3.000	0.000	3.000	0.42
- <i>Short-dated bond funds</i>	3.000	0.000	5.000	0.48
- <i>Strategic bond funds</i>	5.000	0.000	8.000	1.96
- <i>Equity income funds</i>	8.000	0.000	5.000	3.46
- <i>Property funds</i>	5.000	0.000	8.000	5.08
- <i>Multi asset income funds</i>	8.000	0.000		3.48
Total investments	41.810	0.960	42.770	2.20

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 were a feature since March 2020 when Bank Rate was cut to 0.1%, prevailed for much of the 12-month reporting period which resulted in the return on sterling low volatility net asset value (LVNAV) Money Market Funds being close to zero even after some managers have temporarily waived or lowered their fees. However, higher returns on cash instruments followed the increases in Bank Rate in December, February and March. At 31st March, the 1-day return on the Authority's MMFs ranged between 0.55% - 0.70%.

Similarly, deposit rates with the Debt Management Account Deposit Facility (DMADF) initially remained very low with rates ranging from 0% to 0.1%, but following the hikes to policy rates increased to between 0.55% and 0.85% depending on the deposit maturity. The average return on the Authority's DMADF deposits was 0.01%. This facility was only used for a few days during April 2021.

Given the risk and low returns from short-term unsecured bank investments, the Authority maintained its diversification in more secure and/or higher yielding asset classes as shown in the table above with £32m that is available for longer-term investment invested in pooled funds. Notably the CCLA LAMIT property fund which is solely responsible for the 5.08% return on the £5m invested in Property Funds. This fund has been seen a much desired fund to be an investor of during the 2021-22 year, with many bidders offering to buy shares of other authorities.

The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in the table below.

Investment Benchmarking – Treasury investments managed in-house

On 10/03/2022, Arlingclose reviewed the Council's financial strength rating and North Norfolk District Council was promoted to Gold status from Silver, this puts the Council is the top 5% of authorities under Arlingclose for cash and investment management.

Debt	0.4
Interest	1.3
Income	0.1
Reserves	0.8
Budget	1.2
Financial Strength	Gold

Updated: 10/03/2022

Externally Managed Pooled Funds: £32m of the Authority's investments is invested in externally managed strategic pooled equity, property and bank funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds generated an average total return of £934,179.02 (90% of total investment income)

In the nine months to December improved market sentiment was reflected in equity, property and multi-asset fund valuations and, in turn, in the capital values of the Authority's property, equity and multi-asset income funds in the Authority's portfolio. The prospect of higher inflation and rising bond yields did however result in muted bond fund performance. In the January- March quarter the two dominant themes were tighter UK and US monetary policy and higher interest rates, and the military invasion of Ukraine by Russia in February, the latter triggering significant volatility and uncertainty in financial markets.

In light of Russia's invasion, Arlingclose contacted the fund managers of our MMF, cash plus and strategic funds and confirmed no direct exposure to Russian or Belarusian assets had been identified. Indirect exposures were immaterial. It should be noted that any assets held by banks and financial institutions (e.g. from loans to companies with links to those countries) within MMFs and other pooled funds cannot be identified easily or with any certainty as that level of granular detail is unlikely to be available to the fund managers or Arlingclose in the short-term, if at all.

Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's medium- to long-term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rates.

Non-Treasury Investments

The definition of investments in CIPFA's revised 2021 Treasury Management Code covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).

The Authority also held £2.999m of such investments in:

- Directly owned property £0.390m
- loans to housing associations £2.609m

A full list of the Authority's non-treasury investments is below:

- Grove Lane Depot, Holt, Norfolk – Valued at £0.390m
- Loan to Broadland Housing Association – Outstanding value of £2,423,080
- Loan to Homes for Wells – Outstanding value of £186,252

These investments generated £100,623.33 of investment income for the Authority after taking account of direct costs, representing a rate of return of 3.86%.

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 the table below.

Performance

	Actual £m	Budget £m	Over/ under	Actual %	Over/ under
Short-term Borrowing from other LAs	0.0077	0.01000	Under	0.36	Under
Long-term Borrowing	0.0000	0.1446	Under	N/A	Under
Total borrowing	0.0077	0.1546	Under	0.36	Under
Money Market Fund	0.0060	0.0003	Over	0.06	Over
Pooled Funds	0.9342	0.9293	Over	2.92	Over
Total treasury investments	0.9402	0.9296	Over	2.29	Over

Compliance

The Chief Finance Officer 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 the table below.

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

Debt Limits

	2021/22 Maximum £	31.3.22 Actual £	2021/22 Operational Boundary £	2021/22 Authorised Limit £	Complied? Yes/No
Borrowing	13.000m	13.000m	23.530m	28.400m	Yes
Total debt	13.000m	13.000m	23.530m	28.400m	Yes

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, and this is not counted as a compliance failure.

Investment Limits

	2021/22 Maximum	31.3.22 Actual	2021/22 Limit	Complied? Yes/No
Local authorities & other government entities	nil	nil	Unlimited	Yes
Secured investments	nil	nil	Unlimited	Yes
Banks (unsecured)	nil	nil	£5m	Yes
Building societies (unsecured)	nil	nil	£5m	Yes
Registered providers (unsecured)	nil	nil	£10m	Yes
Money market funds	£19.190	£10.770m	£20m	Yes
Strategic pooled funds	£32m	£32m	Unlimited	Yes
Real estate investment trusts	nil	nil	£10m	Yes
The UK Government	£26.3m	nil	Unlimited	Yes
Other investments	nil	nil	£5m	Yes
Any group of pooled funds under the same management	£7m	£7m	£15m	Yes
Negotiable instruments held in a broker's nominee account	nil	nil	£10m	Yes
Foreign countries	nil	nil	£6m	Yes

Treasury Management Indicators

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

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score 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. Unrated investments are assigned a score based on their perceived risk.

	31.3.22 Actual	2021/22 Target	Complied?
Portfolio average credit score	4.79	6.0	Yes

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.

	31.3.22 Actual	2021/22 Target	Complied?
Total sum borrowed in past 3 months without prior notice	£0m	£10m	Yes

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% <u>rise</u> in interest rates	£0.04m	£0.6m	Yes
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	£0.04m	£0.6m	Yes

The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at current rates.

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	100%	100%	0%	Yes
12 months and within 24 months	0%	100%	0%	Yes
24 months and within 5 years	0%	100%	0%	Yes
5 years and within 10 years	0%	100%	0%	Yes

10 years and above	0%	100%	0%	Yes
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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.

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:

	2021/22	2022/23	2023/24
Actual principal invested beyond year end	£32m	£32m	£32m
Limit on principal invested beyond year end	£50m	£50m	£50m
Complied?	Yes	Yes	Yes

Other

IFRS 16: The implementation of the new IFRS 16 Leases accounting standard has been delayed for a further year until 2022/23.

Prudential Indicators: The Prudential Indicators for 2021/22 will be reported to a future committee cycle once the end of year capital accounts have been completed.

3. Corporate Plan Objectives

3.1 This report contributes towards the overall financial performance of the Council

4. Medium Term Financial Strategy

4.1 The Councils Treasury Management supports the Medium Term Financial Strategy through protecting Council funds and cashflows and minimising borrowing costs.

5. Financial and Resource Implications

5.1 The report is financial in nature and implications are included within the content of the report

6. Legal Implications

6.1 This report must be prepared to ensure the Council complies with the CIPFA Treasury Management and Prudential Codes

7. Risks

7.1 Risks are included within the report content.

8. Sustainability

8.1 None as a direct result of this report.

9. Climate / Carbon impact

9.1 None as a direct result of this report.

10. Equality and Diversity

10.1 None as a direct result of this report.

11. Section 17 Crime and Disorder considerations

11.1 None as a direct result of this report

12. Conclusion and Recommendations

12.1 Treasury activities for the year have been carried out in accordance with the CIPFA Code and the Council's Treasury Strategy

12.2 That Council be asked to resolve that the Treasury Management Annual Report for 2021/22 is approved