Annual Report 2021/22
Treasury Management and Actual Prudential Indicators

1. Introduction

1.1 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government in Scotland Act 2003 (the Act), provides the powers to borrow and invest as well as providing controls and limits on this activity. The Act permits the Scottish Ministers to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2021/22);

- Statutory Instrument (SSI) 29 of 2004, requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities, and therefore to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services; and the treasury activity with regard to the CIPFA Code of Practice for Treasury Management in Local Authorities; and

- Statutory Instrument (SI) 2016 No 123 requires the Council to document its policy on the prudent repayment of loans fund advances.

1.2 This Council has adopted both the CIPFA Code of Practice for Treasury Management in the Public Sector and the Prudential Code and operates its treasury management service and capital programme in compliance with these Codes and the above requirements. These require that the prime objective of the treasury management activity is the effective management of risk, and that its borrowing activities are undertaken in a prudent, affordable and sustainable basis.

In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued a revised Treasury Management Code and a revised Prudential Code.

A particular focus of these revised codes was how to deal with local authority investments which are not treasury type investments e.g. by investing in purchasing property in order to generate income for the Authority at a much higher level than can be attained by treasury investments. One recommendation was that local authorities should produce a new report to members to give a high level summary of the overall capital strategy and to enable members to see how the cash resources of the Authority have been apportioned between treasury and non-treasury investments. For 2021/22, a Capital Strategy was reported and approved by Council on 3 March 2021.

1.3 During 2021/22 the minimum reporting requirements were that the Council should receive the following reports:

- an annual treasury strategy in advance of the new financial year (Council 22 March 2021);
- a mid-year treasury update report (Council 22 December 2021); and
- an annual report following the financial year-end describing the activity compared to the strategy (this report).

1.4 This report sets out:

- A summary of the strategy agreed for 2021/22;
- The Council's treasury position at 31 March 2022;
- The main Prudential Indicators and compliance with limits;
- A summary of the economic factors affecting the strategy over 2021/22;
- The Treasury activity during 2021/22;
- Performance indicators set for 2021/22;
- Disclosure regarding the repayment of loan Fund advances for 2021/22; and
- Risk and Performance.

2. A Summary of the Strategy for 2021/22

2.1 **Borrowing** - keeping note of the slightly under-borrowed position of the Council as at 31 March 2022 and the risk within the economic forecast at that time, caution was adopted with the 2021/22 treasury operations. The Section 95 Officer planned to monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

2.2 **Investments -** with the economic background at the time, the investment climate had one over-riding risk consideration - counterparty security risk. As a result of the underlying concerns, officers maintained an operational investment strategy which tightened the controls already in place in the approved investment strategy. The Council's investment strategy primary objectives are safeguarding the re-payment of the principal and interest of its investments on time first and ensuring adequate liquidity second – the investment return being a third objective.

2.3 Based on the above, the treasury strategy was to postpone borrowing (by not borrowing in advance of need) and in particular minimise longer term borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

3. The Council's Treasury Position at 31 March 2022

3.1 During 2021/22, the Chief Officer – Resources, in line with the Treasury Strategy, managed the debt position with the use of internal funds as well as a mix of short term and long term external borrowing, and the treasury position at 31 March 2022 compared with the previous year was:

Table 1

Treasury position – excluding PPP	31 March 2022		31 March 2021	
	Principal	Average Rate	Principal	Average Rate
Fixed Interest Rate Debt	£574.570m	1.91%	£544.813m	1.92%
Variable Interest Rate Debt	£0.000m	0.00%	£0.000m	0.00%
Total Debt	**£574.570m**	**1.91%**	**£544.813m**	**1.92%**
Total Investments	**£11.440m**	**0.42%**	**£17.475m**	**0.02%**
Net borrowing position	**£563.130m**		**£527.338m**	

3.2 From the above table, it can be seen that the average interest rate on the debt held as at 31 March has reduced from 1.92% in 2021 to 1.91% as at 30 March 2022. At the same time the average interest rate has increased on the investments held as at 31 March from 0.02% in 2021 to 0.42% in as at 31 March 2022.

3.3 The external debt figure included within Table 1 includes both short term and long term debt. The low average interest rate is due to a strategy of using short term borrowing to fund long term capital investment enabling the Council to take advantage of lower interest rates.

