Annexes B & C to this Appendix are not for publication as they contain exempt information of the description in Paragraphs 14 and 21 of Schedule 12A of the Local Government Act 1972.

Appendix 1

Draft Treasury Management Annual Report 2021/22

Cardiff Council

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Introduction

1. Treasury management activities are the management of the organisation's 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. The Council carries out its treasury management activities in accordance with a code developed for public services and updated in 2021 by the Chartered Institute of Public Finance and Accountancy (CIPFA).

3. The Council has delegated responsibility for treasury management to the Corporate Director of Resources (S151 Officer). The Council's Treasury Management Practices which are updated annually, identifies specific responsibilities of officers as well as setting out schedules highlighting the way in which treasury activities are managed.

4. On 25th February 2010, Council approved policies and adopted the four clauses of the treasury management code which are replicated in **Annexe A** for information. Council received a report in March 2021 on the Council's Treasury Management Strategy for 2021/22 and a mid-year review in November 2021.

5. The Treasury Management is an integral part of the Council's Strategic and Financial planning framework, with borrowing activities primarily because of historic and future capital expenditure approved by Council as part of the Council's Capital Investment programme.

6. This report provides members with an annual report for the Council's Treasury Management activities for 2021/22. It covers:-

- the economic background to treasury activities
- treasury investment strategy and outturn for 2021/22
- borrowing strategy and outturn for 2021/22 including debt rescheduling
- compliance with treasury limits and prudential indicators
- resilience of the Treasury Management function
- treasury management issues for 2022/23.

7. Council requires scrutiny of the accounting, audit and commercial issues of its Treasury Management Strategy and practices to be undertaken by the Council's Governance and Audit Committee. A glossary of key treasury management terms is included at Annexe E.

Economic Background

8. Over the last two years, the coronavirus outbreak had a huge economic impact on the UK and 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 until raising it to 0.25% at its meeting on 16th December 2021, 0.50% at its meeting of 4th February 2022 and then to 0.75% in March 2022.

9. With most of the economy now opened up and back towards business-as-usual, Gross Domestic Product numbers have been robust (9% y/y Q1 2022) and sufficient for the Bank to focus on tackling the effects of inflation.

10. Borrowing rates for the Council are based on Gilt yields and despite remaining relatively low for much of 2021/22, these have increased despite the war in Ukraine. This is because central banks globally have suggested they will continue to raise interest rates to contain inflation and in many cases are reversing quantitative easing. Inflation and a perfect storm of supply side shortages, labour shortages, commodity price inflation, the impact of Russia's invasion of Ukraine and subsequent Western sanctions have all resulted in inflation being at elevated levels at least into 2023.The squeeze on household disposable incomes arising from increases in prices, including utilities, are strong headwinds for the economy to deal with and will be a bigger drag on real incomes in 2022 than in any year since records began in 1955.

11. Until recent years, world growth has been boosted by increasing globalisation i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This had boosted worldwide productivity and growth, and by lowering costs, had also depressed inflation. However geo-political events such as the invasion of Ukraine have unbalanced the world economy. In addition, after the pandemic exposed how frail extended supply lines were around the world, both factors could lead to a sharp retrenchment of economies and reviews of key supply chain dependencies. This is likely to reduce world growth rates.

Investments and Outturn

12. The Council's treasury investments include those arising from its own temporary cash balances as well as balances held from activities of Joint Committees such as the Cardiff Capital Region City Deal, for which it is the accountable body.

13. The management of the day-to-day cash requirements of the Council is undertaken in-house with credit advice from Link Asset Services, the Council's Treasury Management advisors. This may involve temporary borrowing pending receipt of income or the temporary lending of surplus funds. Investment balances fluctuate daily and arise from a number of sources including differences in timing of revenue and capital cash flows, reserves, provisions and other balances held for future use.

14. The Council invests with institutions approved by Council as part of its Treasury Management Strategy and in accordance with investment guidelines established by the Welsh Government. As part of the Markets and Financial Instruments Directive II, the Council elected for ‘professional’ status. The categories, names, periods and size limits on the Council’s approved investment list can be extended, varied or restricted at any time by the Corporate Director Resources under delegated powers and are monitored closely in conjunction with the Council’s treasury advisors.

