THE VALE OF GLAMORGAN COUNCIL

CORPORATE PERFORMANCE AND RESOURCES SCRUTINY COMMITTEE: 22ND DECEMBER, 2021

REFERENCE FROM CABINET: 22ND NOVEMBER, 2021

“C735 TREASURY MANAGEMENT MID-YEAR REPORT 2021/22 (EL/PR) (SCRUTINY – CORPORATE PERFORMANCE AND RESOURCES) –

The Leader outlined the report, the purpose of which was to provide a mid-year report on the Authority's Treasury Management operations for the period 1st April 2021 to 30th September 2021. All activities were in accordance with the Authority's approved strategy on Treasury Management.

The report referred to the external influences on Treasury Management, such as COVID-19, pressure on prices on energy and fuel, issues with supply chains, inflation and others both at the UK and global levels.

In line with the Authority's existing borrowing strategy the revised estimate for new loans required to support the capital programme for 2021/22 was £11.805M (£3.429M supported).

It was likely that the sum required will now be internally borrowed during 2021/22, although with such a significant PWLB repayment profile and some large sums projected for HRA borrowing this position will need to be kept under review to help manage the Council's interest risk.

The Council invested with the Debt Management Deposit Facility, Local Authorities, Treasury Bills, Money Market Funds and Lloyds Instant Access Accounts in order to secure the best return.

The Authority was currently looking into the possibility of opening a notice account with Santander Bank PLC. This account benefited from a higher return provided the required period of notice was given prior to withdrawal.

The Authority proposed to extend the maturity period of loans to other Local Authorities from 365 days to 2 years. The maximum deposits per institution would be £5m and taking into account reserve projections it was proposed the maximum sum invested over 364 days will be restricted to £10m in total. In order to do this Cabinet and Full Council approval was requested in this report.

As the world emerged from the pandemic the report contained a review of the UK's and other leading nation's economies together with forecasts for interest rates.

The Authority must ensure that the Prudential Code was complied with, which had been developed and written by CIPFA as a professional code of practice. To demonstrate the Authority had fulfilled these objectives, the Code set out prudential indicators that should be implemented and the factors that must be taken into account. The Council fully complied with these prudential indicators during the first 6 months of 2021/22.

This was a matter for Executive and Council decision.

Cabinet, having considered the report and all the issues and implications contained therein

RESOLVED –

(1) T H A T the Treasury Management mid-year report for the period 1st April 2021 to 30th September 2021 be accepted.

(2) T H A T the latest Treasury Management indicators be agreed.

(3) T H A T the report be referred to the next Corporate Performance and Resources Scrutiny Committee for consideration.

(4) T H A T the changes to the investment limits be noted.

(5) T H A T the increase in the maximum maturity period for investments placed with other Local Authorities to 2 years with a maximum investment of £5M per institution and no more than £10M invested beyond 364 days be approved by Cabinet and Full Council.

(6) T H A T the report be referred to Full Council for approval.

<u>Reasons for decisions</u>

(1) To present the Treasury Management mid-year report as required by the CIPFA Treasury Management in the Public Services: Code of Practice.

(2) To present an update of the Treasury Management indicators which are included in the Treasury Management Strategy.

(3) To present this report to the Corporate Performance & Resources Scrutiny Committee.

(4) To ensure members are aware of current Treasury Management practices.

(5) To ensure members are aware of changes to the Treasury Management strategy.

(6) To comply with the Treasury Management Strategy."

Attached as Appendix – Report to Cabinet: 22nd November, 2021

APPENDIX

Meeting of:	**Cabinet**
Date of Meeting:	**Monday, 22 November 2021**
Relevant Scrutiny Committee:	Corporate Performance and Resources
Report Title:	Treasury Management Mid - Year Report 2021/22
Purpose of Report:	To provide a mid-year report on the Authority's Treasury Management operations for the period 1st April 2021 to 30th September 2021.
Report Owner:	Report of the Leader
Responsible Officer:	Carys Lord, Head of Finance / Section 151 Officer
Elected Member and Officer Consultation:	None
Policy Framework:	This report needs to be referred to Council for approval.

Executive Summary:

- This interim report provides an update on the Authority's Treasury Management operations for the period 1st April to 30th September 2021. All activities were in accordance with the Authority's approved strategy on Treasury Management.
- Total external borrowing as at the 30th September 2021 was £146.943M at an average rate of 4.639%. No new external borrowing was undertaken during the first 6 months of 2021/22.
- The Council invested with the Debt Management Deposit Facility, Local Authorities, Treasury Bills, Money Market Funds and Lloyds Instant Access Accounts. Total investments as at the 30th September 2021 stood at £74.720M at an average rate of 0.108%.
- As the world emerges from the pandemic this report contains a review of the UK's and other leading nation's economies together with forecasts for interest rates.
- The Authority must ensure that the Prudential Code is complied with, which has been developed and written by CIPFA as a professional code of practice. To demonstrate the Authority has fulfilled these objectives, the Code sets out prudential indicators that should be implemented and the factors that must be taken into account. The Council fully complied with these prudential indicators during the first 6 months of 2021/22.

