

## APPENDIX 1

### TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2021/22

#### 1. INTRODUCTION AND BACKGROUND

The Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management 2009 was adopted by this Council in February 2010 and this Council fully complies with its requirements. The Code was revised in 2011 and further revised in 2017.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the Council of an annual treasury management strategy report (including the annual investment strategy report) for the year ahead, a mid year review and an annual review report of the previous year.
4. 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, which in this Council is the Chief Officer Resources.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specified named body which in this Council is the Corporate Overview Scrutiny Committee.

Treasury management in this context is defined as:

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

The purpose of this report is to meet one of the above requirements of the CIPFA Code, namely the mid-year review report of treasury management activities, for the financial year 2021/22.

#### 2. THIS TREASURY MANAGEMENT MID YEAR REVIEW REPORT COVERS

- ❖ Economic Background during the period
- ❖ Interest Rate Forecast
- ❖ Treasury Advisors
- ❖ The Council's treasury position as at 30 September 2021;
- ❖ Borrowing and investment rates for the first half of 2021/22;
- ❖ Mid-year review of the borrowing strategy 2021/22;
- ❖ Borrowing outturn for the first half of 2021/22;
- ❖ Debt rescheduling for the first half of 2021/22;

## APPENDIX 1

### TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2021/22

- ❖ Compliance with treasury limits and Prudential Indicators for the first half of 2021/22;
- ❖ Mid-year review of the investment strategy for 2021/22;
- ❖ Investment outturn for the first half of 2021/22;
- ❖ Other treasury management issues.

### 3. ECONOMIC BACKGROUND DURING PERIOD

The Monetary Policy Committee (MPC) voted unanimously to leave Bank Rate unchanged at 0.10% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn; two MPC members voted to stop the last £35bn of purchases as they were concerned that this would add to inflationary pressures.

There was a major shift in the tone of the MPC's minutes at this meeting from the previous meeting in August which had majored on indicating that some tightening in monetary policy was now on the horizon, but also not wanting to stifle economic recovery by too early an increase in Bank Rate. In his press conference after the August MPC meeting, Governor Andrew Bailey said, "the challenge of avoiding a steep rise in unemployment has been replaced by that of ensuring a flow of labour into jobs" and that "the Committee will be monitoring closely the incoming evidence regarding developments in the labour market, and particularly unemployment, wider measures of slack, and underlying wage pressures." In other words, it was flagging up a potential danger that labour shortages could push up wage growth by more than it expects and that, as a result, CPI inflation would stay above the 2% target for longer. It also discounted sharp increases in monthly inflation figures in the pipeline in late 2021 which were largely propelled by events a year ago e.g., the cut in VAT in August 2020 for the hospitality industry, and by temporary shortages which would eventually work their way out of the system: in other words, the MPC had been prepared to look through a temporary spike in inflation.

So, in August the country was just put on alert. However, this time the MPC's words indicated there had been a marked increase in concern that more recent increases in prices, particularly the increases in gas and electricity prices in October and due again next April, are, indeed, likely to lead to faster and higher inflation expectations and underlying wage growth, which would in turn increase the risk that price pressures would prove more persistent next year than previously expected. Indeed, to emphasise its concern about inflationary pressures, the MPC pointedly chose to reaffirm its commitment to the 2% inflation target in its statement; this suggested that it was now willing to look through the flagging economic recovery during the summer to prioritise bringing inflation down next year.

Financial markets are now pricing in a first increase in Bank Rate from 0.10% to 0.25% in February 2022, but this looks ambitious as the MPC has stated that it wants to see what happens to the economy, and particularly to employment once furlough ends at the end of September.

### 4. INTEREST RATE FORECASTS

## APPENDIX 1

### TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2021/22

The Council's treasury advisor, Link Asset Services, has provided the following forecast:

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
<b>BANK RATE</b>	0.10	0.10	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.75
3 month ave eamings	0.10	0.10	0.20	0.20	0.30	0.40	0.50	0.50	0.60	0.70
6 month ave eamings	0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.60	0.70	0.80
12 month ave eamings	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

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

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 23/24.

#### The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is now to the downside, including residual risks from Covid and its variants - both domestically and their potential effects worldwide.
- 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, so should be able to cope well with meeting demand without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the surge to around 4% towards the end of 2021. Three increases in Bank rate are forecast in the period to March 2024, ending at 0.75%.

#### Forecasts for PWLB rates and gilt and treasury yields

As the interest forecast table for PWLB certainty rates above 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 Fed 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?

