PERTH AND KINROSS COUNCIL

Finance & Resources Committee
7 September 2022

ANNUAL TREASURY REPORT 2021/22

Report Head of Finance
(Report No. 22/211)

1. PURPOSE

1.1 A requirement of the Council's approved Treasury Management Practice 6 (TMP6 – Reporting Requirements & Management Information Arrangements) is the reporting to Council of the expected treasury activity for the forthcoming year (i.e. the Treasury and Investment Strategy) and the subsequent reporting of the actual results and activities (i.e. this Annual Treasury Report). The Council meeting on 31 March 2021 approved the Treasury Strategy for the 8 financial years 2021/22 to 2028/29 and the annual Investment Strategy for 2021/22 (Report No. 21/42 refers).

1.2 This Annual Treasury Report covers:

- The Council's treasury position
- The forecast economic outlook and borrowing strategy for 2021/22
- The actual economic situation for 2021/22
- Actual long-term borrowing and repayments in 2021/22
- The Statutory Loans Fund position
- The Investment Strategy and outturn for 2021/22
- Compliance with treasury policies and limits during 2021/22

2. RECOMMENDATIONS

2.1 It is recommended that the Committee notes the content of this report, which is submitted in accordance with the Council's approved Treasury Management Practices.

3. THE TREASURY POSITION

3.1 In order to place this report in context, the Council's Treasury position at the beginning and at the end of the year is shown below:

	Principal 31 Mar 2021 £M	Average Rate %	Principal 31 Mar 2022 £M	Average Rate %
Fixed Rate/Long Term Funding				
• Public Works Loan Board (PWLB)	490.5	2.59	568.0	2.41
• Market & Local Authority Bonds	43.2	4.59	43.2	4.59
• Other Loans & Bonds*	0.1	0.00	0.1	0.00
	533.8	2.75	611.3	2.57
Variable Rate/Short Term Funding				
• Temporary Loans	51.8	0.08	3.0	0.19
• Internal Loans	2.2	0.10	2.2	1.05
	54.0	0.08	5.2	0.56
TOTAL DEBT	**587.8**	**2.51**	**616.5**	**2.55**
Short Term Investments	191.7	0.50	252.0	0.99
Long Term Investments	45.0	0.71	0.0	0.00
TOTAL INVESTMENTS	**236.7**	**0.54**	**252.0**	**0.88**
*Interest free loan from the Scottish Government				

4. THE FORECAST ECONOMIC OUTLOOK AND BORROWING STRATEGY 2021/22

4.1 Following the pandemic it was anticipated that economic growth and inflation would steadily increase, but with no immediate increase in the Bank base rate. However, gilt yields were anticipated to rise gradually throughout 2021/22 and beyond, subject to any new economic restrictions. The Council's Treasury Strategy for 2021/22 was that with no immediate long-term borrowing required as a result of the significant borrowing undertaken in 2019, any such borrowing would only be undertaken if capital expenditure recovered quicker than expected, or if opportunities arose to borrow at low rates. With short term rates expected to rise slower than medium and long-term rates, short term borrowing could be undertaken if required and long-term borrowing would then be deferred.

4.2 The amounts reflected in the Council's approved Capital Budget showed that the estimated capital borrowing requirement for 2021/22 at the start of the year was £86.5M, with further significant borrowing totalling £227.7M required in the subsequent 2 years. However, much of this borrowing had already been undertaken in advance in the previous year.

4.3 Therefore consideration was given to borrowing for future year requirements earlier within the 8-year period, whilst rates were at their forecast low point. This approach is consistent with the Prudential Code but should be considered in conjunction with the assessment of the additional risks and potentially low returns from the resultant short-term increase in the level of investments.

4.4 Whilst the use of short-term borrowing would initially be cheaper, the use of longer-term borrowing would give rise to longer term savings and reduce the refinancing risk in later years. However, if rates stayed low, new borrowing could be delayed and short-term borrowing used to meet immediate cashflow requirements. The approved Treasury Strategy also allowed for consideration of other market borrowing instruments where they offered favourable rates. However, the associated risks due to their variable rate nature and their less flexible terms in comparison to the Public Works Loan Board would also need to be considered.

4.5 Whilst minimising risk by favouring fixed longer-term borrowing, it was acknowledged that there were several factors which could impact on interest rates over the year. Therefore, the Council applies an approach of managing risk and monitoring interest rates on an ongoing basis with a view to reviewing this strategy should circumstances change.

