TREASURY MANAGEMENT ACTIVITY DURING 2021/22

BORROWING REQUIREMENT AND DEBT MANAGEMENT

1. Based on the latest capital programme the Authority and resources available to the authority there is an estimated net movement in the borrowing need at the 31st March 2022 of £110M. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR) while useable reserves and working capital represent the underlying resources available for investments. These are the core drivers of TM Activity and the year-on-year change is summarised in table 1 below.

2. The Authority's current strategy is to maintain borrowing and investments below underlying levels in order to reduce risk and interest costs, resulting in a forecast decrease of internal borrowing of £42.5M as a result of lower useable reserves.

Table 1 – Balance Sheet Summary

	31-Mar-21 Actual £M	31-Mar-22 Strategy £M	31-Mar-22 Forecast £M	31-Mar-22 Forecast Movement in year £M
General Fund CFR	337.18	374.47	363.01	25.83
Housing CFR	169.13	198.94	194.69	25.56
Total CFR	**506.31**	**573.41**	**557.70**	**51.39**
Less Other Debt Liabilities*	(64.44)	(60.62)	(60.62)	3.82
Loans CFR	**441.87**	**512.79**	**497.08**	**55.21**
Less External Borrowing**	(241.95)	(222.84)	(254.65)	(12.70)
Internal (over) Borrowing	**199.92**	**289.95**	**242.43**	**42.52**
Less Usable Reserves	(208.52)	(128.87)	(141.34)	67.18
Less Working Capital Surplus	(58.29)	(58.01)	(58.29)	0.00
New Borrowing or (Investments)	**(66.89)**	**103.07**	**42.80**	**109.69**

** finance leases, PFI liabilities and Transferred debt that form part of the authority's total debt*

3. The forecast movement in the CFR is one of the Prudential Indicators (PIs). When the strategy was last updated in February 2021, the forecast CFR for 31st March 2022 was £573.4M, the current forecast is £557.7M, a net reduction of £15.7M. This decrease reflects changes in borrowing for the capital programme, £11.45M General Fund and £4.2M HRA. The forecast movement in year is shown in table 2 below.

Table 2 – Capital Financing Requirement Movement in year

Capital Financing Requirement	General Fund £M	HRA £M	Total £M
Balance Brought forward	337.18	169.13	506.31
New Borrowing	36.88	28.72	65.60
MRP	(7.24)	(3.16)	(10.40)
Appropriations (to) from HRA	0.00	0.00	0.00
Movement in Other Liabilities	(3.81)		(3.81)
Estimated CFR 31 March 2022	**363.01**	**194.69**	**557.70**

4. The movement in actual external debt and usable reserves combine to identify the Authority's borrowing requirement and potential investment strategy in the current and future years. This is shown in the tables below together with activity in the year.

5. ***Table 3: Borrowing and Investment Position***

	31-Mar-21 Actual £M	31-Mar-21 Average %	30-Sep-21 Actual £M	30-Sep-21 Average %	31-Mar-22 Forecast £M	31-Mar-22 Forecast %
Long Term Borrowing						
Public Works Loan	222.59	2.72	238.84	2.77	378.19	2.70
LOBO Loans from Banks	9.00	4.86	9.00	4.86	9.00	4.86
	231.59	**2.75**	**247.84**	**2.91**	**387.19**	**2.82**
Short Term Borrowing						
Other Local Authorities	10.00	0.28	0.00	0.00	10.00	0.10
Other	0.36	0.28	0.36	0.23	0.36	0.23
Total External Borrowing	**241.95**	**2.75**	**248.20**	**2.85**	**397.55**	**2.78**
Other Long Term Liabilities						
PFI Schemes	50.97	9.16	49.25	8.82	47.52	9.65
Deferred Debt Charges (HCC)	13.47	2.13	13.29	2.61	13.10	2.10
Total Gross External Debt	**306.39**	**3.78**	**310.73**	**4.08**	**458.17**	**3.63**
Investments:						
Managed In-House						
Government & Local Authority	0.00	0.00	(20.55)	0.01		
Cash (Instant access)	(30.13)	0.01	(52.51)	0.01	(10.00)	0.01
Cash (Notice Account)	0.00	0.00	0.00	0.00	0.00	0.00
Long Term Bonds	(3.17)	5.30	(1.06)	5.27	(1.10)	5.27
Managed Externally						
Pooled Funds (CCLA) & Shares	(27.00)	4.16	(27.00)	3.54	(27.00)	3.00
Total Investments	**(60.30)**	**4.26**	**(101.12)**	**3.41**	**(38.10)**	**2.28**
Net Debt	**246.09**		**209.61**		**420.07**	

6. ***Table 4: Forecast Movement in Gross External Debt during the year***

Movement during the year	**2020/21 Actual £M**	**31-Mar-22 Movement £M**	**2021/22 Forecast £M**
Long-term borrowing Carried Forward	266.87		231.59
Maturities in year	(35.28)		(9.30)
New borrowing in year	0.00		164.90
Net Long Term Borrowing	**231.59**	**155.60**	**387.19**
Short-term borrowing Carried Forward	10.36		10.36
Net Maturities in year	40.00		(10.36)
Net new borrowing in year	(40.00)		10.36
Net Short Term Borrowing	**10.36**	**0.00**	**10.36**
Total Borrowing at 31st March	**241.95**	**155.60**	**397.55**
Other Debt Liabilities	**64.43**	**(3.81)**	**60.62**
Total Debt at 31st March	**306.38**	**151.79**	**458.17**

7. The maturity analysis of the Council's actual debt at 30th September 2021 is shown in table 5 below. Debt due in one year includes both short term and long-term loans due in year, LOBO loans are shown as uncertain as although they are within the call option, they are unlikely to be called in the current interest environment.

8. *Table 5: Maturity Structure of Borrowing*

Analysis of Loans by Maturity	Lower Limit	Upper Limit	Compliance with Limit	Outstanding 30/09/2021	% of Debt
Less than 1 Year	0	50	Yes	7.28	3
Between 1 and 2 years	0	50	Yes	7.29	3
Between 2 and 5 years	0	50	Yes	21.85	9
Between 5 and 10 years	0	55	Yes	36.42	15
Between 10 and 20 years	0	60	Yes	45.30	18
Between 20 and 40 years	0	60	Yes	116.45	47
Over 40	0	75	Yes	4.25	2
Uncertain Date**	0	5	Yes	9.00	4
				247.84	**100**

Borrowing Update

9. Local authorities can borrow from the PWLB provided they can confirm they are not planning to purchase 'investment assets primarily for yield' in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 / Section 95 Officer. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing.

Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

Competitive market alternatives may be available, however the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders. Further changes to the CIPFA Prudential Code expected in December 2021 are likely to prohibit borrowing for the primary purpose of commercial return even where the source of borrowing is not the PWLB.

The Authority is not planning to purchase any investment assets primarily for yield within the next three years and so is able fully access the PWLB