3.4 There are four treasury prudential indicators which cover the activity of the treasury function. Complying with these indicators reduces the risk of an adverse movement in interest rates impacting negatively on the Council's overall position:

- Upper limits on variable rate exposure;
- Upper limits on fixed rate exposure;
- Maturity structures of borrowing; and
- Total principal funds invested for greater than 365 days.

3.5 Table 2 shows the actual upper limits set per debt type and maturity as at 31 March 2022.

Table 2

	2021/22 Actual	2021/22 Indicator	
Upper limits on variable interest rates	0%	50%	
Upper limits on fixed interest rates	100%	100%	
Maturity structure fixed rate borrowing *(%)*	**Year end**	**Max**	**Min**
Under 12 months	46.81%	50%	0%
12 months to 2 years	0.19%	50%	0%
2 years to 5 years	5.29%	50%	0%
5 years to 10 years	4.98%	50%	0%
10 years to 20 years	4.01%	50%	0%
20 years to 30 years	5.66	50%	0%
30 years to 40 years	3.40%	50%	0%
40 years to 50 years	24.21%	100%	0%
50 years to 60 years	5.45%	100%	0%
60 years to 70 years	0.0%	100%	0%
Maximum principal funds invested *>365 days*	£0.485m	£7m	Nil

4. The Main Prudential Indicators and Compliance with Limits

4.1 The Council is required by the Prudential Code to report the actual prudential indicators after the year end.

4.1.1 Capital Expenditure and its Financing

This indicator shows total capital expenditure for the year and how this was financed. The decrease in capital expenditure between revised estimate and actual as noted below in Table 3 is due to expenditure which slipped from 2021/22 into the 2022/23 capital programme, together with resources. The indicators for 2022/23 will be revised in line with this.

Table 3

	2021/22 Actual	2021/22 Revised Estimate*
Capital expenditure:	£64.219m	£90.092m
Resourced by:		
Capital receipts and grants	£7.746m	£20.821m
Revenue	£13.247m	£9.003m
Capital expenditure - additional need to borrow for in-year capital spend	**£43.226m**	**£60.268m**

* From the mid-year Treasury Strategy – Council 22 December 2021

4.1.2 Gross Borrowing and the Capital Financing Requirement (CFR)

In order to ensure that borrowing levels are prudent, over the medium term the Council's gross borrowing must only be used for capital purposes. Gross borrowing should not therefore, except in the short term, exceed the total of the capital financing requirement in the preceding year (2021/22) plus the estimates of any additional capital financing requirement for the current (2022/23) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2021/22.

4.1.3 The Chief Officer - Resources reports that the Council has complied with this indicator over the medium term (as can be seen by comparing the gross debt figure at 31 March 2022 with the anticipated CFR at 31 March 2025 as detailed in Table 4 below), and in the short term, the adjusted gross borrowing position also under the CFR as at 31 March 2022.

Table 4

	2021/22 Actual	2021/22 Revised Indicator*
Gross borrowing position per Table1	£574.570m	£597.912m
Long term liability	£92.485m	£92.615m
Adjusted gross borrowing position	**£657.055m**	**£690.527m**
Capital Financing Requirement	**£670.893m**	**£695.609m**

* From the mid-year Treasury Strategy – Council 22 December 2021

	2021/22 Actual
CFR at 31 March 2022	
2021/22 Actual	**£670.893m**
Estimated Movement in CFR*	
2022/23	£63.802m
2023/24	£67.898m
2024/25	£37.805m
Anticipated CFR at 31 March 2025	**£840.398m**
Gross Debt at 31 March 2022	**£667.055m**

* Estimated movement 2022/23 from the Treasury Mid year Update 2022/23 – 26 October 2022
Estimated movement 2023/24 & 2024/25 from the Treasury Strategy 2022/23 – 22 March 2022

4.1.4 The Authorised Limit

The Authorised Limit is the “Affordable Borrowing Limit” required by Section 35 of the Local Government in Scotland Act 2003. The Council does not have the power to borrow above this level. The information in Table 5 demonstrates that during 2021/22 the Council has maintained gross borrowing within its Authorised Limit.

4.1.5 The Operational Boundary

The Operational Boundary is the borrowing position that the Council expects to work around during the year, and periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached. The information in Table 5 demonstrates that during 2021/22 the Council has maintained gross borrowing within its Operational Boundary.

