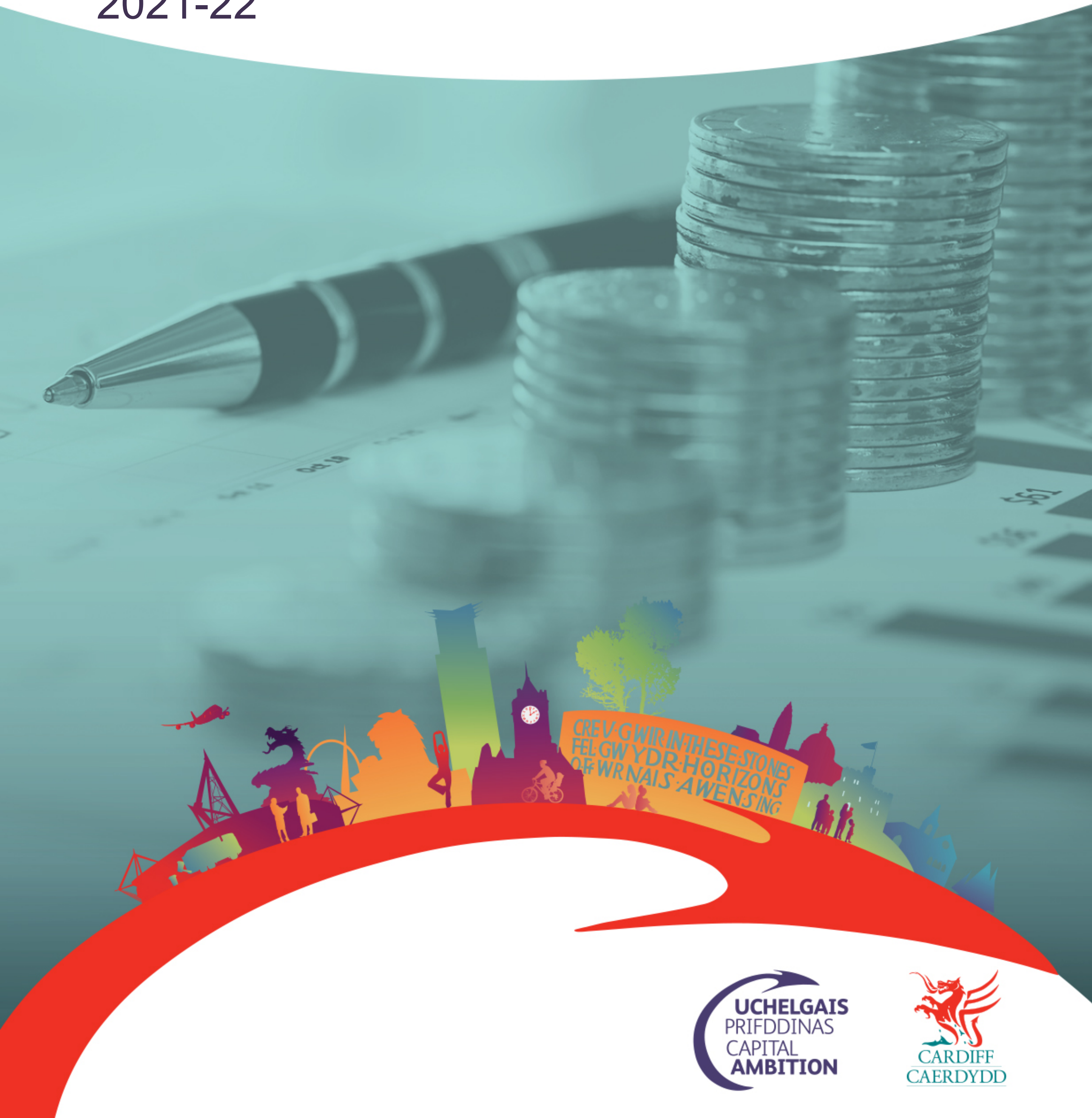
Appendix 1

Treasury Management Mid-Year Report

2021-22



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Introduction

1.1 Treasury management activities are the management of an organisation's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

1.2 The Council carries out its treasury management activities in accordance with a Treasury Management Code of Practice for public services, updated by CIPFA in 2017. This requires the Council to set out the policies and objectives of its treasury management activities and adopt four Clauses of Treasury Management (replicated in **Annexe A**). The code is currently the subject of a consultation, with an update expected in late 2021.