5. ACTUAL ECONOMIC SITUATION 2021/22

5.1 2021/22 was another volatile year for the financial markets. Economic growth in the UK initially fell at the start of the year before increasing over the remainder of the year as restrictions were lifted. However, the rate of growth did decline towards the end of the year. Consumer Price Index (CPIH) inflation steadily rose over the year from 2.4% to 7.0% by March 2022, with forecasts that it would exceed 10% by the end of the year. This was due to a large increase in demand for commodities, including oil and gas, and the war in Ukraine which is affecting global commodity supplies. Unemployment fell throughout the year.

5.2 Whilst no increases in the Bank base rate in 2021 were anticipated, with the rapid rise in inflation and improving economic activity, the Bank of England’s Monetary Policy Committee (MPC) did increase the Bank base rate to 0.25% in November 2021, with further rises to in February 2022 to 0.75% by March 2022. The MPC has subsequently increased the rate further to its current level of 1.75%, with further increases expected over the remainder of this year.

5.3 PWLB rates gradually fell in the first half of the year due to uncertainty over future economic activity, before increasing as inflation started to rise rapidly. However the rise in PWLB rates was reversed in November and December 2021 as fears over the impact of the new coronavirus variant Omicron surfaced. At this time, PWLB rates fell to historic low levels not seen since the start of the pandemic in March 2020. However, with no further restrictions being made in the UK, and with inflation increasing, rates rose rapidly over the remainder of the financial year. The PWLB rates for various periods are shown at Appendix I.

5.4 The 50-year rate was 2.03% at the start of the year and fell to 1.52% by August. This was followed by a period of increases until they peaked at 2.15% in October, before rapidly falling to their low point of 1.26% in December. Thereafter they rose quickly and ended the year at around 2.40% in March 2022. All other durations followed a similar pattern, with the 20 and 30 year rates being higher than the 50-year rate for the whole year. PWLB fixed rates underwent a year of significant volatility and were higher than forecast in the original strategy for most of the year, however the falls in November and December 2021 did give rise to some borrowing opportunities.

5.5 Investment deposit rates were little changed in the first half of the year, however they increased significantly in the second half of the year, and particularly towards the financial year end. This reflected the increased Bank base rate during the year, as well as expectations of further increases in the Bank Rate in the future. The average rate on the Council's investments at the start of the year was 0.54% and increased to 0.99% at the end of the year.

6. ACTUAL LONG-TERM BORROWING & REPAYMENTS

6.1 Treasury activity during 2021/22 is detailed in the four quarterly Treasury reports previously submitted to the Council (Report No 21/141), the Strategic Policy & Resources Committee (Report No's 21/216 and 22/26) and the Finance & Resources Committee (Report No 22/122).

6.2 As noted in paragraph 4.2 above, before the start of the year, the Council's estimated new capital borrowing for 2021/22 was £86.5M. However, as this had already been borrowed in a previous year, no new actual borrowing was expected to be undertaken in the year, unless, for example, interest rates started to increase rapidly or fell to historic low levels. This may have included borrowing of future year's requirements.

6.3 Following a sharp fall in rates, a total of £90M of new longer-term borrowing was undertaken in the year from the PWLB which is summarised below:

Date	Amount (£)	Interest Rate (%)	Duration (Years)
16 Nov 2021	25,000,000	1.51	50
3 Dec 2021	25,000,000	1.46	49.5
3 Dec 2021	25,000,000	1.46	50
15 Dec 2021	15,000,000	1.26	50

6.4 These loans are required to fund the Capital programme. Whilst there was no borrowing required in the year, these loans were drawn down against the borrowing required in 2022/23. With PWLB rates reaching historic lows, these loans give estimated savings in interest of £728,000 per annum against forecast interest rates in future years.

6.5 The Council's scheduled repayments to the PWLB during the year related to 2 maturing loans which had been borrowed for 5 and 12 years totalling £12.5M at an average interest rate of 2.43%. The average PWLB debt portfolio rate for the Council reduced from 2.59% at the start of the year, to 2.41% for the total of £568M of PWLB debt held by the Council on 31 March 2022. There were no other repayments of long-term debt in the year.

6.6 Overall, the Council's total Fixed Rate borrowing increased by £77.5M to £611.3M, whilst the average rate reduced from 2.75% to 2.57%.

6.7 Short term variable funding at the year-end reduced from £54.0M at 31 March 2021 to £5.2M at 31 March 2022. The reduction mostly relates to a reduced requirement for short term funding over the financial year end in March 2022.