15. Whilst the average daily cash balance was £190 million during 2021/22, at 31 March 2022, investments stood at £226.4 million. The Council’s choice of investments maintained an approach of security, where the amount invested is that repayable, then liquidity and only then yield. **Annexe B** shows with whom these investments were held at 31 March 2022.

16. A selection of charts in relation to investments is included in **Annexe C.** The main areas to highlight at 31 March 2022 are as follows:-

    - Counterparty exposure against the maximum allowed directly with an organisation. This shows that at 31 March 2022 no exposure limits set were breached. This was also the case during the year.
    - Investments held with different institutions as a percentage of the total shows that investments are diversified over a number of organisations and this was a strategy applied where possible during the year.
    - The geographic spread of investments as determined by the country of origin of relevant organisations. All investments are in sterling and countries are rated AA and above as per our approved criteria.

17. Using historic data adjusted for current financial market conditions, the probability of any default is low at circa 0.01% of the investments outstanding, i.e. £21,409

18. All investments held at 31 March 2022 are deemed recoverable. Accordingly, no impairment losses are reflected in the Council’s 2021/22 Statement of Accounts arising from the Council’s treasury management activities.

19. The overall level of interest receivable from treasury investments totalled £0.307 million in 2021/22. The average returns achieved compared to current industry benchmarks are shown in the table below.

	Return on Investment 2021/2022	
	Benchmark 7day / 3month (%)	**Achieved (%)**
In-house	0.13 / 0.09	0.16

20. Following a review led by the Bank of England, LIBOR/LIBID benchmark rates were phased out during 2021. For benchmarking purposes, the Sterling Overnight Index Average rate (SONIA) for seven days and 3 months uncompounded is now used, with Council performance exceeding such benchmarks during 2021/22.

21. Investment returns available to the Council were close to zero for much of 2021/22, with an approach of aiming to avoid negative interest rates in place. This was because of low Bank Rate and also with the Bank of England and the Government maintaining various monetary and fiscal measures to supply credit so that banks and public bodies could help businesses to survive the various lockdowns/negative impact on their cashflow. 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. This was until the turn of the year when it was clear that the Bank of England, would need to lift interest rates to combat the effects of growing levels of inflation.

22. The Council continued to take a cautious approach to investing and 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.

Borrowing and Outturn

23. Borrowing is undertaken to finance the Council's capital programme and manage any short-term cash flow requirements. The main sources of borrowing are identified in the table below.

24. At 31 March 2022, the Council had £855.6 million of external borrowing. This was predominantly fixed interest rate borrowing from the Public Works Loan Board (PWLB) payable on maturity.

31 March 2021			31 March 2022	
£m	**Rate (%)**		**£m**	**Rate (%)**
698.9		Public Works Loan Board	763.1	
51.0		Market (Lender Option Borrower Option)	51.0	
22.5		Welsh Government	23.2	
38.3		Local Authorities and other	18.3	
810.7	**4.17**	**Total External Debt**	**855.6**	**4.01**

25. It should be noted that there have been a number of recent changes to PWLB lending criteria which now includes a prohibition to deny access to borrowing from the PWLB for any local authority incurring expenditure on 'assets primarily for yield'.

26. All borrowing is in the name of the Council and a single pool of debt is maintained rather than having separate loans for the Housing Revenue Account. Total interest payable on external debt during 2021/22 was £34.1 million of which £13.2 million was payable by the Housing Revenue Account (HRA). In total £44.5 million was set aside from General Fund and HRA revenue budgets in line with the Councils approved policy on prudent provision for debt repayment.

27. Extracts from the borrowing strategy approved by Council in March 2021 are shown below.

> *The Council's Borrowing Strategy considers all options to meet the long-term aims of:*
> - *promoting revenue cost stability to aid financial planning and avoid a stop-start approach to service delivery, although it is recognised that this may have a financial impact*
> - *pooling borrowing and investments to ensure the whole Council shares the risks and rewards of treasury activities*
> - *Ensuring borrowing plans are aligned to known capital expenditure spending plans and financial reserve levels*
> - *achieving a balanced maturity profile*
> - *having regard to the effects on current and future Council Tax and Rent Payers.*

> External verses internal borrowing
> *Whilst interest rates for borrowing are greater than interest rates the Council receives for investments (the cost of carry), it makes financial sense to use any internal cash balances held in the short-term to pay for capital expenditure and minimise costs (internal borrowing), rather than undertake external borrowing. However, there is a risk that the Council may have to borrow at higher rates when it does actually need to borrow in future and so this position is kept under continuous review and delegated to the Corporate Director Resources.*

28. During 2021/22, the Council repaid £27.5 million of maturing loans. Borrowing totalling £70 million was taken from the PWLB and interest free loans totalling £2.4 million were received from the Welsh Government in respect of energy efficiency schemes. The overall effect of these transactions during the year was to decrease the average rate on the Council's borrowing to 4.01% at 31 March 2022.