- With current low and in some cases negative returns in the investment market the advice of the Council's independent Treasury Management advisor Link Treasury Services Limited remains unchanged therefore the Council is continuing to maximise internal borrowing where possible.
- External borrowing of £11M has been included in the estimates to cover loan maturities during 2021/22 and supported borrowing. However, a decision on whether to proceed will take into account reserve levels and capital spend projections, PWLB rate forward projections and cost of carry considerations. Advice will be sought from the Council's Treasury Management advisers.
- The Authority is in the process of opening a notice account with Santander Bank PLC.
- Approval is requested to extend the maximum maturity period for loans to other Local Authorities from 364 days to 2 years, investments will be limited to a maximum of £5m per institution and no more than £10m will be invested in total over 364 days.

Recommendations

1. That the Treasury Management mid-year report for the period 1st April 2021 to 30th September 2021 be considered.
2. That the latest Treasury Management indicators be considered.
3. That the report be forwarded to the next Corporate Performance & Resources Scrutiny Committee for consideration.
4. That the changes to the investment limits be noted.
5. That the increase in the maximum maturity period for investments placed with other Local Authorities to 2 years with a maximum investment of £5M per institution and no more than £10M invested beyond 364 days be approved by Cabinet and Full Council.
6. That the report be forwarded to Full Council for approval.

Reasons for Recommendations

1. To present the Treasury Management mid-year report as required by the CIPFA Treasury Management in the Public Services: Code of Practice.
2. To present an update of the Treasury Management indicators which are included in the Treasury Management Strategy.
3. To present this report to the Corporate Performance & Resources Scrutiny Committee.
4. To ensure members are aware of current Treasury Management practices.
5. To ensure members are aware of changes to the Treasury Management strategy.
6. To comply with the Treasury Management Strategy.

1. Background

Capital Strategy

1.1 In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities have been required to prepare a Capital Strategy which is to provide the following: -

- A high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services.
- An overview of how the associated risk is managed, and
- The implications for future financial sustainability.

1.2 The Council's Capital Strategy was approved by Council on 10th March 2021, min 471 refers.

1.3 The progress and revisions to the Capital Programme are reported as part of the regular capital monitoring reports to Cabinet and the Initial Capital Programme 2022/23 to 2026/27 report also included on this agenda.

Treasury Management

1.4 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in risk adverse counterparties, providing adequate liquidity initially before considering optimising investment return.

1.5 The second main function of the treasury management service is the funding of 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 operations. 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.

1.6 Accordingly, treasury management is defined as:

"The management of the local authority'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."

2. Key Issues for Consideration

2.1 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).

2.2 The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by the full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report, (stewardship report), covering activities during the previous year.

- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Corporate Resources & Performance Scrutiny Committee.

2.3 This mid-year report has been prepared in compliance with CIPFA's code of Practice on Treasury Management and covers the following:

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

Economic Updates

UK Economic Review

2.4 At its meeting on the 24th September 2021, the Monetary Policy Committee (MPC) voted unanimously to leave the Bank Rate unchanged at 0.10% and made no changes to its programme of Quantitative Easing (QE) purchases which are due to finish by the end of this year and total of £895bn.

2.5 The MPC's minutes at the September meeting revealed a major shift in tone from the previous meeting held in August. These had indicated that some tightening in monetary policy was now on the horizon but at the same time the MPC were prepared to look through a temporary spike in inflation as they did not want to stifle economic recovery by too early an increase in Bank Rate.

2.6 However, the minutes of the September meeting indicated there had been a marked increase in concern that more recent increases in prices, particularly the increases in gas and electricity, were likely to lead to faster and higher inflation expectations and underlying wage growth. These would in turn increase the risk that price pressures would prove more persistent next year than previously expected.

2.7 This suggests now that the MPC is willing to look through the flagging economic recovery during the summer to prioritise bringing inflation down next year.

2.8 This is a reversal of its priorities in August and a long way from words at earlier MPC meetings. In August, the MPC's focus was on getting through a winter of temporarily high energy prices and supply shortages, believing that inflation would return to just under the 2% target after reaching a high around 4% in late 2021. Now, its primary concern is that underlying price pressures in the economy are likely to get embedded over the next year and elevate future inflation to stay significantly above its 2% target and for longer.

2.9 Financial markets are now pricing in a first increase in Bank Rate from 0.10% to 0.25% in February 2022 but could be as early as December 2021.

2.10 However, this appears ambitious as the MPC has stated that it wants to see what happens to the economy, and particularly to employment now that the furlough scheme has ended. At the MPC's meeting in February 2022 it will only have available the employment figures for November 2021, but to get a clearer picture of employment trends, it would need to wait until the May 2022 meeting when it would have data up until February 2022. At its May meeting, it will also have a clearer understanding of the likely peak of inflation.

2.11 The MPC's forward guidance on its intended monetary policy regarding the raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows:

- Placing the focus on raising Bank Rate as "the active instrument in most circumstances''
- Raising Bank Rate to 0.50% before starting on reducing its holdings
- Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts
- Once Bank Rate had risen to at least 1%, it would start selling its holdings.

2.12 The rollout of the COVID 19 vaccines have enormously boosted confidence so that life in the UK could largely return to normal during the summer after a third wave of the virus threatened to overwhelm hospitals in the spring. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in hard hit sectors.

2.13 The big question is whether mutations of the virus could develop which render current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread.

USA Economic Review

2.12 In March 2021 a fiscal boost for the US economy of $1.9trn (equivalent to 8.8% of GDP) as a recovery package from the Covid pandemic was passed in addition to the $900 support package already passed in December 2020.