10. **Revised PWLB Guidance and Changes to PWLB Terms and Conditions:**

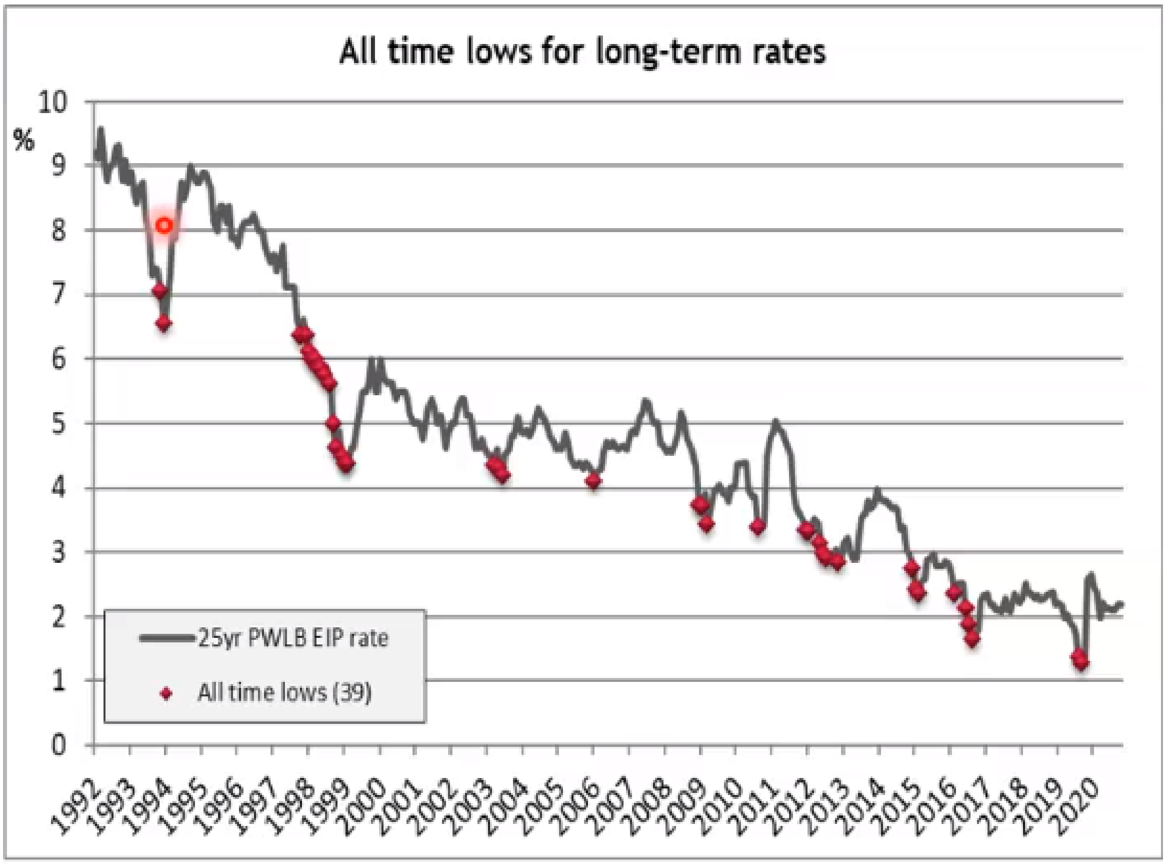
HM Treasury published further guidance on PWLB borrowing in August 2021 providing additional detail and clarifications predominantly around the definition of an 'investment asset primarily for yield'. The principal aspects of the new guidance are:

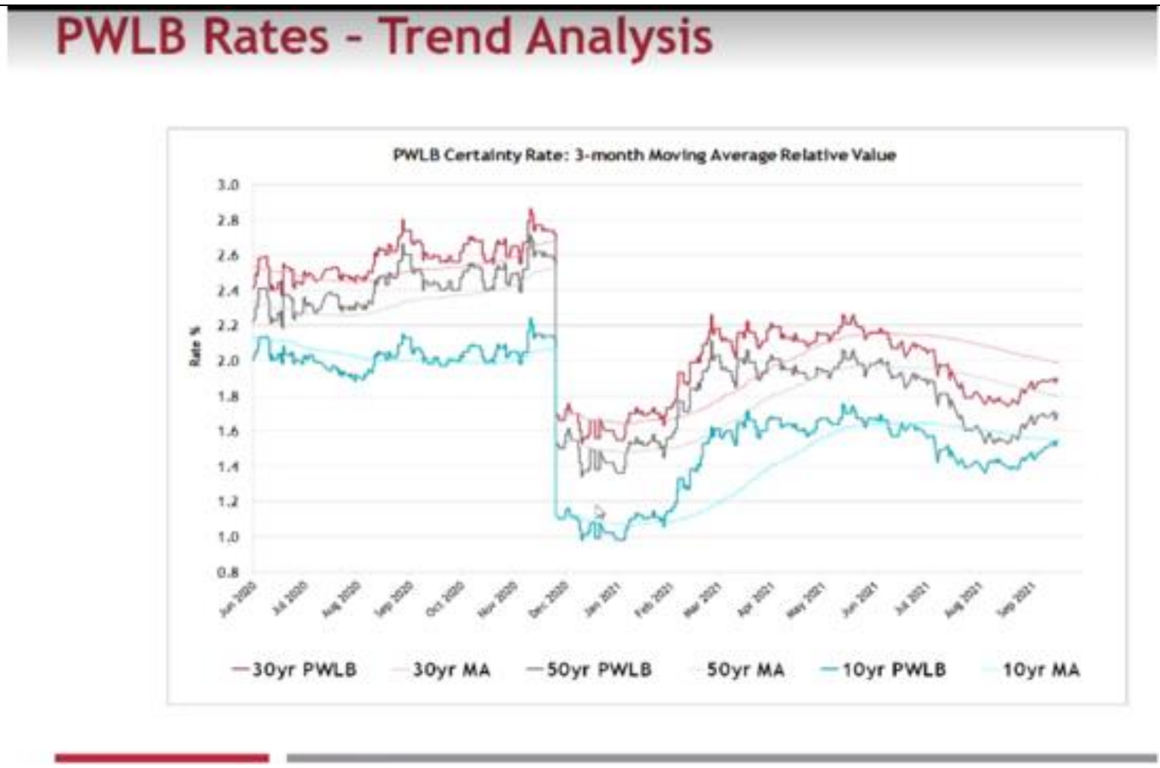
- Capital expenditure incurred or committed to before 26th November 2020 is allowable even for an 'investment asset primarily for yield'.
- Capital plans should be submitted by local authorities via a DELTA return. Returns must be updated in year if there is a change greater than 10%.
- An asset held primarily to generate yield that serves no direct policy purpose should not be categorised as service delivery.
- Further detail on how local authorities purchasing investment assets primarily for yield can access the PWLB for the purposes of refinancing existing loans or externalising internal borrowing.
- Additional detail on the sanctions which can be imposed for inappropriate use of the PWLB loan. These can include a request to cancel projects, restrictions to accessing the PLWB and requests for information on further plans.