6.8 As a result of the above strategy and actual treasury activities in the year, the Council's average Consolidated Loans Fund (CLF) interest rate was broadly unchanged from 3.1% in 2020/21 to 3.11% in 2021/22 (based on applying statutory guidance). The impact of borrowing at lower rates in the year was offset by the small increase in capital debt outstanding, however it will lead to a lower CLF rate in subsequent years (the 2022/23 CLF rate is currently projected to be 2.49%).

6.9 A comparison of the Council's CLF rate over recent years with the average for other Scottish Local authorities is shown graphically at Appendix II. Whilst figures for the 2021/22 Scottish average will not be published until the autumn, this graph shows that over time, this Council's average borrowing costs have reduced to a level significantly below the Scottish average. This equates to savings in Loan Charges of around £2.2M per annum on the Council's portfolio compared to the Scottish average. Further, the impact of the advance borrowing and debt rescheduling undertaken in the last 2 years can be seen in the forecast of the Council's Loans Fund rate over the next few years.

7. STATUTORY LOANS FUND

7.1 The Loans Fund is an internal fund operated by the Council to manage:

- The write down (repayments or "amortisation") of capital expenditure (capital advances) over the life of the various assets being funded by borrowing as part of the Council's Loan Charges, and
- To manage the external borrowing raised to finance the capital expenditure.

7.2 Whilst both these elements of the Loans Fund operate independently of each other, because they are based on the same capital plans of the Council, they will broadly be consistent with each other over the long term. However, significant differences may arise in the short-term due to, for example, delaying external borrowing, or borrowing in advance in light of prevailing interest rates, or where the Council has significant levels of Reserves.

7.3 The approved Loans Fund policies allow the amortisation of capital expenditure (advances) for periods of up to 50 years in line with the asset useful lives, using the annuity method. The repayment of Loans Fund advances is also deferred until the asset being funded is completed and operational.

7.4 It is a requirement of the Loans Fund regulations that the outstanding amount of Loans Fund advances at the end of each financial year is reported as part of the annual report. The value of Loans Fund advances outstanding at 31 March 2022 is £491,270,000 (subject to completion and audit of the Council's Annual Accounts). This is made up as follows:

- Capital Advances outstanding 1 April 2021 - £462,132,000
- Add New capital Advances 2021/22 - £38,460,000
- Less Capital Advances repaid in the year - £9,322,000

7.5 The future repayment of these advances is summarised in the table below:

	Core Composite Programme	Prudential Borrowing	**Sub-Total: General Fund**	Housing Revenue Account	**TOTAL**
(£'000)					
Within 1 Year	2,382	2,747	**5,129**	3,697	**8,826**
Between 1 and 2 Years	2,107	2,802	**4,909**	4,145	**9,054**
Between 2 and 5 Years	3,413	6,504	**9,917**	10,990	**20,907**
Between 5 and 10 Years	(8,091)	5,221	**(2,870)**	19,341	**16,471**
Between 10 and 15 Years	(5,402)	4,062	**(1,340)**	24,807	**23,467**
Between 15 and 20 Years	28,291	3,399	**31,690**	9,461	**41,151**
Between 20 and 25 Years	37,104	3,592	**40,696**	2,490	**43,186**
Between 25 and 30 Years	43,802	4,216	**48,018**	6,055	**54,073**
Between 30 and 35 Years	47,789	5,644	**53,433**	11,338	**64,771**
Between 35 and 40 Years	59,987	3,921	**63,908**	11,455	**75,363**
Between 40 and 45 Years	68,095	3,572	**71,667**	13,543	**85,210**
Between 45 and 50 Years	35,833	155	**35,988**	7,957	**43,945**
Over 50 Years	4,846	0	**4,846**	0	**4,846**
TOTAL	**320,156**	**45,835**	**365,991**	**125,279**	**491,270**

7.6 Comparison of the outstanding capital advances above with the long-term external debt shown in paragraph 3.1 demonstrates that actual capital expenditure funded by borrowing is lower than the actual borrowing undertaken to date by around £120M. This reflects the strategy adopted in recent years of undertaking new borrowing whilst rates were at historic low levels, in order to fund the significant borrowing requirement approved by the Council over the next 2-3 years. This strategy has reduced the risks and the interest charges of borrowing in future at higher interest rates.