4.1.6 Actual financing costs as a proportion of net revenue stream

This indicator shows the actual impact of capital expenditure in 2021/22 compared to the projected impact of the General Services Capital Plan Refresh and the HRA Capital Plan Update as approved by Members on 22 March 2021 and 3 March 2021, respectively. The cost of capital is described as loan charges within the revenue budgets

Table 5

	2021/22	
Revised Indicator - Authorised Limit*	£829.832m	
Revised Indicator - Operational Boundary*	£760.680m	
Maximum gross borrowing position during 2021/22	£674.625m	
Minimum gross borrowing position during 2021/22	£620.415m	
	Estimated	**Actual**
Financing costs as a proportion of net revenue stream:		
General Fund	3.63%	3.28%
Housing	25.07%	23.55%

* From the mid-year Treasury Strategy – Council 16 December 2021

5. Summary of the Economic Factors affecting the Strategy during 2021/22

5.1 The Economy and Interest Rates 2021/22 – to March 2022

It should be noted that this update covers 2021/22, prior to the recent effects of the Ukraine war and the cost of living crisis.

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

By March 2022, most of the economy had opened up and was nearly back to business-as-usual, the GDP numbers were robust (9% y/y Q1 2022) and sufficient for the MPC to focus on tackling the second-round effects of inflation, with the CPI measure rising to 7% in March 2022.

The Bank of England's Monetary Policy Committee . During the pandemic, the governments of western countries provided massive fiscal support to their economies which resulted in a big increase in total government debt in each country. It was therefore very important that bond yields stay low while debt to GDP ratios slowly subside under the impact of economic growth. This provided governments with a good reason to amend the mandates given to central banks to allow higher average levels of inflation than we have generally seen over the last couple of decades. Both the Fed and Bank of England already changed their policy towards implementing their existing mandates on inflation, (and full employment), to hitting an average level of inflation. Greater emphasis was also placed on hitting subsidiary targets e.g. full employment before raising rates. Higher average rates of inflation would also have helped to erode the real value of government debt more quickly.

USA. The upward pressure on inflation from higher oil prices and potential knock-on impacts on supply chains all argue for tighter policy (CPI was estimated at 7.8% across Q1), but the hit to real disposable incomes and the additional uncertainty points in the opposite direction. More recently, there was predictable speculation that the interest rate hikes would quickly push the US economy into recession. Q1 GDP growth was likely to be only between 1.0% and 1.5% annualised (down from 7% in Q4 2021). But, on a positive note, the economy created more than 550,000 jobs per month in Q1, a number unchanged from the post-pandemic 2021 average. Unemployment was only 3.8%.

EU. With euro-zone inflation having jumped to 7.5% in March it seems increasingly likely that the European Central Bank would accelerate its plans to tighten monetary policy. And the market was anticipating possibly three 25bp rate hikes later this year followed by more in 2023. While inflation hit the headlines, the risk of recession was also rising. Among the bigger countries, Germany was most likely to experience a "technical" recession because its GDP contracted in Q4 2021, and its performance has been subdued in Q1 2022. However, overall, Q1 2022 growth for the Eurozone was expected to be 0.3% q/q with the y/y figure posting a healthy 5.2% gain. Unemployment fell to only 6.8% in February.