The settlement time for a PWLB loan has been extended from two workings days (T+2) to five working days (T+5). In a move to protect the PWLB against negative interest rates, the minimum interest rate for PWLB loans has also been set at 0.01%

	and the interest charged on late repayments will be the higher of Bank of England Base Rate or 0.1%.
11.	**Municipal Bonds Agency (MBA):** The MBA is working to deliver a new short-term loan solution, available in the first instance to principal local authorities in England, allowing them access to short-dated, low rate, flexible debt. The minimum loan size is expected to be £25 million. Importantly, local authorities will borrow in their own name and will not cross guarantee any other authorities. If the Authority intends future borrowing through the MBA, it will first ensure that it has thoroughly scrutinised the legal terms and conditions of the arrangement and is satisfied with them and as reported previously, it will report to full council before engaging and seek advice from our financial advisors.
12.	UK Infrastructure Bank: £4bn has been earmarked for lending to local authorities by the UK Infrastructure Bank. The availability of this lending to local authorities is due to commence in summer 2021 for which there is expected to be a bidding process. Loans will be available for qualifying projects at gilt yields plus 0.6%, which is 0.2% lower than the PWLB certainty rate.
Borrowing Strategy during Period	
13.	At 30th September 2021 the Authority held £248.2M of loans, (a increase of £6.3M since 31st March 2021), as part of its strategy for funding previous and current years' capital programmes. Outstanding loans are summarised in Table 3 and 5 above.
14.	The Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective. In keeping with these objectives, new borrowing was kept to a minimum resulting in reduced net borrowing costs (despite foregone investment income) and reduced overall treasury risk.
15.	With short-term interest rates remaining much lower than long-term rates and surplus of liquidity continuing to feature in the LA to LA market, the Authority considered it to be more cost effective to utilise internal resources. However, this will not be sustainable as cash levels decrease through the year, we expect to borrow up to £143M to cover the ongoing capital programme (£66M), expected reduction in reserves (£67M) and to refinance debt maturing in year.
16.	The authority has an increasing CFR (see table 1) due to the capital programme and an estimated borrowing requirement as determined by the Liability Benchmark which takes into account usable reserves and working capital (see table 4). Having considered the appropriate duration and structure of the Authority's borrowing need, the decision was made to take advantage of the fall in external borrowing rates and borrowed £22M from the PWLB on a EIP basis as detailed below. These loans provide some longer-term certainty and stability to the HRA debt portfolio.