1.3 Council received a report in March 2021 on the Council's Treasury Management and Capital Strategy for 2021/22. Governance and Audit Committee has received periodic updates on the position and performance of treasury management and the issues included in the report below. In addition, Council received in October 2021 the Annual Outturn Report for Treasury Management for 2020/21.

1.4 In accordance with Council policy, this report provides members with a 2021/22 mid-year update as at 30 September 2021 and covers:-

- the economic background to treasury activities
- investments
- borrowing
- debt rescheduling
- compliance with treasury limits and prudential indicators
- Treasury Strategy update for remainder of the year.

1.5 Annexe E includes a glossary which defines key terms used in this report.

Economic Background

2.1 The coronavirus outbreak has resulted in huge economic damage to the UK and economies around the world. COVID-19 vaccines enormously boosted confidence that the UK could largely return to normal during the summer after a third wave of the virus threatened to overwhelm hospitals in the spring. From a previous view that price increases were a temporary spike in inflation, the Monetary Policy Committee (MPC) highlighted a marked concern that such pressures could prove more persistent. Recent increases in prices, particularly increases as a result of supply shortages and utility prices are likely to lead to faster and higher inflation expectations and underlying wage growth, which would in turn increases the risk that price pressures would prove more persistent next year than previously expected. This suggests that the MPC may now be willing to look through any flagging economic recovery to prioritise bringing inflation down next year to ensure that underlying price pressures in the economy do not get embedded and elevate future inflation to stay significantly above its 2% target and for longer.

2.2 With these factors in mind, the table below shows the Council's treasury management advisors November forecast for bank rate and Public Works Loan Board (PWLB) certainty borrowing rates, based on their current lending policy. This shows a gradual increase in bank rate over the forecast horizon ending on 31st March 2025. Economic recovery is expected to be only gradual and, therefore, prolonged, with geopolitical events, impact of the ending of the furlough scheme and residual risks from Covid and its variants having downside risks to the forecasts.

	Actual 30/09/2021	March 2022	March 2023	March 2024	March 2025
Bank Rate	0.10%	0.25%	0.75%	1.00%	1.25%
5yr PWLB rate	1.38%	1.50%	1.70%	1.80%	2.00%
10yr PWLB rate	1.77%	1.90%	2.10%	2.20%	2.40%
25yr PWLB rate	2.14%	2.20%	2.40%	2.60%	2.70%
50yr PWLB rate	1.91%	2.00%	2.20%	2.40%	2.50%

2.3 PWLB rates are based on gilt (UK Government bonds) yields, however HM Treasury determine a specified margin to add to gilt yields for any local authority borrowing. As the interest forecast table for PWLB certainty rates above shows, there is likely to be a steady rise over the forecast period, however there is exceptional volatility and unpredictability in respect of gilt yields and PWLB rates. Gilt yields and PWLB rates were on a falling trend between May and August. However, they rose sharply towards the end of September. The 50-year PWLB target certainty rate for new long-term borrowing started 2021/22 at 1.90%, rose to 2.00% in May, fell to 1.70% in August and returned to 2.00% at the end of September after the MPC meeting of 23rd September 2021.

Investment

3.1 The management of the Council's cash flows may involve temporary lending of surplus funds to low-risk counterparties or temporary borrowing pending receipt of income.

3.2 The Council's investment priorities remain the security and then liquidity of its Treasury investments. The Council also aims to achieve the optimum return appropriate to these priorities.

3.3 The Council invests with financial institutions in accordance with criteria approved in its Treasury Strategy. The categories, names, periods and size limits on this list can be extended, varied or restricted at any time by the Corporate Director Resources under delegated powers. Based primarily on Fitch credit criteria and a number of other factors which the Council takes into account, lending to these institutions is subject to time and size limits and credit worthiness continues to be carefully monitored.

3.4 There have been no changes made or required to be made to the list of eligible counterparties included as part of the 2021/22 Treasury Management Strategy approved by Council, but these will continue to be reviewed using data from Treasury advisors and will be updated in the 2022/23 Strategy.