## APPENDIX 1

### TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2021/22

- 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 i.e., without causing a panic reaction in financial markets as happened in the “taper tantrums” in the US in 2013?
- Will exceptional volatility be focused on the short or long-end of the yield curve, or both?

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 ructions 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.

#### **Gilt and treasury yields**

Since the start of 2021, there has been a lot of volatility in gilt yields, and hence PWLB rates. During the first part of the year, US President Biden’s, and the Democratic party’s determination to push through a \$1.9trn (equivalent to 8.8% of GDP) fiscal boost for the US economy as a recovery package from the Covid pandemic was what unsettled financial markets. However, this was in addition to the \$900bn support package already passed in December 2020 under President Trump. This was then followed by additional Democratic ambition to spend further huge sums on infrastructure and an American families plan over the next decade which are caught up in Democrat / Republican haggling. Financial markets were alarmed that all this stimulus, which is much bigger than in other western economies, was happening at a time in the US when: -

1. A fast vaccination programme has enabled a rapid opening up of the economy.
2. The economy had already been growing strongly during 2021.
3. 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 is likely to stoke inflationary pressures more in the US than in other countries.
4. And the Fed was still providing monetary stimulus through monthly QE purchases.

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 could then force the Fed to take much earlier action to start tapering monthly QE purchases and/or increasing the Fed rate from near zero, despite their stated policy being to target average inflation.

## 5. TREASURY ADVISORS

## APPENDIX 1

### TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2021/22

The Council uses external treasury management advisors. The Council recognises that responsibility for Treasury Management decisions remains with the Authority at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

The Council retendered for the provision of Treasury Management advisory services as a result of the existing contract expiring on 30<sup>th</sup> April 2017. This resulted in the appointment of Link Asset Services for a period of two years until 20<sup>th</sup> April 2019, with an option to extend for a further two years, this option has been exercised by the Chief Officer Resources and Link have been appointed to the 30<sup>th</sup> April 2021.

### 6. TREASURY POSITION AS AT 30 SEPTEMBER 2021

The Council's debt and investment position at the beginning of the year and the end of the half year was as follows:

This illustrates that the total debt outstanding as at 30 September 2020 was £144.2 million, comprising of long term debt of £97.9 million and short term debt of £46.2 million.

	31March 2021 Principal	Average Rate/ Return	30Sept 2021 Principal	Average Rate/ Return	Increase/ (Decrease) in Borrowing
	<u>£000</u>		<u>£000</u>		<u>£000</u>
Fixed Rate Funding:					
- PWLB	76,764	4.05%	74,077	3.70%	(2,687)
- Market Loans	17,000	1.38%	14,000	1.40%	(3,000)
Variable Rate Funding:					
- Market (LOBO *)	4,000	4.5%	4,000	4.50%	0
Interest Free Loans:					
Welsh Government	72,570	0.00%	72,570	0.00%	0
<b>Total Long Term Debt</b>	<b>170,334</b>	<b>3.63%</b>	<b>164,647</b>	<b>3.70%</b>	<b>(5,687)</b>
Short Term Loans(<365 days)	65,315	0.52%	48,365	0.08%	(16,950)
<b>Total Debt</b>	<b>235,649</b>	<b>2.56%</b>	<b>213,012</b>	<b>2.42%</b>	<b>(22,637)</b>
Investments:					

## APPENDIX 1

### TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2021/22

- Short Term	84,870		67,000		(17,870)
<b>Total Investments</b>	<b>84,870</b>		<b>67,000</b>		<b>(17,870)</b>

\* LOBO – Lenders Option Borrowers Option. This loan has a fixed rate for the first two years of 3.85%. The remaining period of the loan (which we are now in) has a rate of 4.5%, but the lender can increase this rate at six month intervals.

### 7. BORROWING AND INVESTMENT RATES IN 2021/22

The following table displays a selection of interest rates prevailing as at 1<sup>st</sup> April 2021 and 30<sup>th</sup> September 2021.

	01/04/2021	30/09/2021
Bank Base Rate	0.10%	0.10%
7 day LIBID	-0.08%	-0.08%
PWLB 10 year Maturity	1.90%	2.01%
PWLB 15 year maturity	2.20%	2.26%
PWLB 25 year maturity	2.39%	2.39%

### 8. MID YEAR REVIEW OF THE BORROWING STRATEGY FOR 2021/22

The Treasury Management Strategy Statement for 2021/22 was approved by Council in March 2021. The Borrowing Strategy adopted as part of this was as follows:

*To utilise the Authority's overdraft facility:*

To fund unexpected daily cash deficits;  
To fund temporary cash shortfalls where there are no other sources of funding available within the marketplace.