29. Despite borrowing rates being more expensive than investment rates during most of the year, the additional borrowing was taken to mitigate risk and limit the level of internal borrowing. This enabled some fixed long-term borrowing to be locked in at average rates of circa 1.8%. This is prior to the recent rises in borrowing rates resulting from increased inflation and geo-political impacts.

30. As part of its loan portfolio, the Council has six Lender Option Borrower Option (LOBO) loans totalling £51 million. These are 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, but this option is conditional and would require the lender to ask for an increase in the current rates to trigger such an event. 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.

31. Interest rates on the LOBO's held range between 3.81% and 4.35% which are not unreasonable given the council's average rate. Details of the loans are shown in the table below.

32. None of the LOBO's had to be repaid during 2021/22. £29 million of the LOBO loans are subject to the lender having the right to change the rate of interest payable during the next financial year. The Council has the right to refuse the change, triggering early repayment and the need to re-finance. This is a manageable refinancing risk as LOBO's form a relatively low proportion of the Council's overall borrowing at 5.96%.

£m	Rate	Potential Repayment Date	Option Frequency	Full Term Maturity
6	4.28%	23/05/2022	6 months	21/11/2041
6	4.35%	23/05/2022	6 months	21/11/2041
6	4.06%	23/05/2022	6 months	23/05/2067
6	4.08%	02/09/2022	6 months	23/05/2067
5	4.10%	15/01/2023	5 years	17/01/2078
22	3.81%	21/11/2025	5 years	23/11/2065

33. In accordance with the strategy, the Council is undertaking some internal borrowing which is when it uses temporary cash balances it holds in the short term instead of undertaking external borrowing. The level of internal borrowing is £13 million as at 31 March 2022, and this is confirmed by a comparison of the Council's external level of debt and its Capital Financing Requirement at 31 March 2022 as shown later in this report. The borrowing strategy will continue to look at options to manage the Council's future borrowing requirement using a mix of internal and external borrowing and to secure long term certainty where possible.

Debt Rescheduling

34. No debt rescheduling or early repayment of debt was undertaken during 2021/22. The main obstacle remained the level of premium (penalty) that would be chargeable on early repayment by the PWLB. The premium payable on the balance of PWLB loans at 31 March 2022, which are eligible for early repayment (£763 million), is £380 million. 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 flexibility of Local Authorities to make savings. This has been a significant thorn in the ability of local authorities to manage debt more effectively.

35. The Council has previously considered the opportunity for early repayment of LOBO loans but any required premiums payable are unviable. 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

36. During the financial year the Council operated within the treasury limits and prudential indicators set out in the annual Treasury Management Strategy. The actual outturn is shown in the following paragraphs and compared to the original estimates contained in the 2021/22 Budget Report. Future year's figures are taken from the Budget Report for 2022/23 and will be updated in the Budget Report for 2023/24.

Capital Expenditure

37. The "Prudential Code" requires the Council to estimate the capital expenditure that it plans to incur over the Medium Term. The actual capital expenditure incurred in 2021/22 and estimates of capital expenditure for the current and future years as set out in the Budget Report of March 2022 are as follows:-

Capital Expenditure							
	2021/22 Actual £m	**2021/22 Original Estimate £m**	**2022/23 Estimate Month 4 £m**	**2023/24 Estimate £m**	**2024/25 Estimate £m**	**2025/26 Estimate £m**	**2026/27 Estimate £m**
General Fund	157	158	154	262	212	88	39
Housing Revenue Account	61	86	80	111	106	70	54
Total	**218**	**244**	**234**	**373**	**318**	**158**	**93**

