REPORT TO: **MORAY COUNCIL ON 28 SEPTEMBER 2022**

SUBJECT: **REPORT ON TREASURY MANAGEMENT PERFORMANCE AND TREASURY AND CAPITAL INVESTMENT PRUDENTIAL INDICATORS FOR 2021/22**

BY: **DEPUTE CHIEF EXECUTIVE (ECONOMY, ENVIRONMENT AND FINANCE)**

1. REASON FOR REPORT

1.1 To provide Council with the annual outturn report on Treasury Management and details of the Council's Prudential Indicators for Treasury Management and Capital Investment for the year ended 31 March 2022.

1.2 This report is submitted to Committee in terms of Sections III B (8) of the Council's Scheme of Administration relating to Treasury Management and the Capital Plan.

2. RECOMMENDATION

2.1 It is recommended that the Council consider and note the Treasury Management Performance and the Council's Treasury Management and Capital Investment Prudential Indicators for 2021/22 as set out in the attached APPENDIX 2.

3. BACKGROUND

3.1 Members have agreed that reports on Treasury Management Performance are submitted twice annually. One report to agree the Treasury Management and Investment Strategies with relevant Performance Indicators and the second report to submit the annual review and actual performance of Treasury Management activities. Quarterly Treasury Management monitoring reports are posted on the Members Portal throughout the year.

3.2 The Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector 2021 (the Code) and the Local Government Investment (Scotland) Regulations 2010. All treasury management activities are carried out in accordance with the Code and regulations.

3.3 The primary requirements of the Code are as follows:

- An approved Treasury Management Policy, which sets out the policies and objectives of the Council's treasury management activities.

- Approved Treasury Management Practices, which set out the manner in which the Council will seek to achieve those policies and objectives.

- An annual treasury management strategy report to Council for the year ahead and an annual review report to Council of the previous year.

3.4 The Local Government (Scotland) Act 2003 requires the Council to adopt the CIPFA Prudential Code for Capital Finance in Local Authorities and to produce the prudential indicators set out in the Prudential Code. These indicators are designed to support and record affordable and sustainable capital investment and treasury management.

4. <u>TREASURY PERFORMANCE 2021/22</u>

4.1 This annual Treasury Management performance report covers:

- The Economy and Interest Rates 2021/22
- Treasury Management Strategy for 2021/22
- Annual Investment Strategy 2021/22
- Investment Outturn for 2021/22
- Long Term Borrowing and Debt Rescheduling
- Short Term Borrowing
- Prudential Code for Capital Finance in Local Authorities

The Economy and Interest Rates 2021/22

4.2 Throughout 2020/21 oil prices steadily increased following a slump as a result of the pandemic and this was a trend that continued throughout 2021/22. However due to the war in Ukraine and the impact this has had on fuel supplies, prices saw a significant increase in March up to $117.25 a barrel, which is the highest since 2008.

4.3 The UK Consumer Price Inflation (CPI) has steadily increased throughout 2021/22. It was originally thought that inflation was to be temporary as areas of the economy such as leisure and retail re-opened after the pandemic, however, price rises became more widespread due to a combination of rising costs and demand which was exacerbated by supply chain shortages. The end of the year saw increases in the price of gas and electricity which saw CPI for February reaching 6.2% and this is a trend that has continued into 2022/23 with inflation currently at record levels and forecast to rise further. During the first three quarters of the year the labour market was sheltered from the worst impacts of the pandemic due to the Government's furlough scheme. The labour market data for the three months to March 2022 showed that the employment rate was 75.7%, 0.1% higher than the previous quarter but still 0.9% lower than pre-pandemic levels. The unemployment rate was 3.7%. Average pay growth for the private sector was 8.2%, but was only 1.6% for the public sector. The rate of pay growth was 7.0% for total pay (including bonuses) and 4.2% for regular pay. In real terms (adjusted for inflation), growth in total pay was 1.4% while regular pay fell by 1.2%. Strong bonus payments have kept real total pay growth positive. The increasing difference between nominal and real growth rates is because of increasing CPI.

4.4 Gross Domestic Product (GDP) in the quarter to March 2021 increased by 0.8%, which was slightly below the estimated 1.0% when compared with the previous quarter and 8.7% when compared with the same quarter of the previous year. Although the increase in GDP was lower than originally anticipated what was more telling was that in February and March GDP did not increase at all which indicated that businesses and households had reduced spending activity, perhaps in anticipation of the April increase in energy prices. Construction saw a 3.8% quarter on quarter increase. This is mainly because the sector saw a 7.4% increase in non-housing repairs and maintenance. Other areas of the economy also saw increases with services and production increasing by 0.4% and 1.2% respectively.

