North Devon Council

Report Date: 4th July 2022

Topic: Annual Treasury Management Report 2021/22

Report by: Director of Resources and Deputy Chief Executive

1. INTRODUCTION

   1.1. The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

2. RECOMMENDATIONS

   2.1 The Committee is asked to recommend to full Council that:

   - The annual treasury management report for 2021/22 be noted;
   - The actual 2021/22 prudential and treasury indicators be approved.

3. REASONS FOR RECOMMENDATIONS

   3.1 This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2021/22. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

   3.2 During 2021/22 the minimum reporting requirements were that the full Council should receive the following reports:

   - an annual treasury strategy in advance of the year (Council 24/02/2021)
   - a mid year treasury update report (Council 24/11/2021)
   - an annual review following the end of the year describing the activity compared to the strategy (this report)

   3.3 This Council confirms that it has complied with the requirements under the Code to give prior scrutiny to all the above treasury management reports by the Policy Development Committee before they were reported to the full Council.

4. REPORT

4.1 The Council's Capital Expenditure and Financing

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

£000	31 March 2021 Actual	2021/22 Estimate	31 March 2022 Actual
Capital expenditure	**6,171**	**29,029**	**21,754**
Financed in year	(5,786)	(9,462)	(5,023)
Unfinanced capital expenditure	**385**	**19,567**	**16,731**

- *Estimate from the Mid-Year Treasury Management Report*

4.2 The Council's Overall Borrowing Need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the Council's unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Reducing the CFR – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the borrowing need.

The Council's MRP policy, (as required by DLUHC guidance), was approved as part of the Treasury Management Strategy Report for 2021/22.

The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes leasing schemes on the balance sheet, which increases the Council's borrowing need. No borrowing it actually required against these schemes as a borrowing facility is included in the contract.

CFR £000	31 March 2021 Actual	31 March 2021 Estimate	31 March 2022 Actual
Opening balance	4,746	4,591	4,591
Add unfinanced capital expenditure (as above)	385	19,567	16,731
Add finance leases			891
Less MRP	(540)	(514)	(514)
Closing balance	4,591	23,644	21,699

A finance lease scheme was introduced during 2021/22 for our vehicle fleet. Previously these costs would have been included in the capital expenditure, but these have now been shown separately as above.

A large capital programme during 2021/22 including the new Leisure Centre, Watersports Centre and purchase of Green Lanes Shopping Centre has resulted in an increased CFR of circa £17m. The CFR was below the estimate due to slippages in the wider capital programme, with this spend re-profiled into 2022/23.

Borrowing activity is constrained by prudential indicators for gross borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2021/22) plus the estimates of any additional capital financing requirement for the current (2022/23) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

£000	31 March 2021 Actual	2021/22 Estimate	31 March 2022 Actual
Gross borrowing position	500	17,500	3,891
Total CFR	**4,591**	**23,644**	**21,699**
Over / (under) funding of CFR	(4,091)	(6,144)	(17,808)

- *Estimate from the Mid-Year Treasury Management Report*

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2021/22 the Council has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream.

	2021/22 £
Authorised limit	*37.5m
Maximum gross borrowing position during the year	3.89m
Operational boundary	17.5m
Average gross borrowing position	1.3m
Financing costs as a proportion of net revenue stream	3.91%

* The Extraordinary Council meeting held on 14th June 2021 approved the increase in the authorised borrowing limit to £37.5m as part of the report detailing the purchase of Green Lanes.

4.3 Treasury Position as at 31st March 2022

At the beginning and the end of 2021/22 the Council's treasury position, excluding borrowing by finance leases, was as follows:

DEBT PORTFOLIO **£000**	31 March 2021 Principal	Rate/ Return	31 March 2022 Principal	Rate/ Return
Total debt (PWLB)	500	1.56%	3,000	1.66%
CFR	4,591		20,808	
Over / (under) borrowing	(4,091)		(17,808)	
Total investments	23,844	0.16%	19,402	0.05%
Net debt/(investments)	(23,344)		(16,402)	

On 30th March 2022 we received £5.8m from Central Government for the Council Tax Energy Rebate scheme to be paid out during 2022/23. At year end we also had a balance of £5.2m in relation in relation to Covid-19 business grants and circa £2.5m in relation to Omicron business grant payments to be repaid to central government during 2022/23 once the final reconciliations have been carried out.

The cash balances and reserves have supported a large under borrowing position which is considered further in the borrowing strategy below.

The maturity structure of the debt portfolio was as follows:

	31 March 2021 actual	2021/22 Estimate limits	31 March 2022 actual
Under 12 months	£0m	60%	£0m
12 months and within 24 months	£0m	60%	£0m
24 months and within 5 years	£0m	100%	£0.50m (16.67%)
5 years and within 10 years	£0.50m (100%)	100%	£0m
10 years and above	£0m	95%	£2.50m (83.33%)

All investments were for maturities less than one year

INVESTMENT PORTFOLIO **£000**	31 March 2021 Actual	31 March 2022 Actual
Treasury investments		
Banks	22,780	18,260
TOTAL TREASURY INVESTMENTS	**22,780**	**18,260**

During 2021/22, the Council made no material non-treasury investments in property with the sole purpose of generating an income stream.

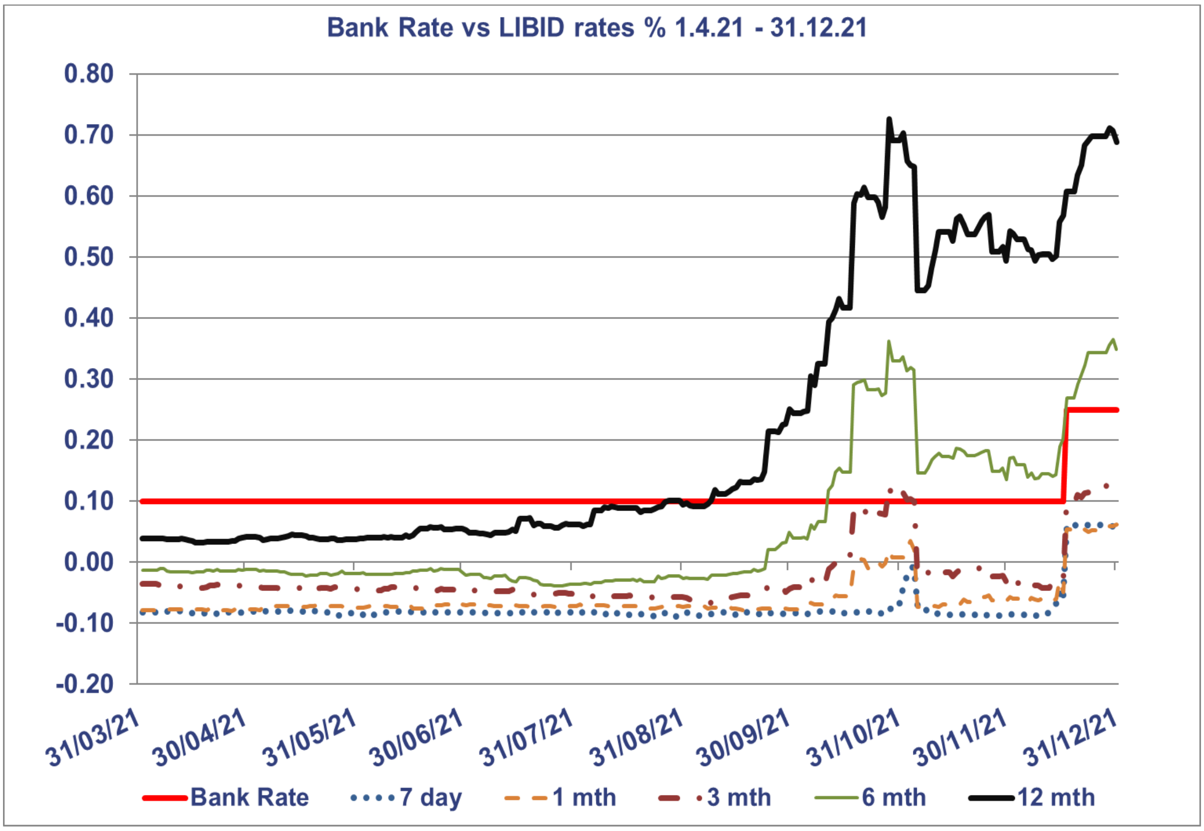
4.4 The Strategy for 2021/22

Investment strategy and control of interest rate risk - Investment returns remained close to zero for much of 2021/22. Most local authority lending managed to avoid negative rates. The expectation for interest rates within the treasury management strategy for 2021/22 was that Bank Rate would remain at 0.1% until it was clear to the Bank of England that the emergency level of rates introduced at the start of the Covid-19 pandemic were no longer necessitated.

The Bank of England and the Government also maintained various monetary and fiscal measures, supplying the banking system and the economy with massive amounts of cheap credit so that banks could help cash-starved businesses to survive the various lockdowns/negative impact on their cash flow. The Government also supplied huge amounts of finance to local authorities to pass on to businesses. This meant that for most of the year there was much more liquidity in financial markets than there was demand to borrow, with the consequent effect that investment earnings rates remained low until towards the turn of the year when inflation concerns indicated central banks, not just the Bank of England, would need to lift interest rates to combat the second-round effects of growing levels of inflation (CPI was 6.2% in February).

While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates as illustrated in the charts shown below. Such an approach has also provided benefits in terms of reducing counterparty risk exposure, by having fewer investments placed in the financial markets.



Borrowing strategy and control of interest rate risk - During 2021-22, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council’s reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

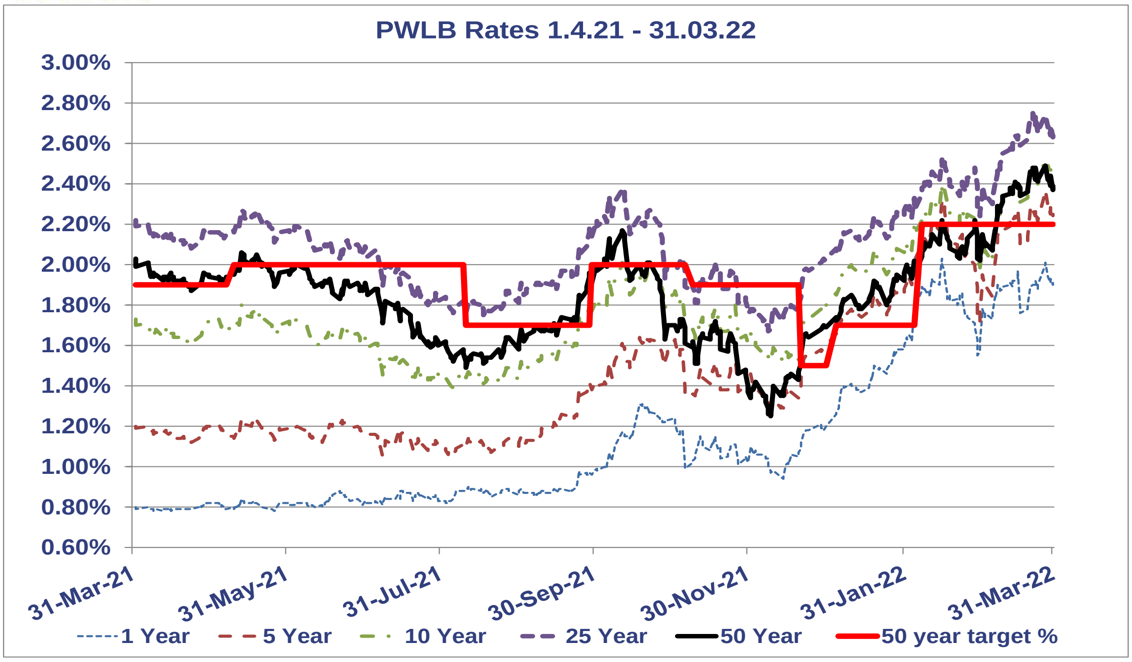
The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Section 151 Officer therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks

- if it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

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

Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2021/22 and the two subsequent financial years until the turn of the year, when inflation concerns increased significantly. Internal, variable, or short-term rates, were expected to be the cheaper form of borrowing until well in to the second half of 21/22.