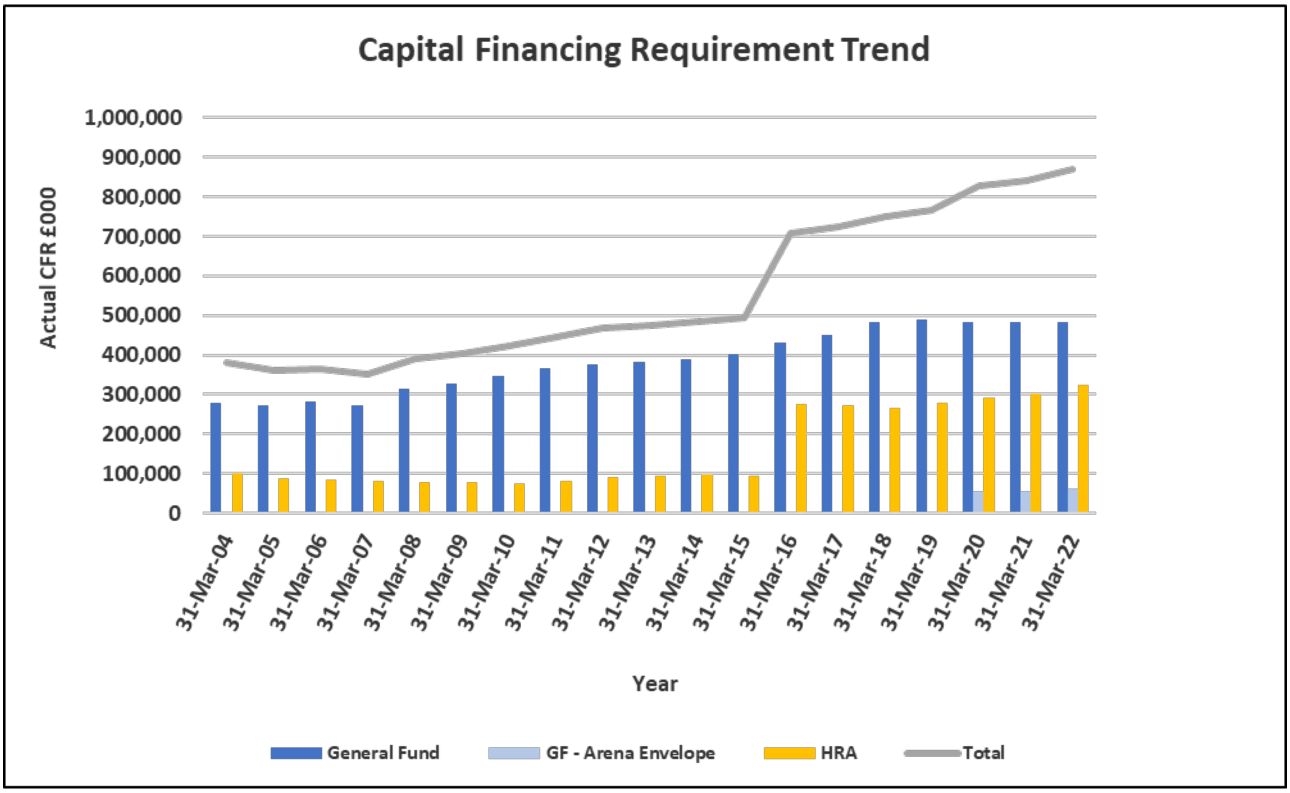
Capital Financing Requirement (CFR) – The Borrowing Requirement (Excluding Landfill Provision)

38. 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)**

39. 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. With future expenditure commitments, primarily those assumed to pay for themselves from future income or savings such as the indoor arena, new affordable housing, City Deal and the 21st century school's financial model, the CFR

is forecast to increase in future years, with forecasts to be updated as part of the budget report for 2023/24.



40. The CFR as at 01 April 2021 was £841 million. The actual CFR as at 31 March 2022, estimates for current and future years (estimated in the March 2022 budget) are shown in the table below and exclude non cash backed provisions in relation to Landfill after care provision:-

Capital Financing Requirement (Excludes landfill provision)							
	2021/22 Actual £m	**2021/22 Original Estimate £m**	**2022/23 Estimate Month 4 £m**	**2023/24 Estimate £m**	**2024/25 Estimate £m**	**2025/26 Estimate £m**	**2026/27 Estimate £m**
General Fund	482	517	539	621	642	648	640
General Fund (Arena Affordability Envelope)	62	67	60	198	246	242	238
Housing Revenue Account	325	362	346	438	505	534	556
Total CFR	**869**	**946**	**945**	**1,257**	**1,393**	**1,424**	**1,434**
External Debt	**856**						
Over / (Under) Borrowing	**(13)**						

41. By comparing the CFR at 31 March 2022 (£869 million) and the level of external debt at the same point in time (£856 million), it can be seen that the Council is internally borrowed.i.e. it is using some internal cash balances to finance its capital expenditure as at 31 March 2022 (£30 *million at 31 March 2021).*

Actual External Debt

42. The Code requires the Council to indicate its actual external debt at 31 March 2022 for information purposes. This was £856 million as shown in the earlier paragraphs.