4.5 Having increased the base rate from 0.10% to 0.25% in December, the Bank of England increased it further to 0.50% in February and 0.75% in March. In the March interest rate announcement the Monetary Policy Committee (MPC) noted that the invasion of Ukraine had caused further large increases in energy and commodity prices, with the expectation that the conflict will worsen supply chain disruptions globally and push CPI higher, which has been the case with CPI currently at record levels.

4.6 Globally economies have seen the same trend as here in the United Kingdom. The Federal Reserve in the America has increased interest rates and outlined that future increases are likely. The Euro Zone saw nine successive months of rising inflation and this is putting pressure on the European Central Bank's long term policy of holding its main interest rate at 0%.

2021/22 Treasury Management Strategy

4.7 The Treasury Management Strategy, incorporating the Annual Investment Strategy, was approved by the Council at its meeting on 3 March 2021 (paragraph 5 of the minute refers).

4.8 The Council's main objective when borrowing is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which the funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

4.9 Given the significant real reduction in local government funding in recent years and the impact of the pandemic, the Council's borrowing strategy continued to address the key issues of affordability without compromising the longer term stability of the debt portfolio. With short-term interest rates much lower than long-term rates, it was more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead. By adopting this approach, the Council was able to reduce net borrowing costs and reduce overall treasury risk.

4.10 The Public Loans Works Board (PWLB) is the Council's preferred source of long-term borrowing given the transparency and control that its facilities continue to provide.

Annual Investment Strategy

4.11 The Council's primary principle when investing is the security of capital and liquidity of investments. As a secondary aim the Council will also aim to achieve the optimum return on its investments, commensurate with proper levels of security and liquidity. It is considered prudent to only invest with highly credited UK financial institutions that have a long-term credit rating of BBB+ or higher.

4.12 The Council's creditworthiness policy has been formulated after consultation with Arlingclose, the Council's treasury advisers. The Chief Financial Officer maintains a counterparty list in compliance with the minimum criteria approved by Full Council on 3 March 2020 (paragraph 4 of the minute refers) and any revision to the criteria is submitted to Council for approval as necessary.

4.13 All credit ratings are monitored daily and the Counterparty list is amended to reflect any changes.

Investment Outturn for 2021/22

4.14 The Council manages its investments in-house and invests with the institutions listed on the Council's approved Counterparty list.

4.15 The table below shows the overall investment undertaken by the Council during 2021/22:

	Total Sum Deposited (£m)	Average Rate (%)
Approved Financial Institutions	294.982	0.06
Council's Bankers	2.938	0.14
TOTAL	**297.920**	**0.10**

The above figures are cumulative and the actual amounts invested at any one time ranged from £10.51 million to £36.925 million.

4.16 The average rate of interest earned on investments during the year was 0.10%, compared to the average 7 day London Inter Bank Bid Rate (LIBID) of 0.15%. When the Bank of England base interest rate increases, our Bank of Scotland call account rate is increased from that day and so is the LIBID rate. The money market funds in which we invest the balance of our funds take time to catch up as their interest rates are not set and fluctuate depending on the market and the size of investment in each fund. Our investments are in line with our Treasury Management practices with money deposited in the funds available to us, redeeming from the ones with lower rates first.

4.17 As at 31 March 2022, the following balance was invested:

Counterparty	Investment	Amount (£m)	Interest Rate (%)
Bank of Scotland	Call Account	10.000	0.70
Federated	Money Market Fund	0.210	0.51

Counterparty	Investment	Amount (£m)	Interest Rate (%)
Blackrock	Money Market Fund	4.355	0.53
CCLA	Money Market Fund	5.000	0.58
		19.565	**0.63**

Long Term Borrowing and Debt Rescheduling

4.18 The Council's long term external debt position at 31 March 2022 compared with the position at the end of the last financial year was as follows:

	31 March 2021			31 March 2022		
	Actual (£000)	**Rate (%)**	**Average Life (years)**	**Actual (£000)**	**Rate (%)**	**Average Life (years)**
Fixed Rate Funding – PWLB	142,758	4.70	17.34	134,150	4.85	17.26
Fixed Rate Funding – Market	33,400	4.68	52.82	33,400	4.68	52.82
TOTAL DEBT	**178,158**	**4.69**		**167,550**	**4.77**	

There was no variable rate borrowing in the year.