2.13 Financial markets were alarmed that all this stimulus, much bigger than in other western economies, was happening at a time in the US when:

- A fast vaccination programme had enabled a rapid opening up of the economy.
- The economy had already been growing strongly during 2021
- It started from a position of little spare capacity due to less severe lockdown measures than in many other countries.
- A combination of shortage of labour and supply bottle necks seemed likely to stoke inflationary pressures more in the US than in other countries.
- The Federal Government was still providing monetary stimulus through monthly QE purchases.

2.14 These factors could cause an excess of demand in the economy which could then unleash stronger and more sustained inflationary pressures in the US than in other western countries. This in turn could then force the Federal Government to take much earlier action to start tapering monthly QE purchases and/or increasing the Federal Bank rate from near zero despite their stated policy being to target average inflation.

2.15 Weak growth in August, (announced 3rd September 2021) has now spiked anticipation that tapering of monthly QE purchases could start by the end of 2021.

2.16 These purchases are currently acting as downward pressure on treasury yields and as the US financial markets are by far the biggest financial markets in the world, any trend upwards in the US will invariably impact and influence financial markets in other countries.

Eurozone Economic Review

2.17 The slow role out of vaccines in the Eurozone initially delayed economic recovery in early 2021 but the vaccination rate has picked up sharply since then.

2.18 After a contraction in Gross Domestic Product (GDP) of -0.3% in Quarter 1, Quarter 2 came in with strong growth of 2%, which is likely to continue into Quarter 3, though some countries more dependent on tourism may struggle.

2.19 Recent sharp increases in gas and electricity prices have increased overall inflationary pressures but the European Central Bank (ECB) is likely to see these as being only transitory after an initial burst through to around 4%, so is unlikely to be raising rates for a considerable time.

China Economic Review

2.20 After a concerted effort to get on top of the virus outbreak in Quarter1 2020 economic recovery was strong for the rest of the year enabling China to recover all the initial contraction of the economy.

2.21 During 2020, policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth. At the same time, China's economy benefited from the shift towards online spending by consumers in developed markets.

2.22 These factors helped to explain its comparative outperformance compared to western economies during 2020 and earlier in 2021. However, the pace of economic growth has now fallen back after this initial surge of recovery caused mainly by the resurgence of the pandemic and the questionable effectiveness of Chinese vaccines.

Japan Economic Review

2.23 In Japan 2021 has been patchy year in combating Covid, however, after a slow start, nearly 50% of the population are now vaccinated and Covid case numbers are falling.

2.24 After a weak Quarter 3 there is likely to be a strong recovery in Quarter 4. The Bank of Japan is continuing its very loose monetary policy but with little prospect of getting inflation back above 1% towards its target of 2%, any time soon. Inflation was negative in July 2021.

World Growth

2.25 World growth was in recession in 2020 but recovered during 2021 until starting to lose momentum more recently. Inflation has been rising due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022. It is likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products, and vice versa. This is likely to reduce world growth rates from those in prior decades.

2.26 The pandemic and extreme weather events have been highly disruptive to extended worldwide supply chains. At the current time there are major queues of ships unable to unload their goods at ports across the globe.

2.27 Such issues have led to misdistribution of shipping containers around the world and have contributed to a huge increase in the cost of shipping. Combined with a shortage of semi-conductors, these issues have had a disruptive impact on production in many countries.

2.28 Many western countries are also hitting up against a difficulty in filling job vacancies. It is expected that these issues will be gradually sorted out, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods on shelves.

Interest Rate Forecasts

2.29 The Council's Treasury Advisor, Link Asset Services, has provided the following forecasts on the 29th September 2021, Public Works Loan Board (PWLB) rates are certainty rates, gilt yields plus 80 basis points.

Link Group Interest Rate View	29.9.21									
	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.75
3 month ave earnings	0.10	0.10	0.20	0.20	0.30	0.40	0.50	0.50	0.60	0.70
6 month ave earnings	0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.60	0.70	0.80
12 month ave earnings	0.30	0.40	0.50	0.50	0.50	0.60	0.70	0.80	0.90	1.00
5 yr PWLB	1.40	1.40	1.50	1.50	1.60	1.60	1.60	1.70	1.70	1.70
10 yr PWLB	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10
25 yr PWLB	2.20	2.20	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.60
50 yr PWLB	2.00	2.00	2.10	2.20	2.20	2.20	2.20	2.30	2.30	2.40

Additional notes by Link on this forecast table: -

LIBOR and LIBID rates will cease from the end of 2021. Work is currently progressing to replace LIBOR with a rate based on SONIA (Sterling Overnight Index Average). In the meantime, our forecasts are based on expected average earnings by local authorities for 3 to 12 months.

Forecasts for average earnings are averages i.e., rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short term cash at any one point in time.

2.30 The coronavirus outbreak has done huge economic damage to the UK and economies around the world, as outlined above. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10% it has left Bank Rate unchanged at its subsequent meetings.

2.31 As shown in the forecast table above, one increase in Bank Rate from 0.10% to 0.25% has now been included in quarter 2 of 2022/23, a second increase to 0.50% in quarter 2 of 23/24 and a third one to 0.75% in quarter 4 of 2023/24.

Significant Risks to the Forecasts

2.32 There are a number of significant risks to the forecasts in the above table which are listed here.

- COVID vaccines do not work to combat new mutations and/or new vaccines take longer than anticipated to be developed for successful implementation.
- The pandemic causes major long-term scarring of the economy.
- The Government implements an austerity programme that supresses GDP growth.
- The MPC tightens monetary policy too early, either raising Bank Rate or unwinding QE.
- The MPC tightens monetary policy too late to ward off building inflationary pressures.
- The influence of the Major Stock Markets.
- Geo-political risks.