*To borrow over the short term:*

To fund temporary cash shortfalls;  
To maintain a suitably balanced maturity profile; to make short term savings required in order to meet budgetary constraints;  
In anticipation of securing longer term loans at more attractive rates.

*To borrow over the long term:*

To reduce the Authority's average cost of borrowing;  
To maintain a stable, longer term portfolio;  
To maximise the potential for future debt rescheduling.

*If appropriate to avoid all new external borrowing:*

To maximise savings in the short term;  
To run down temporary investment levels;  
To minimise exposure to interest rate and credit risk.

Borrowings undertaken during the period (see section 7 below) have been done so in accordance with this strategy and has focused on short term borrowings in order to minimise borrowing costs. Current short-term borrowing rates continue to be very low,

## APPENDIX 1

### TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2021/22

however are likely to increase following the expected rise of the Bank of England Base Rate in the first half of next year. The Authority is therefore taking advantage of such rates and is predominantly borrowing short term where necessary to fund the remainder of its capital expenditure and maturing debt until such time the market indicates that long term rates are more advantageous. In March 2020 The Welsh Government awarded the Authority a specific loan in relation to the Rail Track project. This resulted in longer term borrowing increasing by £70million, which in turn has reduced the need to borrow in the first half of the 2021/22 financial year.

In the current economic climate, it is considered that the approved strategy is still fit for purpose and therefore no revisions are proposed.

### 9. BORROWING OUTTURN FOR THE FIRST HALF OF 2021/22

#### Long Term Borrowing

##### *Definition*

Long term borrowing relates to debt taken out for a period of greater than one year. It is taken out for periods of 1 year up to 50 years. This borrowing is required to finance capital expenditure undertaken in the year that is funded through:

- Borrowing approvals from Welsh Government, known as un-hypothecated supported borrowing (USB), for which revenue support for the borrowing costs is provided through the revenue support grant;
- Prudential borrowing, for which borrowing costs are funded through revenue savings.

##### *Total outstanding as at 30<sup>th</sup> September 2021*

The total long term debt outstanding as at 30<sup>th</sup> September 2020 was £164.6 million. This is made up of debt taken from the Public Works Loan Board (PWLB), from other local authorities (through the market place), Specific Welsh Government Loans and from the market (LOBO). This debt is due to be repaid within the following years:

Maturing Within	£000s
1YR	10
1-2YRS	10,920
2-3YRS	8,764
3-4YRS	15,451
4-5YRS	3,277
5-6YRS	12,609
6-10YRS	23,792
10-15YRS	9,570
15+ YRS	80,254
<b>Total</b>	<b>164,647</b>

##### *New borrowings for the First Half of 2021/22*

## APPENDIX 1

### TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2021/22

Long-Term borrowings of £5.6m (PWLB £2.7m and Market Loans £3m) have been repaid during the financial year. No new Long Term borrowing has been undertaken to 30 September 2021.

#### Short Term Borrowing

##### **Definition**

Short term borrowing relates to debt taken out for a period of less than one year i.e. it will all be fully repaid within a year. These short term loans are taken out to manage the Authority's short term cash flow i.e. to fund deficits in cash flow on a daily basis pending receipt of income from grants or other sources, or pending the taking out of longer term debt to fund capital expenditure whilst we wait for advantageous longer term borrowing opportunities. Current short term borrowing rates are very low and are forecast to stay at these levels for the short term. The Authority is therefore taking advantage of such rates and is borrowing short term to fund its capital expenditure and maturing debt until such time the market indicates that long term rates are more advantageous.

##### **Total outstanding as at 30<sup>th</sup> September 2021**

The total short term debt outstanding as at 30<sup>th</sup> September 2021 was £48.4 million. This is made up of debt taken from other local authorities through the market place.

##### **New borrowings for the First Half Year of 2021/22**

Appendix A lists the short term loan activity during for the first half year and shows that over the period a total of £65.3 million loans were brought forward from the previous year and £44.0 million of new short term loans were raised. A total of £61 million of these loans were repaid during the first half year, leaving a balance outstanding as at 30<sup>th</sup> September 2021 of £48.4 million.

The following table gives a summary which shows that the average rate of interest paid was in line with the benchmark.