Affordable Borrowing Limit

43. The Council has a statutory duty under section 3 of the Local Government Act 2003 and supporting regulations to determine and keep under review how much it can afford to borrow and to enter into credit arrangements (the “Affordable Borrowing Limit”). This cannot be breached without Council approval. Council must have regard to the Prudential Code when setting this limit which is intended to ensure that total capital investment remains within sustainable limits and that the impact upon future council tax/rent levels is affordable.

44. During 2021/22 the Council remained within the authorised limit of £1,472 million set for that year.

Operational Boundary

45. The operational boundary is the estimated level of external borrowing set at the start of the year and is subject to the level and timing of borrowing decisions during the year. The actual level of borrowing can therefore be below or above this initial estimate, but what cannot be breached is the affordable borrowing limit mentioned above. The boundary was estimated to be £946 million at 31 March 2022, to match the forecast for the CFR when setting the 2021/22 budget in March 2021.

Maturity Structure of Fixed Rate Borrowing

46. The maturity structure remains within the limits below approved as part of the 2021/22 strategy below. These limits are set to avoid having large amounts of debt maturing in a short space of time, thus being exposed to significant liquidity risk and interest rate risk.

	31-Mar-21			31-Mar-22			
	Loans to Maturity		Upper limit	Loans to Maturity		Loans if LOBO's Paid Early	
	%	£m	%	%	£m	%	£m
Under 12 months	3.33	27.0	10	2.66	22.8	6.05	51.8
12 months and within 24 months	2.80	22.7	10	0.53	4.5	0.52	4.5
24 months and within 5 years	1.65	13.4	15	2.13	18.2	4.70	40.2
5 years and within 10 years	8.18	66.3	20	8.95	76.6	8.96	76.6
10 years and within 20 years	21.62	175.3	30	20.40	174.5	18.99	162.5
20 years and within 30 years	20.97	170.0	35	20.66	176.8	20.66	176.8

30 years and within 40 years	26.24	212.7	35	25.47	217.9	25.47	217.9
40 years and within 50 years	14.59	118.3	35	18.62	159.3	14.65	125.3
50 years and within 60 years	0.62	5.0	15	0.58	5.0	0	0

47. The maturity profile of the Council's borrowing as at 31 March 2022 is also shown in a chart in **Annexe D**. In the medium to long term, efforts will be made to restructure loans maturing in 2056/57 and to review LOBO maturities in order to reduce refinancing risk. Benchmarking previously undertaken has demonstrated that the Council's maturity profile is not inconsistent with other local authorities where information is available.

Ratio of financing costs to net revenue stream

48. This indicator identifies the trend in the cost of capital financing, showing the percentage of the Council's revenue budget that is committed for this purpose. Financing costs include:

- interest payable on borrowing and receivable on treasury investments
- penalties or any benefits receivable on early repayment of debt
- prudent revenue budget provision for repayment of capital expenditure paid for by borrowing and
- re-imbursement of borrowing costs from directorates in respect of Invest to Save/Earn schemes.

49. For the General Fund, net revenue stream is the amount to be met from non-specific WG grants and Council Tax, whilst for the HRA it is the amount to be met from rent payers.

Ratio of financing costs to Net Revenue Stream							
	2021/22 Original Estimate %	**2021/22** Actual %	**2022/23** Estimate %	**2023/24** Estimate %	**2024/25** Estimate %	**2025/26** Estimate %	**2026/27** Estimate %
General Fund – **Net** Capital Financing Budget	4.68	4.72	4.58	4.69	4.71	4.70	4.90
General Fund – **Gross** Capital Financing Budget	7.27	7.27	6.90	7.50	8.22	8.39	8.44
HRA	33.93	32.36	32.16	33.36	36.23	38.49	37.72

50. Although there may be short term implications, invest to save/earn schemes are intended to be net neutral on the capital financing budget. However, there are risks that the level of income, savings or capital receipts anticipated from such schemes will be delayed or will not materialise. This would have a detrimental long-term consequence on the Revenue budget and requires careful monitoring when considering future levels of additional borrowing.