Forecasts for Bank Rate

2.33 Bank Rate is not expected to go up fast after the initial rate rise as the supply potential of the economy has not generally taken a major hit during the pandemic. This means it should be able to cope well with meeting demand without causing inflation to remain elevated in the medium-term. It should also not inhibit inflation from falling back towards the MPC's 2% target after the surge to around 4% towards the end of 2021.

2.34 In the current forecast there are three increases in Bank Rate expected in the period to March 2024, ending at 0.75%. However, these forecasts may well need changing within a relatively short time frame for the following reasons:

- There are increasing grounds for viewing the economic recovery as running out of steam during the summer and now into the autumn. This could lead into stagflation which would create a dilemma for the MPC as to which way to face.
- Some current key supply shortages e.g., petrol and diesel, may spill over into causing economic activity in some sectors to take a significant hit
- Rising gas and electricity prices in October and next April and some increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation. There is also the Government's October Spending Review which could also end up in reducing consumer spending power.

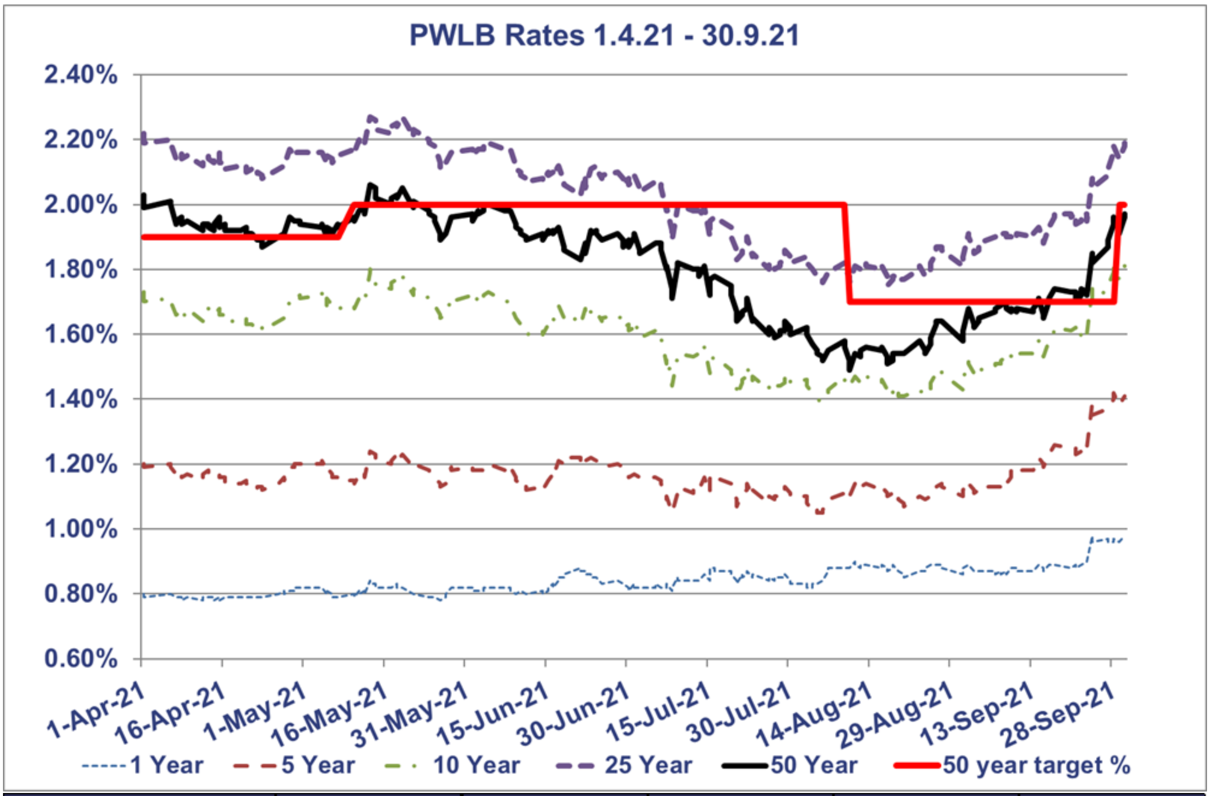
- On the other hand, consumers are sitting on around £200bn of excess savings left over from the pandemic so they may spend this sum, in part or in total
- 1.6 million people came off furlough at the end of September and it is not clear how many of those will be available to fill labour shortages in many sectors of the economy. So, supply shortages which have been driving up both wages and costs, could reduce significantly within the next six months or so and alleviate the MPC's current concerns.
- There is a risk that that there could be further impact on the Covid front on top of the flu season this winter, which could depress economic activity.

2.35 In summary, with the high level of uncertainty prevailing on several different fronts, it is likely that these forecasts will need to be revised again soon, in line with what future new data brings.

2.36 It also needs to be borne in mind that Bank Rate being cut to 0.10% was an emergency measure to deal with the Covid crisis hitting the UK in March 2020. At any time, the MPC could decide to simply take away that final emergency cut from 0.25% to 0.10% on the grounds of it no longer being warranted and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

Forecasts for PWLB Rates

2.37 The graph below details the movements in PWLB rates together with a table summarising the high, low, average and spread of rates over the period under review.