3.5 Following the introduction of The Markets in Financial Instruments Directive (MiFID) in January 2018, the Council opts to be classified as a professional client rather than a retail client by financial institutions.

3.6 Investments returns are likely to remain negligible during 2021 and in many cases market rates on deposits are currently negative for shorter periods. It is now impossible to earn the level of interest rates on deposits commonly seen in previous decades as all investment rates are barely above zero now that Bank Rate is at 0.10%. Whilst there is discussion about increases in base rate to mitigate against inflation risks, investment returns are expected to remain low. The approach of deferring external borrowing by using temporary cash balances will continue to be used as part of the borrowing strategy.

3.7 At the 30 September 2021, investments stood at £147.8 million. These temporary funds fluctuate daily and arise for a number of reasons, including the timing differences between the receipt of grant and other income and the utilisation of these funds on salaries and other operating costs. They also include the level of reserves, provisions, and balances held on behalf of Joint Committees such as City Deal. It is also affected by the timing of borrowing and capital expenditure transactions. **Annexe B** shows with whom these investments were held as at 30 September 2021. All investments are deemed recoverable.

3.8 A selection of performance indicators and benchmarking charts, is included in **Annexe C** as follows:-

- **Counterparty exposure** displays actual investment against the maximum permitted directly with an organisation. This demonstrates that we are not exceeding any exposure limits. As a response to the Covid crises, the Council activated use of the HM Treasury's Debt Management Office account in order to support the treasury team to manage funds held.
- **Remaining maturity profile of investments**. This shows the duration of investments over time. The Council will take advantage of longer-term rates where reasonable to do so.
- **Investments by institution.** This expresses the investments held with different institutions as a percentage of the total and shows diversification is sought where possible.
- **Geographic spread of investments** as determined by the country of origin of relevant organisations. All countries are rated AA and above as per our approved criteria and are licensed to take UK deposits. Investments are in Sterling only.
- **Investments by Financial Sector.** The majority of investments continue to be with banks.

3.9 Whilst a difficult figure to forecast due to the uncertainty of the markets, cash flows and the number of variables that impact on the figure, the forecast level of interest receivable from treasury investments for 2021/22 is £130,000. The return achieved since the start of the year is 0.10% compared to the average of the benchmark rate since the 1 April 2021 for the 7-day London Interbank Bid Rate (LIBID) of -0.08% and 3 month LIBID -0.05%. This positive performance is primarily as a result of deposits placed for longer and use of notice accounts where deemed prudent to do so.

Borrowing

4.1 Long term borrowing is undertaken to finance the Council's Capital Programme. The administrations 'Capital Ambition' identifies the opportunities facing the city and sets out the response to challenges. This is not just a consideration of how challenges are responded to, but it is also about investing in future economic growth and development, prioritising investment in schools, affordable housing, tackling homelessness, and protecting the city's most vulnerable people. It sets out the approach for tackling congestion and air pollution, improving recycling rates and keeping our streets clean, along with a series of commitments to respond to the climate emergency, to create opportunities for local people and addressing inequality. All these capital projects play an important role in supporting and accelerating the Council's work in responding to Covid-19 and leading the recovery. The budget report and its capital strategy considered by Council in March 2021 provided an update on the Indoor Arena, and subject to due diligence, direct funding of the arena construction by the Council as an alternative for third party funding, fully funded by annual lease income from the Arena Operator. The Council is also continuing to develop a number of strategic projects, which, subject to approval of business cases, due diligence and affordability may be considered for approval as part of future iterations of the detailed investment programme. These include projects arising from the Transport White Paper including Metro; Atlantic Wharf Masterplan; Core Office Strategy; 21st Century Schools and responding to the climate emergency.

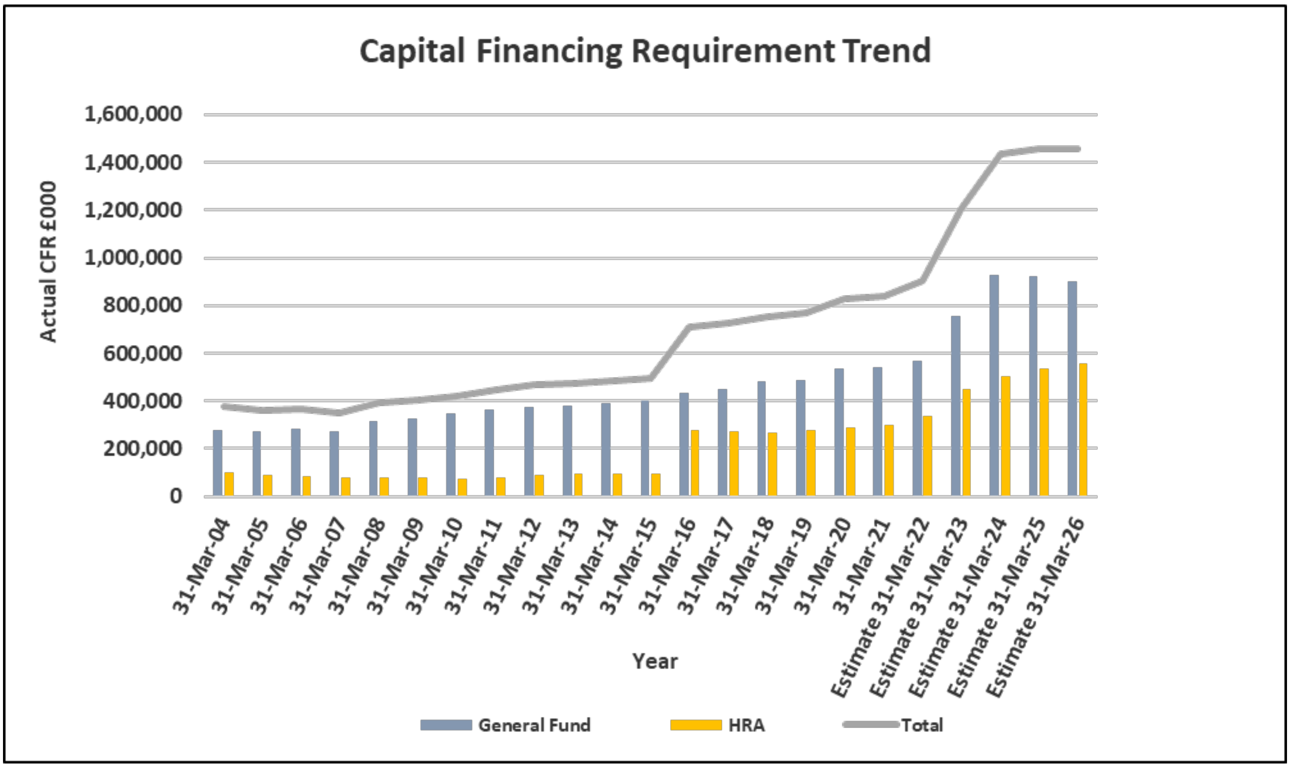
4.2 The main sources of borrowing currently are the PWLB and the Money Markets. The Council does not separate General Fund and Housing Revenue Account borrowing as all borrowing is the liability of the Council i.e. borrowing is 'pooled'.

4.3 Where capital expenditure has been incurred without a resource to pay for it i.e. when proposed to be paid for by supported or unsupported borrowing, this will increase what is termed the Council's Capital Financing Requirement (CFR) which is the Council's underlying need to borrow. The Council is required to make a prudent provision for the repayment of historic capital expenditure from its revenue budget in line with its agreed policy which reduces the CFR. Calculation of the CFR is summarised in the table below and results in the need to borrow money.

Movement	Opening Capital Financing Requirement (CFR)
+	Capital expenditure incurred in year
-	Grants, contributions, reserves and receipts used for capital expenditure
-	Prudent Minimum Revenue Provision and Voluntary Repayment
=	**Closing Capital Financing Requirement (CFR)**

4.4 The CFR forecast is subject to the timing of capital expenditure, capital receipts and new schemes that may be considered for approval in future years. It can be seen that the Council's underlying need to borrow is increasing and will need to be repaid from future revenue budgets either from savings, revenue income or Council Tax and Housing Rents.

4.5 The chart below shows the trend in the CFR including the Housing Revenue Account. The latter includes the £187 million payment made from the HRA to HM Treasury to exit the subsidy system in 2015/16 and also future expenditure to create new Council owned affordable housing in accordance with the Housing 30 Year Business Plan, which will be updated in March 2022. The increase for the General Fund relates to previous commitments and new expenditure commitments primarily those assumed to pay for themselves from future income or savings such as the indoor arena, City Deal and the 21st century school's financial model. Future projections of the CFR are based on the timing of the Capital investment programme and resources deemed available to fund it as set out in the budget in March 2021. These projections will be updated in the Capital Strategy for 2022/23 in March 2022.



4.6 At 30 September 2021, the Council had £824.8 million of external borrowing predominantly made up of fixed interest rate borrowing payable on maturity.

31 March 2021			30 September 2021	
£m	**Rate (%)**		**£m**	**Rate (%)**
698.9		Public Works Loan Board	713.1	
51.0		Market (Lender Option Borrower Option)	51.0	
22.5		Welsh Government	22.4	
38.3		Local Authorities and other	38.3	
810.7	**4.17**	**Total External Debt**	**824.8**	**4.09**

The estimated total interest payable on borrowing for 2021/22 is £34.1 million which includes interest payable by the Housing Revenue Account of circa £13.1 million.

New borrowing undertaken during the first half of the year

4.7 During the first half of the year an Interest free loan of £0.441 million was received from Welsh Government in respect of energy efficiency schemes in school's buildings and £20 million of the Council's borrowing requirement has been taken from the PWLB at an average rate of 1.67%. It should be noted that since the 30 September 2021, a further £50 million of PWLB Loans have been taken at an average rate of 1.87% to mitigate against the risk of rising interest rates and to lock in some of the Council's planned borrowing requirement. Opportunities for additional borrowing will continue to be considered during the remainder of the year, with further details will be provided in the Treasury Management Strategy to be received by Council in March 2022.

Maturing Loans in year to date

4.8 **Annexe D** shows the maturity profile of the Council's borrowing as at 30 September 2021. Maturing loans of £6.3 million have been repaid in the first half of this year with a further £20.7 million due to be repaid by 31 March 2022.

4.9 (LOBO) products are loans to the Council where the lender can request a change in the rate of interest payable by the Council on pre-determined dates. The Council at this point has the option to repay the loan without penalty.

4.10 The Council has six such loans totalling £51 million. Apart from the option to increase rates, these loans are comparable to PWLB and have no other complications such as variation in interest rates or complex terms.

4.11 Interest rates on these loans range between 3.81% and 4.35% which are not unreasonable and are below the Council's average rate of interest payable. Details of the loans are shown in the table below.

£m	Rate	Potential Repayment Date	Option Frequency	Full Term Maturity
6	4.28%	21/11/2021	6 months	21/11/2041
6	4.35%	21/11/2021	6 months	21/11/2041
6	4.06%	21/11/2021	6 months	23/05/2067
6	4.08%	02/03/2022	6 months	23/05/2067
5	4.10%	16/01/2023	5 years	17/01/2078
22	3.81%	21/11/2025	5 years	23/11/2065

4.12 LOBO's to the value of £24 million are subject to the lender potentially requesting a change in the rate of interest payable every six months. This is deemed unlikely, and any risk is a manageable refinancing risk as LOBOs in total, form a relatively low proportion of the Council's overall borrowing at 6.18%.

Borrowing Strategy

4.13 As shown in the interest rate forecasts set out earlier in this report, borrowing rates are higher than investment rates which means that the cost of undertaking new borrowing would have a negative impact on the revenue budget. External borrowing may be deferred in order to minimise short term costs by using temporary cash balances to meet the Capital Financing Requirement rather than placing in an investment. This is termed 'internal borrowing'. However deferring borrowing is only a short-term measure and could expose the Council to higher borrowing rates and costs in the future. The Council has taken an approach of regularly undertaking external borrowing towards its borrowing requirement to provide certainty and mitigate any such risk.

4.14 If no further borrowing is undertaken, the value of external loans at 31 March 2022 will be £856 million. At the same point, the Council's need to borrow for capital expenditure purposes, its Capital Financing Requirement (CFR), is currently forecast to be circa £905 million (General Fund £570 million and HRA £335 million). Without any further borrowing this financial year internal borrowing would be £49 million. The Council will consider further options in respect to borrowing in the last quarter of the financial year.

4.15 The Council is also considering a number of projects that involve the Welsh Government providing interest free loans to the Council or an income stream to undertake specified projects such as town centre loans and energy projects. Welsh Government take no risk in such projects and expect all loans to be repaid. Where the Council is taking on specific loans for the delivery of specified projects, robust business case processes and legal charges if appropriate should be in place to ensure any loans can be repaid following implementation of projects.

Debt Rescheduling

5.1 No debt rescheduling or early repayment of debt has been undertaken to date in 2020/21. The main obstacle remains the level of premium (penalty) that would be chargeable on early repayment by the PWLB. Of the existing PWLB loans of £713 million, £690 million are eligible for early repayment. However, this would incur a premium of £475 million as at 30 September 2021. This premium is payable primarily because:

- Interest rates on loans of equivalent maturities compared to those held are currently lower
- A penalty rate or lower early repayment rate was introduced by HM Treasury in November 2007, which increased the cost of premiums and reduced the flexibility of Local Authorities to make savings. This remains an obstacle in the ability of local authorities to manage debt more effectively.

5.2 Whilst the cost of Premiums can be spread over future years, options for restructuring that have been considered result in an adverse Net Present Value (NPV). Whilst there may have been short terms savings, these were outweighed by potentially longer-term costs and not deemed cost effective.

Compliance with treasury limits and prudential indicators

6.1 During the financial year to date, the Council has operated within the treasury limits and prudential indicators set out in the annual Treasury Management Strategy in March 2021. The treasury and capital prudential indicators will be updated as part of the 2022/23 Capital and Treasury Strategies in the Budget Report to Council in March 2022. Affordability of additional investment will need to be monitored closely as part of the Medium-Term Financial Plan and HRA Business Planning process.

Treasury strategy for the remainder of 2021/22

7.1 The Treasury Strategy approved in March 2021 remains valid despite the impact of Covid-19 and continued uncertainty in financial markets. The use of temporary cash balances instead of borrowing to pay for capital expenditure continues will continue to result in short term savings. However, with a significant overall borrowing requirement, now that that the outcome of the consultation on PWLB lending policy being known, further opportunities to take additional borrowing from PWLB in the remainder of the year will be considered including other future options to diversify the Council's borrowing requirement for the capital programme and major projects.

7.2 The Council will continue to look for good quality investment counterparties, where the focus remains security, liquidity and risk in that order, whilst trying to avoid negative interest rates where possible. In addition, LIBOR which is used to derive LIBID will be phased out in 2021, so options will need to be considered to change the Investment Benchmark. This impact of these issues will be considered in the Treasury Management Strategy report to Council in March 2022 as well as setting in place approaches to implement agreed changes to the CIPFA Treasury Management Code, which are likely to include, changes in indicators for borrowing and investments, strengthened requirements for skills and training and for investments which are not specifically held for treasury management purposes.

Annexes

Annexe A – Treasury Management Policy and Four Clauses of Treasury Management
Annexe B – Investments at 30 September 2021
Annexe C – Investment Charts at 30 September 2021
Annexe D – Maturity Analysis of Borrowing as at 30 September 2021
Annexe E – Glossary of Treasury Management terms

Annexe A

Treasury Management Policy and Four Clauses of Treasury Management adopted by Council 25/02/2010

Council's treasury management Policy / Activities

1. This Council defines its treasury management activities as: the management of its 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. This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications.

3. This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

Four Clauses of Treasury Management

4. In compliance with the First Clause, this Council will create and maintain, as the cornerstones for effective treasury management:-

    - A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities
    - Suitable Treasury Management Practices (TMPs), setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities

5. In compliance with the Second Clause, this Council will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy in advance of the year, a mid-year review and an annual report after the year's close, in the form prescribed in its TMPs.

6. In compliance with the Third Clause, this Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Executive, and for the execution and administration of treasury management decisions to the Corporate Director Resources in accordance with existing delegations, who will act in accordance with the Policy Statement, TMPs and CIPFA's Standard of Professional Practice on Treasury Management.

7. In compliance with the Fourth Clause, this Council requires the scrutiny of the accounting, audit and commercial issues of its Treasury Management Strategy and Practices to be undertaken by the Council's Audit Panel due to the technical nature of the documents.