7.7 The last report to the Strategic Policy & Resources Committee on 20 April 2022 (report 22/88) approved adjustments to the General Fund Composite Capital Budget and Housing Investment Programmes. The amount of capital expenditure to be funded by borrowing (ie new Loans Fund advances) in each of the next 6 years as approved in April is as follows:

	Composite Programme	Housing Investment Programme	**TOTAL**
(£'000)			
2022/23	125,644	15,349	**140,993**
2023/24	155,102	13,338	**168,440**
2024/25	117,980	10,5420	**128,522**
2025/26	41,974	16,035	**58,009**
2026/27	35,115	11,765	**46,880**
2027/28	26,188	0	**26,188**
TOTAL	**502,003**	**67,029**	**569,032**

7.8 All the above Loans Fund repayments and new borrowing have been included in the Loan Charge estimates within the approved Medium Term Financial Plan, and therefore remain affordable under the current Loan Charge Budget strategy. This also includes estimates of new borrowing in the years beyond 2027/28.

8. INVESTMENT STRATEGY AND OUTURN 2021/22

8.1 Short term deposit rates remained at low levels throughout most of the year, however they did increase from December 2021 following the increases in the Bank base rate. The low deposit rates also reflect funding requirements for banks which make it less attractive for banks to hold short term cash deposits. Therefore, instant access and short-term deposit rates offered by most banks and institutions remained low relative to the bank base rate.

8.2 The original Strategy anticipated that investments would reduce gradually over the year unless, for example, new borrowing was undertaken in the year or the Council's expenditure during the year was later than anticipated. As described in paragraph 6.3, a total of £90M of new borrowing was undertaken in November and December 2021. Consequentially, the level of investments gradually reduced in the first half of the year before they increased and peaked at £294M on 16 December 2021. They then gradually reduced again over the remainder of the year, reflecting the Council's day-to-day cashflow over that period. The level of investments stood at £236.7M at the start of the year, peaked at £294.1M in December, before ending at £252.0M on 31 March 2022.

8.3 For shorter investment periods, notice deposit accounts and money market funds held by the Council provided a higher return on investments than rates available on instant access bank accounts and shorter-term fixed deposits. In the first half of the year, notice deposit rates for 3 months with some of the banks were particularly competitive and increased relative to other investment rates. These facilities also helped to meet short term cashflow requirements and keep within counterparty limits. As the investment rates increased, short term fixed deposit rates become more attractive relative to notice accounts. With the expectation of rates increasing further as the year progressed, the strategy was to invest in shorter term fixed deposits (up to 3 months) in order to benefit from the rising interest rates as they matured. Towards the end of the year, fixed deposits up to 12 months became more attractive, with several deposits then being undertaken for this period.

8.4 During the year, no investment was made for more than 12 months, and all investment activities were in line with the approved strategy for 2021/22. The average rate on investments outstanding at 31 March 2022 was 0.88% (0.54% at 31 March 2021). This increase in the average rate over the year reflected the increase in the Bank base rate. In comparison, the average temporary borrowing rate for the year was 0.14%. Total interest received on investments in 2021/22 amounted to £1,076,000. Whilst this was lower than the previous year (£1,663,000 in 2020/21), the previous year included significant levels of local authority borrowing at higher than market rates (reflecting local authority cash requirements at the height of the pandemic).

8.5 All financial investments by the Council's Common Good Funds and Charitable Trusts were made through the Council's Loans Fund, in accordance with the Council's and Common Good Fund's policy for Permitted Investments. As a result, £2,169,000 of Common Good funds and Charitable Trusts are placed on deposit with the Loans Fund for periods of between 6 and 12 months at an average rate of 1.05%.

8.6 Any investments held with external fund managers are outside the scope of the investment regulations, as they all relate to funds held by Council administered Charities or Trusts.

8.7 The Annual Property Investment Strategy for 2021/22 was also approved by the Council at its meeting on the 31 March 2021 and was complied with in full, with no breaches in compliance with permitted investment limits. The budgeted income from the Council's property portfolio for 2021/22 was £1,819,000, whilst the final position (subject to audit) was £1,847,000. There were no additional risks identified or new property investments entered into over the year. The strategy action plan remained on programme.

9. COMPLIANCE WITH TREASURY POLICIES AND LIMITS

9.1 There were no breaches of compliance with the Council's approved borrowing and investment policies and strategy in 2021/22. All aspects of the Prudential Code, including Prudential Indicators and limits, were also fully adhered to throughout the year.