51. Accordingly, an additional local indicator has to date been calculated for the general fund to support decision making and is shown in the table below for the period up to 2026/27.

These indicators show capital financing costs of the Council as a percentage of its controllable budget, excluding treasury investment income:

Capital Financing Costs as percentage of Controllable Budget									
	2011/12 Actual %	**2021/22** Original Estimate %	**2021/22** Actual %	**2022/23** Estimate %	**2023/24** Estimate %	**2024/25** Estimate %	**2025/26** Estimate %	**2026/27** Estimate %	**Difference** 11/12-26/27 %
Net	13.47	11.00	11.20	9.83	10.14	10.19	10.21	10.68	(20.71)
Gross	15.17	17.02	17.14	14.73	16.11	17.66	18.12	18.34	20.90

52. An increasing percentage indicates that a greater proportion of the controllable budget is required for capital financing costs which are committed in the long term. The requirement to meet these additional costs can only come from future savings or from increases in Council Tax. An increasing ratio limits the scope for additional borrowing in future years and reduces the Council's overall flexibility when making decisions on the allocation of its revenue resources. The percentages consider the impact on the controllable base budget of the level of savings having to be found in 2022/23 and over the medium term as set out in the budget report for 2022/23. They are based on future assumptions in respect to Aggregate External Financing, council tax income and housing rents at a point in time, so are extremely variable as an indicator.

<u>Principal Invested for over 364 days</u>

53. An upper limit for principal invested over 364 days was set at £100 million and this was not breached during the year, primarily due to the strategy adopted of minimising the period for which investments were made during 2021/22

<u>Resilience of the Treasury Management Function</u>

54. The Treasury function performs a key role including ensuring that sufficient funds are available to meet the Council's financial commitments and is often the payment mechanism of last resort. The Section 151 Officer and Head of Finance are responsible for ensuring that Treasury Management activities are resourced with relevant skills and experience, consistent with the complexity and size of the activity undertaken. The requirements to meet high standards, accuracy and governance requirements are significant for a small specialist team. An internal audit report during the year found no issues of significant concern for the function. Contingency plans in terms of access to bank and systems were trialled and implemented early (pre the national lockdown in March 2020), with continued review of systems, controls and opportunities to improve resilience such as use of mobile banking applications and making effective use of software capability for reporting to be considered.

55. Treasury Management activities continue to be the subject of regulatory change with the requirements of the 2021 Code updates required to be implemented in future updates to the Strategy. This and some of the other issues and challenges outlined below continue to test skills and resilience, something that will need to continue to be monitored closely by the S151 Officer.

Treasury Management issues for 2022/23 and future years

56. Whilst this report is primarily backward looking in relation to Treasury Activities for 2021/22, some key issues for 2022/23 are:

- The balance of internal borrowing and timing of external borrowing to pay for the Council's longer term need to borrow in light of increasing interest rates.
- Ongoing financial market uncertainty.
- Inclusion of Environmental, Social and Governance (ESG) issues within Treasury Management Practices.
- Ensuring compliance with HM Treasury revised lending policies and processes aimed to prevent borrowing undertaken to fund investment purely for financial gain. It should be noted that any such expenditure would preclude any borrowing from the PWLB.
- A requirement for the Council to adopt a debt liability benchmark treasury indicator.
- Review of knowledge and skills register for individuals involved in the Treasury management function.
- Updating the Treasury Management Strategy for the 2023/24 budget in line with any updates to the Capital Investment Programme forecasts and scheme delivery including the impact of major regeneration projects.

57. In accordance with the Council's Treasury Management Policy, Council will receive a further update on Treasury Management issues as part of the 2022/23 Mid-Year Treasury Management report in November 2022.

Christopher Lee
Corporate Director Resources
27 September 2022

The following Annexes are attached:-
Annexe A – Treasury Management Policy and Four Clauses of Treasury Management
Annexe B – Investments at 31 March 2022
Annexe C – Investment charts at 31 March 2022
Annexe D – Maturity analysis of debt as at 31 March 2022
Annexe E – Glossary of Treasury Management terms