4.19 The Council has been maintaining an under borrowed position which means that the capital borrowing need (Capital Financing Requirement) has not been fully funded with loan debt. Cash supporting the Council's reserves, balances and cash flows have been used as temporary measures to offset the need to borrow.

4.20 The strategy of effectively delaying new long term borrowing by utilising internal and temporary borrowing has served well at a time when comparatively cheaper temporary borrowing from other local authorities is readily available, and historically low investment returns give rise to potentially significant carrying costs for new long-term borrowing.

4.21 There was no new long term borrowing from the Public Works Loans Board (PWLB) in the year.

4.22 No debt rescheduling was undertaken during the year as the differential between PWLB new borrowing rates and PWLB premature repayment rates made rescheduling unviable.

Short Term Borrowing

4.23 During the year, seventeen new temporary loans totalling £68m were borrowed from other UK local authorities. A table detailing the short term loans outstanding at 31 March 2022 can be found at **APPENDIX 1.**

The Prudential Code for Capital Finance in Local Authorities

4.24 The Local Government (Scotland) Act 2003 requires the Council to undertake its treasury activities with regard to the Prudential Code for Capital Finance in Local Authorities.

4.26 CIPFA published a revised Prudential Code for Capital Finance and Treasury Management Code in December 2021. The key changes from the previous code are around permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments.

4.27 To comply with the Prudential Code, authorities must not borrow to invest primarily for financial return. This Code also states that it is not prudent for local authorities to make investment or spending decisions that will increase the Capital Financing Requirement (CFR) unless directly and primarily related to the functions of the authority. Borrowing is permitted for cash flow management, interest rate risk management, to refinance current borrowing and to adjust levels of internal borrowing. Borrowing to refinance capital expenditure primarily related to the delivery of a local authority's function but where a financial return is also expected is allowed, provided that financial return is not the primary reason for the expenditure. The changes align the CIPFA Prudential Code with the PWLB lending rules.

4.25 The Code requires the Council to produce mandatory indicators aimed at assisting members in ensuring that proposed capital investment levels and treasury management decisions satisfy the key requirements of affordability, prudence and sustainability. The Prudential Indicators for 2021/22 were approved at Full Council on 3 March 2021 (paragraph 5 of the minute refers). The indicator of the proportion of debt maturing in less than 12 months was breached in 2021/22. Very low interest rates were available for short term borrowing and advantage was taken of this to reduce the cost of borrowing to the Council. This was a carefully considered action and was advised by the Council's Treasury Advisors and is not considered to be indicative of problems with treasury management practice. Performance against key indicators is shown in the **APPENDIX 2.**

5. SUMMARY OF IMPLICATIONS

(a) Corporate Plan and 10 Year Plan (Local Outcomes Improvement Plan (LOIP))

None arising specifically from this report.

(b) Policy and Legal

The Local Government (Scotland) Act 2003 provides the power to borrow and invest as well as providing controls and limits on these activities.

The Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector which details best practice The Local Government Investment (Scotland) Regulations 2010.

All Treasury Management activities are carried out in accordance with the Code and Regulations.

(c) Financial implications
The financial implications are highlighted within the report and the attached **APPENDIX 2**.

(d) Risk Implications
The Council is aware of the risks of passive management of the treasury portfolio and, with the support of the Council's treasury advisers, will proactively manage its investments and debt over the year.

(e) Staffing Implications
There are no staffing implications arising directly from this report

(f) Property
There are no property implications arising directly from this report.

(g) Equalities/Socio Economic Impact
There are no equalities issues arising from this report

(h) Climate Change and Biodiversity Impacts
There are no climate change or biodiversity issues arising from this report.

(i) Consultations
This report has been produced in consultation with Arlingclose Limited, the Council's Treasury Advisers.

6. CONCLUSION

6.1 The Council's requirements for funds continues to be managed in accordance with the agreed Treasury Management Strategy Statement. All treasury management and capital investment activities have been undertaken with the limits set by the Prudential Code Performance Indicators for 2021/22.

Author of Report:	Laurie Milne, Senior Accountant
Background Papers:	Various working papers held within Financial Services.
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