10. CONCLUSION

10.1 Global economic and political uncertainties have kept UK interest rates low for several years, and particularly in the last couple of years during the pandemic. However, whilst there was no immediate expectation of rates rising in 2021/22, the interest rate forecast was that rates would start rising gradually from the end of the year. As a result of rapidly rising inflation, the Bank base rate did increase, and at a faster rate than anticipated. However, some uncertainties did remain and thus market and interest rate volatility continued, giving rise to new borrowing opportunities in the year. Consequently, £90M of new long-term borrowing was undertaken in the year

10.2 As the new borrowing is required to fund the 2022/23 capital programme, there was increased short term investment activity as a result of the increased balances arising from the borrowing. As interest rates rose over the year, the investment Strategy moved from notice accounts to shorter term fixed deposits.

10.3 There were no breaches of compliance with the lending policy and all Prudential Indicators were complied with throughout the year. As a result of the activities undertaken during 2021/22 the Council's plans remain affordable, prudent and sustainable. The report also includes detailed information on the repayment profiles and future estimates of Loans Fund Advances.

10.4 The Council's Consolidated Loans Fund (CLF) rate for the year remained broadly unchanged, increasing marginally from 3.10% last year to 3.11%. However, as a result of the treasury activities during 2021/22, the CLF rate in future years is projected to reduce significantly (currently estimated at 2.49% for 2022/23).

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ANNEX

1. IMPLICATIONS, ASSESSMENTS, CONSULTATION AND COMMUNICATION

Strategic Implications	**Yes / None**
Community Plan / Single Outcome Agreement	None
Corporate Plan	Yes
Resource Implications	
Financial	Yes
Workforce	Yes
Asset Management (land, property, IST)	Yes
Assessments	
Equality Impact Assessment	Yes
Strategic Environmental Assessment	Yes
Sustainability (community, economic, environmental)	Yes
Legal and Governance	None
Risk	None
Consultation	
Internal	Yes
External	Yes
Communication	
Communications Plan	None

1. Strategic Implications

Corporate Plan

1.1 The Council's Corporate Plan 2018 – 2023 lays out five outcome focussed strategic objectives which provide clear strategic direction, inform decisions at a corporate and service level and shape resources allocation. They are as follows:

(i) Giving every child the best start in life;
(ii) Developing educated, responsible and informed citizens;
(iii) Promoting a prosperous, inclusive and sustainable economy;
(iv) Supporting people to lead independent, healthy and active lives; and
(v) Creating a safe and sustainable place for future generations.

1.2 This report relates to all of these objectives.

2. Resource Implications

Financial

2.1 There are no direct financial implications arising from this report other than those reported within the body of the main report.

Workforce

2.2 There are no direct workforce implications arising from this report other than those reported within the body of the main report.

Asset Management (land, property, IT)

2.3 There are no direct asset management implications arising from this report other than those reported within the body of the main report.

3. Assessments

Equality Impact Assessment

3.1 Under the Equality Act 2010, the Council is required to eliminate discrimination, advance equality of opportunity, and foster good relations between equality groups. Carrying out Equality Impact Assessments for plans and policies allows the Council to demonstrate that it is meeting these duties.

3.2 The information contained within this report has been considered under the Corporate Equalities Impact Assessment process (EqIA) and has been assessed as **not relevant** for the purposes of EqIA.

Strategic Environmental Assessment

3.3 The Environmental Assessment (Scotland) Act 2005 places a duty on the Council to identify and assess the environmental consequences of its proposals.

3.4 The information contained within this report has been considered under the Act. However, no action is required as the Act does not apply to the matters presented in this report.

Sustainability

3.5 Under the provisions of the Local Government in Scotland Act 2003 the Council has to discharge its duties in a way which contributes to the achievement of sustainable development. In terms of the Climate Change Act, the Council has a general duty to demonstrate its commitment to sustainability and the community, environmental and economic impacts of its actions.

3.6 The information contained within this report has been considered under the Act. However, no action is required as the Act does not apply to the matters presented in this report.

4. Consultation

4.1 The Chief Executive, and the Council’s Treasury advisors, Capita Asset Services, have been consulted in the preparation of this report.

2. BACKGROUND PAPERS

No background papers, as defined by Section 50D of the Local Government (Scotland) Act 1973 (other than any containing confidential or exempt information) were relied on to any material extent in preparing the above report.

3. APPENDICES

- Appendix I – PWLB Fixed Maturity Interest Rates From 1 April 2021 to 1 April 2022.
- Appendix II – Average Loans Fund Rates