	Total Value of Loans during the period	Average Loan	Interest paid during the period	Average Interest Rate	Benchmark Interest Rate *
<b>Short Term borrowing</b>	£109M	£3.3M	£49K	0.31%	1.00%

\* Benchmark = 1.0% Budgeted interest rate for short term borrowings

## 7. DEBT RESCHEDULING

No debt rescheduling was undertaken during the period.

## 8. COMPLIANCE WITH TREASURY LIMITS



## APPENDIX 1

### TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2021/22

During the financial year the Council operates within the treasury limits and Prudential Indicators set out in the Treasury Strategy Statement 2021/22, approved by Council in March 2021.

#### Operational Boundary for external debt

The Council resolved that this limit be set at £237.7 million for 2021/22. The average level of borrowings to the 30<sup>th</sup> September 2021 was £214.7 million, this is well below the limit.

The operational boundary can be exceeded on an occasional basis, and this is to be expected due to cash flow fluctuations. Sustained breaches however, would indicate that either the limit has been set too low, or that the Authority is breaching its prudential boundaries and that corrective action needs to be taken.

Monitoring of the operational boundary is undertaken on a daily basis and any such continual breaches would be investigated and a recommended course of action reported to Council.

#### Authorised Limit for external Debt

The Council resolved that this limit be set at £261.5 million for 2021/22. The Authorised Limit is set having regard to the operational boundary above.

The average level of borrowings for the first half year to the 30<sup>th</sup> September 2021 was £214.7 million, so well within the limit set.

The Authorised Limit must not be breached.

#### Maturity Structure of Fixed Rate Borrowing

The Council resolved the following limits for the maturity structure of fixed rate borrowings for 2021/22;

	Upper Limit	Lower Limit	Actual as at 30/09/2021
under 12 months	20%	0%	0.01%
12 months and within 24 months	20%	0%	6.63%
24 months and within 5 years	50%	0%	16.70%
5 years and within 10 years	75%	0%	22.11%
10 years and above	95%	5%	54.56%

The actual debt maturity profile at 30<sup>th</sup> September 2021 is well within the limits set.

#### Upper Limit on Variable Interest Exposure

Council resolved the upper limit on variable rate exposures for 2021/22 should be set at 30% of outstanding long term debt. This strategy limits the proportion of interest which is subject to variable rate terms and hence protects the Council against increased costs in times of rising interest rates.

## APPENDIX 1

### TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2021/22

The actual level of variable borrowings is £4 million (LOBO) which equates to 2.4% of the outstanding long term debt as at 30<sup>th</sup> September 2021, so is well within the limit set.

#### 9. MID YEAR REVIEW OF INVESTMENT STRATEGY FOR 2021/22

The Annual Investment Strategy for 2021/22 adopted by Council in March 2021 was to maintain only temporary, short term investments and to make those investments in accordance with anticipated cash flow requirements (including the investing of sums borrowed at prevailing low interest rates in anticipation of capital spending). The Council's investment priorities are:

- a. the security of capital;
- b. The liquidity of its investments.

The Council also aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to the security of its investments.

In order to ensure that the Authority's investments are secure and that risk is minimised an investment matrix is used to determine investment counterparties, which factors in Fitch and Moody's credit ratings, credit default swap (CDS) spread data, and credit rating agency comments.

Currently, the approved investment counterparties available to the Authority are Barclays, the Authority's bank, Lloyds Bank, the Debt Management Account Deposit Facility (DMADF) other Local Authorities and the Public Sector Deposit Fund. In order to diversify its investment portfolio, the Authority has undertaken fixed term deposits with other banks in line with the counterparty list. Whilst interest rates receivable on these counterparties is low the security of the capital sum is high and there is no cost associated with placing cash there.

This strategy has been adhered to in determining the investments for the first half of 2021/22 outlined in section 11 below.

#### 10. INVESTMENT OUTTURN FOR THE FIRST HALF OF 2021/22

Appendix B gives details of the investments made during the first half of the year, and the following table gives a summary, which shows the Authority's average rate of return was below the benchmark.

	Total Value of Investments during period	Average Investment	Investment Returns	Average Rate of Return	Benchmark Return *

## APPENDIX 1

### TREASURY MANAGEMENT MID YEAR REVIEW REPORT 2021/22

<b>Internally Managed</b>	£692M	£7M	£13k	0.02%	-0.08%
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\* *Benchmark = 7 day LIBID*

*- 0.07%*

No institutions in which investments were made had any difficulty in repaying investments and interest in full during the year.

### 11. OTHER TREASURY MANAGEMENT ISSUES

None to report