Long Term Loans	Amount £M	Rate %	Period (Years)
PWLB EIP Loan 1	11.00	1.45%	20
PWLB EIP Loan 2	11.00	1.46%	20
Total Borrowing	**22.00**		

17.	The PWLB were the Council's preferred source of long-term borrowing given the transparency and control that its facilities continue to provide, but PWLB funding margins have lurched quite substantially in the last year and there remains a strong argument for diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields plus 0.80. The Authority will evaluate and pursue these lower cost solutions and opportunities with its advisor Arlingclose.
18.	Due to the continued depressed markets and the 'cost of carry' associated with long term debt, defer long term borrowing will be deferred in favour of using internal resources to finance capital spend, to minimise the cost of TM by keeping debt interest payments as low as possible without compromising the longer-term stability. This will be kept under review during 2021/22 with the need to resource an increasing capital programme and if opportunities arise to secure beneficial rates. Our advisors assist with this 'cost of carry' and breakeven analysis.
19.	The Authority's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short and long-term borrowing will be maintained.
20.	The charts below show the pattern of the 25 year PWLB rate since 1992, the rise in 2019 is where the 1% over gilts was implemented, but otherwise it has generally been a downward trend. The recent spike is shown in more detail in 3 month average rate chart. 



Lender's Option Borrower's Option Loans (LOBOs)

21. The council continues to hold £9M of LOBO loans where the lender has the option to propose an increase in the interest rate at set dates, following which the council has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOS had options during the year, none of which were exercised by the lender, but if they were to then they would be replaced by a PWLB loan.

Other Debt Activity

22. Although not classed as borrowing the Council has previously raised capital finance via Private Finance Initiative (PFI). The mid-year balance was £49.3M and will fall to £47.5M after further repayment in year.

23. In addition, the Authority holds debt in relation to debt transferred from Hampshire County Council on the 1st April 1997 when we became a unitary authority which is being repaid over 50 years at £0.4M per annum, the balance at 30th September was £13.3M.

INVESTMENT ACTIVITY

24. Both the CIPFA and government guidance requires the council to invest prudently and have regard to the security and liquidity of investments before seeking the optimum yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low income returns.

25. Ultra low short-dated cash rates which have been a feature since March 2020 when Bank Rate was cut to 0.1% have resulted in the return on sterling low volatility net asset value money market funds (LVNAV MMFs) being close to zero even after some managers have temporarily waived or lowered their fees. At this stage net negative returns are not the central case of most MMF managers over the short-term, and fee cuts or waivers should result in MMF net yields having a floor of zero, but the possibility cannot be ruled out.

26. Deposit rates on Debt Management Account Deposit Facility (DMADF) are also largely around 0.01% so have been used to add some diversity to portfolio.

The impact of COVID-19 will continue during the year and will be reported at each quarter and as part of the mid-year Treasury Report to Governance Committee.

27. As a result of additional grant funding investment balances have remained higher than expected during the year to date but are expected to fall to an estimated £40M by the end of the year, due to several debt maturities and an ongoing capital programme, but this will be dependent on actual capital spend and movement in balances. Investment balances have ranged between £117M and £43M in year and are currently £99M.

This supports our decision to only borrow for cash flow purposes at this stage as savings on borrowing costs more than offset the loss on short term investments.

Movement in year is summarised in table 6 below:

28. ***Table 6: Investment activity during the year***

	Balance on 01/04/2021 £M	Investments Repaid £M	New Investments £M	Balance on 30/09/2021 £M	(Increase)/ Decrease in Investment for Year £M	Average Life of Investments Life
Multi- National Bonds (not subject to bail in)	(3.17)	(2.11)	0.00	(1.06)	2.11	4 years
Money Market Funds and Call Account	(30.13)	(156.37)	133.99	(52.51)	(22.38)	on day notice
Government & Local Authority	0.00	(165.98)	188.23	(20.55)	(20.55)	13 days
Managed Externally (CCLA Pooled funds)	(27.00)			(27.00)	0.00	Unspecified
Total Investments	**(60.30)**	**(324.46)**	**322.22**	**(101.12)**	**(40.82)**	

29. Security of capital has remained the council's main investment objective. This has been maintained by following the Authority's counterparty policy as set out in its TM Strategy Statement for 2021/22. The council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio, which is supplied by our advisors. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

	Target	Actual
Portfolio average credit rating	A	AA-

30. Counterparty credit quality was assessed and monitored with reference to credit ratings (the Authority's minimum long-term counterparty rating is A-) across rating agencies Fitch, S&P and Moody's); for financial institutions analysis of funding structure and susceptibility to bail-in, credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. The authority also used secured investments products that provide collateral in the event that the counterparty cannot meet its obligations for repayment.