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.78%	1.05%	1.39%	1.75%	1.49%
Date	08/04/2021	08/07/2021	05/08/2021	17/08/2021	10/08/2021
High	0.98%	1.42%	1.81%	2.27%	2.06%
Date	24/09/2021	28/09/2021	28/09/2021	13/05/2021	13/05/2021
Average	0.84%	1.16%	1.60%	2.02%	1.81%
Spread	0.20%	0.37%	0.42%	0.52%	0.57%

2.38 As the interest forecast table for PWLB certainty rates at paragraph 2.29 shows, there is likely to be a steady rise over the forecast period, with some degree of uplift due to rising treasury yields in the US. There is likely to be exceptional volatility and unpredictability in respect of gilt yields and PWLB rates due to the following factors:

- How strongly will changes in gilt yields be correlated to changes in US treasury yields?
- Will the Federal Bank (FB) take action to counter increasing treasury yields if they rise beyond a yet unspecified level?
- Would the MPC act to counter increasing gilt yields if they rise beyond a yet unspecified level?
- How strong will inflationary pressures turn out to be in both the US and the UK and so impact treasury and gilt yields?

- How will central banks implement their new average or sustainable level inflation monetary policies?
- How well will central banks manage the withdrawal of QE purchases of their national bonds?
- Will exceptional volatility be focused on the short or long-end of the yield curve, or both?

2.39 The forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within our forecasting period, despite the major challenges that are looming up, and that there are no major disputes in international relations, especially between the US and China / North Korea and Iran, which have a major impact on international trade and world GDP growth.

2.40 One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the USA Federal Bank, the Bank of England and the European Central Bank, to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target to bear down on so as to stop it going above a target rate. There is now also a greater emphasis on other targets for monetary policy than just inflation.

2.41 For local authorities, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.

Treasury Management Strategy 2021/22

2.42 Council approved the 2021/22 Treasury Management Strategy Statement (TMSS) at its meeting on 10th March 2021 minute no 468.

2.43 The Authority's investment strategy is to secure the best return on its investments whilst having regard to capital security within the parameters laid down.

2.44 In line with the Authority's existing borrowing strategy the revised estimate for new loans required to support the capital programme for 2021/22 is £11.805M (£3.429M supported). This sum will fluctuate dependent on the delivery and financing of the capital programme key schemes that will impact the level of borrowing in 2021/22. These are the Housing Revenue Account (HRA) business plan, 21st Century Schools, vehicle purchases and City Deal. The net increase in the capital financing requirement after adjusting for Minimum Revenue Provision is £6.231M as set out in the table at paragraph 2.60 below.

2.45 Given the current and projected level of Council reserves, the current low interest environment with some counterparties offering negative interest rates and the potential risks associated with Brexit, it is likely that the sum required will now be internally borrowed during 2021/22, although with such a significant PWLB repayment profile and some large sums projected for HRA borrowing this position will need to be kept under review to help manage the Council's interest risk.

2.46 The effect of coronavirus on the capital programme objectives are being assessed, therefore, the Authority's borrowing strategy will be reviewed and then revised in order to achieve optimum value and risk exposure in the long-term.

2.47 Council officers in conjunction with the treasury advisors continually monitor the prevailing interest rates and the market forecasts and adopt a pragmatic approach to changing circumstances in respect of its borrowing needs.

2.48 The Head of Finance (Section 151 Officer) is pleased to report that all Treasury Management activity undertaken during the period complied with the approved strategy, the CIPFA Code of Practice and the relevant legislative provisions.

2.49 Throughout the period under review the Authority has continued to use the broader range of investment tools placing investments with other Local Authorities, the Debt Management Office (DMO), Treasury Bills, Money Market Funds (MMFs) and instant access accounts with Lloyds Bank PLC.

2.50 The Authority is currently looking into the possibility of opening a notice account with Santander Bank PLC. This account benefits from a higher return provided the required period of notice is given prior to withdrawal. The period of notice can be set at 35 days, 90 days, 180 days or 365 days or a mixture. The longer the period of notice the better the return.

2.51 The Authority is proposing to extend the maturity period of loans to other Local Authorities from 365 days to 2 years. The maximum deposits per institution would be £5m and taking into account reserve projections it is proposed the maximum sum invested over 364 days will be restricted to £10m in total. In order to do this Cabinet and Full Council approval is requested in this report.

2.52 As at 30th September 2021 there were no policy changes to the Treasury Management Strategy Statement (TMSS.) The details in this report update the position in the light of the updated economic position and budgetary changes which were already approved.

2.53 The introduction of the IFRS16 Leasing has been further delayed due to the pandemic and will now be introduced in April 2022. Therefore, the 2021/22 prudential indicators do not need to be revised for the additional financial liabilities brought onto the Council's balance sheet as previously reported. These will now form part of the 2022/23 Treasury Management and

Investment Strategy and will be reported to Cabinet and Council early next year. Work is still ongoing to establish values for the lease liabilities in accordance with the standard and to agree an acceptable low value lease policy with Audit Wales in accordance with the standard. Whilst it is not expected that the introduction of this standard will impact the bottom line of the Council's balance sheet the standard will attempt to quantify the additional debt that the Council commits to when it enters into leasing agreements which is set against a controllable asset for the period.

2.54 A more detailed report concerning the introduction of IFR16 was presented to the Governance and Audit Committee on 23rd September 2021 (Min 399) to outline the Council's approach to implementing the standard. An assessment of the likely impact and implications will be reported to the Governance and Audit Committee early in 2022 alongside the Treasury Management Strategy for 2022/23.