HIGH/LOW/AVERAGE PWLB RATES FOR 2021/22

	1 Year	5 Year	10 Year	25 Year	50 Year
01/04/2021	0.80%	1.20%	1.73%	2.22%	2.03%
31/03/2022	1.91%	2.25%	2.43%	2.64%	2.39%
Low	0.78%	1.05%	1.39%	1.67%	1.25%
Low date	08/04/2021	08/07/2021	05/08/2021	08/12/2021	09/12/2021
High	2.03%	2.37%	2.52%	2.75%	2.49%
High date	15/02/2022	28/03/2022	28/03/2022	23/03/2022	28/03/2022
Average	1.13%	1.45%	1.78%	2.10%	1.85%
Spread	1.25%	1.32%	1.13%	1.08%	1.24%

PWLB rates are based on gilt (UK Government bonds) yields through H.M.Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields. Regarding PWLB borrowing rates, the various margins attributed to their pricing are as follows: -

- **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)

There is likely to be a further rise in short dated gilt yields and PWLB rates over the next three years as Bank Rate is forecast to rise from 0.75% in March 2022 to 1.25% later this year, with upside risk likely if the economy proves resilient in the light of the cost-of-living squeeze. Medium to long dated yields are driven primarily by inflation concerns but the Bank of England is also embarking on a process of Quantitative Tightening when Bank Rate hits 1%, whereby the Bank's £895bn stock of gilt and corporate bonds will be sold back into the market over several years. The impact this policy will have on the market pricing of gilts, while issuance is markedly increasing, is an unknown at the time of writing.

4.5 Borrowing Outturn

At 31st March 2022, the CFR, excluding finance leases, was £20.8m. External borrowing was only £3m as our cash flow and reserve balances enabled us to internally borrow the remaining £17.8m.

£2.5m of new long term PWLB borrowing was added in February 2022, to secure the rate and provide some long term budget certainty, prior to potential further increases in bank rate. This was also at a time when rates temporarily reduced due to uncertainties around the conflicts in Russia and Ukraine.

The loans drawn during February 2022 were:

Lender	Principal	Type	Interest Rate	Maturity
PWLB	£0.75m	Fixed interest rate	2.19%	40 years
PWLB	£0.75m	Fixed interest rate	2.13%	45 years
PWLB	£1m	Fixed interest rate	2.08%	50 years

The 2021/22 budget for external borrowing interest was £109,000 but the actual interest paid was a much lower £12,251.

The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

No debt rescheduling was done during the year as it was not a viable option.

4.6 Investment Outturn

Investment Policy – the Council's investment policy is governed by DLUHC investment guidance, which was implemented in the annual investment strategy approved by the Council in February 2021. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

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

Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

Balance Sheet Resources (£000)	31 March 2021	31 March 2022
General Fund Balance	1,211	1,211
Earmarked reserves	7,715	9,977
Provisions	725	688
Usable capital receipts/grants	2,436	2,322
Total	**12,087**	**14,198**

Investments held by the Council - the Council maintained an average balance of circa £38m of internally managed funds. The internally managed funds earned £17,859 interest at an average rate of return of 0.05%. The comparable performance indicator is the average 7-day LIBID rate, which was -0.07%. Please note the LIBID rate stopped from 31st December 2021. On-going our performance will be compared to the 7 day backward looking SONIA (Sterling Overnight Index Average) uncompounded rate which was 0.1355% for the year. This compares with a budget assumption of £35,000 investment interest.

5. RESOURCE IMPLICATIONS
   5.1. As detailed in the report

6. EQUALITIES ASSESSMENT
   6.1. There are not any equalities implications anticipated as a result of this report, as the purpose of the report is to present the Council's financial position only.

7. CONSTITUTIONAL CONTEXT
   7.1. Part 3 Annexe 1, Para 1(c) - delegated power
   7.2. Article 4.5.26 and Part 4 (Financial Procedure Rules) para 13.8 -referred power.

8. STATEMENT OF CONFIDENTIALITY
   8.1. This report contains no confidential information or exempt information under the provisions of Schedule 12A of 1972 Act.

9. STATEMENT OF INTERNAL ADVICE
   9.1 The author (below) confirms that advice has been taken from all appropriate Councillors and Officers

Jon Triggs, Director of Resources and Deputy Chief Executive