Credit Developments and Credit Risk Management

31. Credit default swap spreads were flat over most of period and are broadly in line with their pre-pandemic levels. In late September spreads rose by a few basis points due to concerns around Chinese property developer Evergrande defaulting but are now falling back. The gap in spreads between UK ringfenced and non-ringfenced entities continued to narrow, but Santander UK remained an outlier compared to the other ringfenced/retail banks.

Over the period Fitch and Moody's upwardly revised to stable the outlook on a number of UK banks and building societies on our counterparty list, recognising their improved capital positions compared to last year and better economic growth prospects in the UK. Fitch also revised the outlooks for Nordea, Svenska

	Handelsbanken and Handelsbanken plc to stable from negative. The rating agency considered the improved economic prospects in the Nordic region to have reduced the baseline downside risks it previously assigned to the lenders. The successful vaccine rollout programme is credit positive for the financial services sector in general and the improved economic outlook has meant some institutions have been able to reduce provisions for bad loans. While there is still uncertainty around the full extent of the losses banks and building societies will suffer due to the pandemic-related economic slowdown, the sector is in a generally better position now compared to earlier this year and 2020. At the end of the period Arlingclose had completed its full review of its credit advice on unsecured deposits. The outcome of this review included the addition of NatWest Markets plc to the counterparty list together with the removal of the suspension of Handelsbanken plc. In addition, the maximum duration for all recommended counterparties was extended to 100 days. The institutions and durations on the Authority's counterparty list recommended by treasury management advisors Arlingclose remain under constant review. Further information is available in Appendix 1, Economic Background.
32.	**Benchmarking:** Our advisors Arlingclose produce quarterly benchmarking which shows the breakdown of our investments and how we compare to their other clients and other English Unitary Authorities. Details can be seen in Appendix 3. Investments managed internally are currently averaging a return of 0.08% which is slightly higher than the average unitary authority at 0.06% whilst maintaining a higher average credit rating at AA-. Total income returns at 1.31% is also higher than the average for both unitary (0.85%) and LA's (0.78%), this is primarily due to historic investment in EIB bonds which return 5.27%, although on a small balance of £1M, since maturities cannot be replaced at the same level. We hold 28% of our investments in strategic funds which offer higher return over the long term. This is higher than the average but in line with our strategy. In addition, due to the increase in the capital value of our external funds of +10.82% our total investment return at 4.33% is significantly higher than the average LA's at 2.82% and the average unitary at 2.35%. As previously reported, it is the income return that is the driver to invest and they are deemed less risky than buying individual properties and do not constitute capital spend.
Liquidity Management	
33.	In keeping with the LUHC Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of Money Market Funds and call accounts. There is no perceived risk that the Council will be unable to raise finance to meet its commitments. The Council also has to manage the risk that it will be exposed to replenishing a significant proportion of its borrowing at a time of unfavourable interest rates. The Council would only borrow in advance of need where there is a clear business case for doing so and will only do so for the current capital programme or to finance future debt maturities.
Externally Managed Funds	
34.	The Council has invested £27M in property funds which offer the potential for enhanced returns over the longer term but will be more volatile in the shorter term. These funds are managed by professional fund managers which allows the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments.

35.	Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives is regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three to five-year period total returns will exceed cash interest rates. In light of their performance over the long-term and the Authority's latest cash flow forecasts, investment in these funds has been maintained.
36.	The market has continued to improve since year end when the value was reported at £26.28M, and at September 2021 has a value of £28.11M (June 2021, £27.18M) an increase of £1.83M since March and is now £1.11M above the initial investment of £27M. The dividend for April to September is estimated at £0.26M, 3.86% of the original investment. If rates remain at this level the forecast dividend for the year is £1.02M.
Non – Treasury Investments	
37.	The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. This is replicated in LUHC Investment Guidance, in which the definition of investments is further broadened to also include all assets held partially for financial return.
38.	Between 2016 and 2017, SCC implemented a strategy to invest in commercial properties with the expected return on investment being used to fund council services, known as the Property investment fund (PIF).
39.	All of the properties remain fully let and the tenants are meeting their financial obligations under the leases. The rate of return on these investments in 2021/22 is expected to be 6.03% gross and 2.13% net (after borrowing costs of £1.2M) which represents a contribution to the revenue account of around £0.63M.