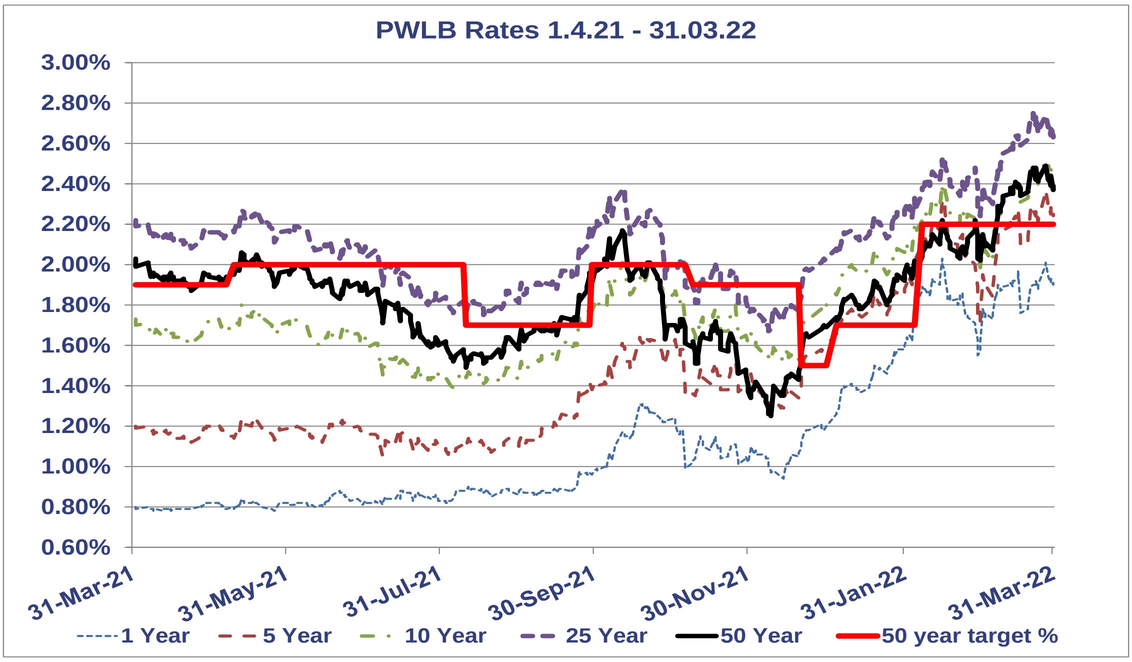
China. After a concerted effort to get on top of the virus outbreak in Q1 of 2020, economic recovery was strong in the rest of the year; however, 2021 has seen the economy negatively impacted by political policies that have focussed on constraining digital services, restricting individual freedoms, and re-establishing the power of the One-Party state. With a further outbreak of Covid-19 in large cities, such as Shanghai, near-term economic performance was expected to be subdued.

Japan. The Japanese economic performance through 2021/22 is best described as tepid. With a succession of local lockdowns throughout the course of the year, GDP was expected to have risen only 0.5% y/y with Q4 seeing a minor contraction. Unemployment was only 2.7% and inflation under 1%, with cost pressures mounting.

Deglobalisation. 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 has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last 30 years, which now accounts for 18% of total world GDP (the USA accounts for 24%), and the then recent invasion of Ukraine, unbalanced the world economy. In addition, after the pandemic exposed how frail extended supply lines were around the world, both factors are now likely to lead to a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China (and Russia) to supply products and vice versa. This is likely to reduce world growth rates.

5.2 Borrowing Rates in 2021/22

The graph for PWLB interest rates below shows that, after remaining relatively static until interest rates started to increase from November 2021, most PWLB rates have been on a general upward trend since.



Source: Link Treasury Management Annual Report Template 2021/22 (Scotland)

6. Treasury Activity during 2021/22

6.1 **Borrowing** – The Council raised new long term loans of £35.000m and new short term loans of £315.500m during 2021/22 for the replacement of naturally maturing debt and to finance the Council's capital programme.

6.2 **Rescheduling** – No debt rescheduling has taken place in 2021/22.

6.3 **Repayment** – The Council repaid naturally maturing debt of £320.748m.

6.4 **Summary of Debt Transactions** – The overall position of the debt activity resulted in the average annual interest rate paid throughout the year, year on year falling to 1.87% (2021/22) from 2.11% (2020/21).

6.5 **Investment Policy –** The Scottish Government issued The Local Government Investments (Scotland) Regulations 2010 on 1 April 2010.

6.6 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

6.7 The Council's short term cash investments decreased from £17.475m at the beginning of the year to £11.440m at the end of the year with an average balance of £11.877m and received an average return of 0.063% over the year. In addition to the short term cash investments the Council also had 2 long term investments in Clydebank Property Company and Hub West Scotland with a total value of £0.485m as at 31 March 2022 as identified in table 2 above (investments over 364 days).

7. Performance Indicators set for 2021/22

7.1 The treasury strategy defined a set of performance indicators covering the following areas:

7.1.1 **Security** - In the context of benchmarking, assessing security is a very subjective area. Security is currently evidenced by the application of minimum quality criteria to financial institutions that the Council may choose to invest in, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody's and Standard & Poors). The Council has benchmarked security risk by assessing the historical likelihood of default for investments placed with any institution with a long term credit rating of A- (this is the minimum long term credit rating used in the Council's investment strategy). The Council's maximum security risk is that 0.05% of investments placed with financial institutions could theoretically default based on global historical data. During the year all investments within the Council's portfolio were repaid on their due dates with no defaults of the principal sums recorded.