The Authority's Capital Position (Prudential Indicators)

2.55 This part of the report is structured to update**:**

- The Authority's capital expenditure plans**.**
- How these plans are being financed.
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow.
- Compliance with the limits in place for borrowing activity**.**

2.56 It is a statutory duty for the Authority to determine and keep under review the affordable borrowing limits. During the half year ended 30th September 2021, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2021/22. The Head of Finance (Section 151 Officer), reports that no difficulties are envisaged for the current or future years in complying with these indicators.

2.57 This table shows a comparison of the original capital programme as agreed by Authority on the 10th March 2021 with the revised capital budget as proposed in a report elsewhere on this agenda.

Capital Expenditure by Service	2021/22 Original Estimate £m	2021/22 Revised Estimate £m
Learning & Skills	51.942	38.194
Social Services	0.100	1.799
Neighbourhood & Transport	11.846	22.214
Managing Director & Resources	4.662	10.513
City Deal	2.240	0.092
Housing Revenue Account	36.754	31.444
Total Capital Expenditure	**107.544**	**104.256**

Changes to the Financing of the Capital Programme

2.58 The table below shows the main sources of funding for the capital expenditure plans shown above, highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

2.59 It can be noted that the level of borrowing in 2021/22 has reduced significantly from the original estimate, this is partly due to some slippage on the capital programme but also due to increased use of reserves and revenue contributions to deliver the capital programme.

Sources of Capital Financing	2021/22 Original Estimate £m	2021/22 Revised Estimate £m
Total Capital Expenditure	107.544	104.256
Financed by:		
GCF Grant	3.438	3.438
General Fund Reserves & Revenue	14.507	20.718
HRA Reserves & Revenue	6.392	19.086
S106	13.177	6.758
Welsh Government Grants	25.912	34.474
Capital Receipts (General & HRA) and Appropriations	8.570	7.977
Total Financing	71.996	92.451
Prudential Borrowing Requirement	**32.119**	**8.376**
Supported Borrowing Requirement	**3.429**	**3.429**

Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary

2.60 The table below shows the CFR, which is the underlying external need for the Council to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary. The Authority has revised the Capital Financing Requirement estimate for 2021/22 downwards which primarily reflects a decrease in the estimated borrowing for the Housing Revenue Account (HRA).

	2021/22 Original Estimate £m	**2021/22 Revised Estimate £m**
Prudential Indicator – the Capital Financing Requirement		
CFR – Non Housing	126.943	119.339
CFR – HRA	104.078	85.678
Total CFR	231.021	205.017
Borrowing Requirement		11.805
Less Minimum Revenue Provision		(5.574)
Net movement in CFR		**6.231**
Prudential Indicator – the Operational Boundary for External Debt		
Borrowing	239.140	222.552
Other Long Term Liabilities	0	0
Total Debt (Year End Position)	**239.140**	**222.552**

Borrowing Activity

2.61 A key control over the treasury activity is 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. In line with CIPFA guidance the Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds. The figure shown below reflects the Council's current strategy as outlined in paragraph 2.44 of this report in respect of maximising internal borrowing. This will be kept under review in consultation with the Council's Treasury Management advisers.

	2021/22 Original Estimate £m	2021/22 Revised Estimate £m
External Net Borrowing	198.382	155.610
Other Long Term Liabilities	0	0
Total Debt	198.382	155.610
CFR (Year End Position)	**231.021**	**205.017**

2.62 No difficulties are envisaged for the current or future years in complying with this prudential indicator.

The Authorised Limit

2.63 The Authorised Limit represents that limit beyond which borrowing is prohibited, and this needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt	2021/22 Original Indicator £m	2021/22 Revised Indicator £m
Borrowing	251.843	232.750
Other long term liabilities	0	0
Total	**251.843**	**232.750**

Interest Rate Exposure

2.64 This indicator is set to control the Authority's exposure to interest rate risk. The exposures to fixed and variable rate interest rates, expressed as an amount of net principal borrowed as at 30th September 2021 were:

	Limit (£m)	Actual (£m)	Met
Upper limit on fixed rate exposures	146.943	140.843	✓
Upper limit on variable rate exposures	0	0	✓

2.65 If the Council proceed with the £11M external borrowing referenced in this report then the estimated fixed rate interest exposure limits at the 31st March 2022 are set out in the table below. Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that either mature during the financial year or have a floating interest rate are classed as variable rate.

	Limit (£m)	Actual (£m)	Met
Upper limit on fixed rate exposures	155.610	151.510	✓
Upper limit on variable rate exposures	0	0	✓

Maturity Structure of Borrowing

2.66 This indicator is set to control the Authority's exposure to refinancing risk. The maturity date of borrowing is the earliest date on which the lender can demand repayment. The maturity structure of fixed rate borrowing as at 30th September 2021 was:

	Upper Limit	**Lower Limit**	**Actual**	**Met**
Under 12 months	20%	0%	1.51%	✓
12 months and within 24 months	20%	0%	5.58%	✓
24 months and within five years	30%	0%	15.57%	✓
Five years and within 10 years	40%	0%	16.46%	✓
10 years and above	100%	0%	60.89%	✓

Investments

2.67 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity and to obtain an appropriate level of return which is consistent with the Council's risk appetite.

2.68 The Authority has made the following investments for the period 1st April 2021 to 30th September 2021 as set out below:-

Investment Counterparty	Opening Balance	Invested	Returned	Closing Balance
	01/04/2021			**30/09/2021**
	£m	**£m**	**£m**	**£m**
UK Local Authorities	68.750	50.500	(71.250)	48.000
Debt Management Office	0.000	129.300	(129.300)	0.000
Treasury Bills	0.000	4.000	0	4.000
Lloyds Deposit Accounts	4.760	35.750	(35.340)	5.170
Money Market Funds (MMF)	18.650	23.300	(24.400)	17.550
Total	**92.160**	**242.850**	**(260.290)**	**74.720**

2.69 Interest, at an average rate of 0.108% and amounting to £209,538 including interest accrued has been received from these investments during the first 6 months of 2021/22.

2.70 Throughout the period under review the Authority placed investments in the broader mix of investment tools as detailed above.

2.71 This strategy is considered prudent considering the continuing pressures in the financial markets, the negative rates on offer from various counterparties, the threat of bail in for fixed term investments with banks and the remaining uncertainty with Brexit. The Head of Finance (Section 151 Officer) will continue to have regard to the security and liquidity of the investments before seeking the highest rate of return or yield.

Borrowing

2.72 The Council's estimated revised CFR for 2021/22 is £205.017M. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing).

2.73 During 2021 PWLB introduced revised guidance that prevented Local Authorities borrowing for commercial purposes. The guidance set out a number of permitted purposes these were primarily for Service Capital Investment, Economic Regeneration and Debt Refinancing.

2.74 The following table sets out the monies externally borrowed / repaid during the period.

Loan Type	Opening Balance	Received	Repaid	Closing Balance
	01/04/2021			**30/09/2021**
	£m	**£m**	**£m**	**£m**
PWLB	144.417	0	(5.792)	138.625
LOBO	6.000	0	0	6.000
Salix Loans	1.168	0	0	1.168
Temporary Loans	0.100	0	0	0.100
WG Loans	1.050	0	0	1.050
Total	**152.735**	**0**	**(5.792)**	**146.943**

- Loans borrowed from the PWLB are intended to assist local authorities in meeting their longer-term borrowing requirements. The above PWLB loans are all at fixed rates of interest. The rate paid on each loan is largely dependent upon the original duration of the loan and date taken out. The loans taken out for the Housing Revenue Account Subsidy buyout were at a predetermined range of rates specified by HM Treasury. The Council has a significant repayment schedule over the next five years that will see the Council repay some historic debt at high interest rates with the opportunity to refinance at the current lower PWLB rates taking into account cost of carry considerations.
- Other longer-term loans represent those non-PWLB loans that are repayable at least 1 year or more from the date they are advanced. This debt is represented by two LOBO loans of £2M and £4M. The £2M LOBO is due for repayment during 2021/22.
- Two loans are included for Salix for £1,134K and £34K respectively which have been borrowed for energy management schemes primarily Street Lighting.
- Temporary loans represent those loans that are borrowed for a period of less than 1 year. They are borrowed on a 7 day notice arrangement.
- Welsh Government (WG) Loan is made up of two interest free loans provided by WG, a concessionary loan for £500K and a Town Centre Loan for £550K.

2.75 External interest at an average rate of 4.639% and amounting to £3,394,603.97 has been paid on these loans during the first 6 months of 2021/22.

2.76 With current low and in some cases negative returns in the investment market the advice of the Council's independent Treasury Management advisor Link Treasury Services Limited remains unchanged although the Council has been advised to keep the approach under regular review in the context of PWLB rates at a historic low therefore, the Council is currently continuing to maximise internal borrowing where possible. The Section 151 Officer will continue to liaise with Link Asset Management and will keep the position in respect of the Council's borrowing strategy and potential PWLB borrowing under review.

2.77 As stated in the table at 2.74 the Authority has repaid £5.792m of maturing PWLB loans and is due to repay another long -term loan of £2.000m in November 2021. Depending on the progress of the capital programme and the drawdown of reserves, £11.000M has been included in the projections for external borrowing for the remainder of 2021/22 to refinance these maturities and finance supported borrowing of £3.429M. These funds will only be borrowed externally if it represents value for money taking into account low investment returns and cost of carry or is considered prudent to mitigate the interest rate risk the Council is exposed to given the significant amount of borrowing and repayment in the period to 2025.

2.78 As at the 31st March 2021 the Authority internally borrowed £46.051M to finance the capital programme. If the Authority continues this approach it is estimated that this amount could increase by a further £15.853M during 2021/22 based on the current borrowing requirement and if the refinancing of matured debt and financing of supported borrowing is not undertaken. This position will be kept under review by the Section 151 Officer, and advice sought from Link as required. The Council needs to keep this approach under review in the context surety of borrowing and use of reserves to ensure internal borrowing does not exceed a prudent proportion of reserves and core cash in maintained for operational purposes. An update shall be included in the Treasury Management and Investment Strategy 2022/23.

2.79 Internal borrowing, borrowing that is not supported by a revenue stream is charged using the Sterling Overnight Interest Average rate (SONIA). The average rate calculated to the 30th September 2021 is 0.0498%.

2.80 SONIA rates were introduced in the March 1997 and was reformed by the Bank of England in 2018 to provide a benchmark that complies with the international best practice. The use of London Interbank Bid Rate (LIBID) will continue in the financial markets until it is phased out in 2021. However, Link Group Market Services, the Councils Treasury Management Advisors have stated that they would expect that most investors may well use the Term SONIA rates as their investment benchmarks, as these would reflect their own circumstances (cash flow, liquidity requirements, their own interest rate outlook etc.) as well as market expectations of policy rates as at the point of investment.

2.81 Internal Borrowing currently represents a far cheaper alternative to borrowing externally for the Council and is affordable given the current and projected level of reserves. The estimated total interest to be charged to revenue for internal borrowing for pooled loans assuming the £11.000M external borrowing is undertaken in 2021/22 is £18,725.

2.82 When pooling the interest charges for external and internal borrowing, the average rate charged to the Council to deliver the capital programme is estimated to be 3.56%.

2.83 In addition, the Council has previously internally borrowed for the Local Government Borrowing Initiative (LGBI) for 21st Century Schools, Affordable Housing & Highways initiatives. The interest to be charged for this element of the internal borrowing for 2021/22 is £355,686.

Debt Rescheduling

2.84 Debt rescheduling opportunities have been very limited in the current economic climate. No debt rescheduling has therefore been undertaken to date in the current financial year.

Changes in Risk Appetite

2.85 The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy should be brought to members' attention in treasury management update reports.

Non Treasury Service Investment Strategy

2.86 On this agenda there is a proposal in respect of a new Non Treasury Service Investment Strategy to support Recovery and Regeneration through Economic Development schemes and development of Green Infrastructure. Under the proposals up to £2.2M of earmarked reserves and £10M of PWLB borrowing could be utilised. These schemes are expected to recover the cost of financing any borrowing, however, they would increase the Council's Capital Financing Requirement, External Borrowing and Minimum Revenue Provision requirements. Should the proposals be approved and progressed the projected commitments as part of this scheme would be reflected in the Councils Treasury Management Strategy. A specialist investment Committee would be set up to ensure sufficient oversight and scrutiny of any proposals.

Treasury Bills

2.87 The Authority has placed one deposit with the UK Government in Treasury Bills. For the majority of the period under review returns have not been favourable and have even gone negative.

Money Market Funds

2.88 The 2018 No.325 (W.61) Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2018 introduced changes to accounting practice for Money Market Funds (MMFs) and they are no longer treated as capital expenditure.

2.89 The Authority uses this investment tool regularly and has accounts with CCLA & Federated Hermes. Federated has made a commitment to keep the rate it is paying on MMF deposits positive (even if the fund is paying a negative return) by waiving fees, whilst the Bank of England's rate remains positive. The CCLA rate has been consistently positive throughout the period.

2.90 Both funds are domiciled in the UK and their funds rated 'AAAmmf' (highest credit quality) by the Fitch credit rating agency. Funds to a maximum of £10m may be invested in each fund in accordance with the Council's revised counterparty limits.

Lloyds Deposit Accounts

2.91 The Authority opened two interest earning deposit accounts with Lloyds Bank in October 2020. The accounts are low yield but have the advantage of having instant access to the funds deposited. This has proved invaluable as cash flow forecasting has been problematic during the pandemic where revenue streams and outgoings have not been easily identifiable.

2.92 As part of the agreement with Lloyds Bank, the Council is asked on an annual basis to sign a set off agreement which includes accounts that are included in our overdraft agreement. The agreement gives the bank the right at any time and without notice to combine or consolidate all of these accounts with any of our liabilities and set off or transfer any credit balance towards setting off a liability.

2.93 The accounts covered by this agreement are managed on a day to day basis by the Council so that the total balance of these accounts remains positive. However, the Council does have a £2m overdraft facility so therefore this agreement currently has no impact on the Council's financial position. This does not include any stewardship accounts held on behalf of Social Services clients.

Non Treasury Investment

Big Fresh Catering Company

2.94 On 1st January 2020, the Council set up a Local Authority Trading Company to deliver Catering Services called Big Fresh Catering Company. The Council owns 100% of the company shares. Profits from the venture will be given to local schools or reinvested back into the business. In accordance with WG Guidance this will be classified as a Non Treasury Investment.

Service Investment Strategy

2.95 Work is currently underway to develop a new Non Treasury Service Investment Strategy to support Recovery and Regeneration through Economic Development schemes and development of Green Infrastructure. Under the proposals up works could be funded via the use of earmarked reserves and PWLB borrowing could be utilised. These schemes are expected to recover the cost of financing any borrowing, however, they would increase the Council's Capital Financing Requirement, External Borrowing and Minimum Revenue Provision requirements. Should the proposals be approved and progressed the projected commitments as part of this scheme would be reflected in the Councils Treasury Management Strategy. A specialist investment Committee would be set up to ensure sufficient oversight and scrutiny of any proposals.

3. How do proposals evidence the Five Ways of Working and contribute to our Well-being Objectives?

3.1 The Treasury Management and Investment Strategy ensures that the financial plans of the Council are sustainable into the future and do not adversely impact on future generations.

3.2 The Treasury Management and Investment Strategy underpins the financial management of the Council and its ability to achieve its Well Being objectives as set out in the Corporate Plan.

4. Resources and Legal Considerations

Financial

4.1 Money is borrowed for capital purposes and interest is charged to revenue accounts

Employment

4.2 There are no direct employment issues relating to this report.

Legal (Including Equalities)

4.3 Compliance with the Local Government Act 2003 and CIFPA'S "Code of Practice for Treasury Management in the Public Services" is mandatory.

5. Background Papers

CIPFA's "Code of Practice for Treasury Management in the Public Service" (2017 Edition), "The Prudential Code" (2017 Edition) and WG guidance on local authority investments.