7.1.2 **Liquidity** – As required by the CIPFA Treasury Management Code of Practice the Council has stated that it will "ensure that it has adequate, though not excessive, cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives". In respect to liquidity as defined above the liquidity arrangements during the year were maintained in line with the facilities and benchmarks previously set by the Council as follows:

- Bank overdraft - £1.000m; and
- Liquid short term deposits of at least £5.000m available overnight.

7.1.3 **Return** – For the financial year the investment return averaged 0.063% which is a decrease of 0.189% from the previous year. Table 6 illustrates that the Council's average return identified of 0.063% was less than the average return from the Council's bankers investment account (0.19%) and slightly more than the Money Market Funds rate (noted in table 6) which are the local measures of return investment benchmarks approved in March 2012.

The Council's bankers (and therefore the bank with which the investment account is held) are currently Virgin money (formerly Clydesdale Bank plc) which falls within the Category 3 Investment Category approved in the investment strategy approved in February 2017. Due to the credit rating of this bank this category specified a maximum limit £5million which may be held on an overnight basis only thus limiting the ability to attract interest on this account.

Table 6

Benchmark	Benchmark Return	Average Return
Compound 12 month SONIA*	0.06%	0.063%

* SONIA is Sterling Overnight Index Average and has replaced LIBOR & LIBID

8. Short term financial flexibility for statutory repayment of debt 2021/22

8.1 The Local Government Finance Circular 5/2022 introduced a short term financial flexibility for statutory repayment of debt, whereby in 2021/22 or 2022/23 Councils could agree a loans fund principle repayment holiday for one year only, with conditions attached for the repayment of the debt due, but not, repaid. The Council took advantage of this flexibility in 2021/22 and therefore repaid not advances for General Services in 2021/22. The effects of this have been included within this annual report.

9. Disclosure regarding the repayment of loans fund advances for 2022/23

9.1 The policy on the prudent repayment of loans fund advances was detailed in the Mid-Year Monitoring Report 2021/22 - Treasury Management and Prudential Indicators reported to Council on 22 December 2021.

9.2 Table 7 shows the movement in the level of loan fund advances between 1 April 2021 and 31 March 2022 (excluding PPP).

Table 7

	General Fund	Housing
Opening Balance at 1 April 2021	**£312.703m**	**£233.474m**
New Advances in 2021/22	£26.771m	£16.457m
Repayments in 2021/22*	(£0.000m)	(£5.495m)
Closing Balance at 31 March 2022	**£339.747m**	**£244.436m**

** Refer to paragraph 8.1 regarding use of flexibility granted by Scottish Government regarding a loans fund principle repayment holiday*

9.3 Table 8 details the anticipated repayment profile of the balance on the internal loans fund advances (excluding PPP) for both General Services and Housing held at 31 March 2022 (note, this is not external debt).

Table 8

Future Repayment Profile at 31 March 2022	General Fund	Housing	Total
	£m	£m	£m
Under 12 months	2.942	6.510	9.452
2 years to 5 years	13.209	27.080	40.289
6 years to 10 years	19.854	38.567	58.421
11 years to 15 years	25.698	30.964	56.662
16 years to 20 years	23.688	38.527	62.215
21 years to 25 years	16.921	42.462	59.383
26 years to 30 years	11.520	25.349	36.869
31 years to 35 years	9.279	5.304	14.583
36 years to 40 years	10.961	3.250	14.211
41 years to 45 years	11.691	3.378	15.069
46 years to 50 years	13.492	4.785	18.277
51 years to 55 years	18.334	7.114	25.448
56 years to 60 years	23.849	8.395	32.244
61 year +	138.036	2.753	140.789
Total	**339.474**	**244.436**	**583.910**

10. Risk and Performance

10.1 The Council has complied with all relevant statutory and regulatory requirements which require the Council to identify and, where possible, quantify the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach. Ongoing consideration of future affordability and sustainability are reported and considered by Members each year when setting the Council's General Fund and HRA capital and revenue budgets.

10.2 The Council is aware of the risks of passive management of the treasury portfolio and, with the support of the Council's treasury advisers, has proactively managed its treasury position within the current economic climate taking advantage of lower interest rates where it is deemed appropriate. The Council has complied with its internal and external procedural requirements.

There is little risk of volatility of costs in the current debt portfolio as the interest rates are predominantly fixed, with the majority of debt comprised of long-term loans.

10.3 Shorter-term rates and likely future movements in these rates predominantly determine the Council's investment return. These returns can therefore be volatile and, whilst the risk of loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult.