TREASURY MANAGEMENT ACTIVITY DURING 2021/22

BORROWING REQUIREMENT AND DEBT MANAGEMENT

1. On the 31st March 2022, the Authority had a reduction in its net borrowing need of £12M arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR) while useable reserves and working capital are 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, as we have an increasing borrowing requirement, is to minimise both external borrowing and investments and to only borrow to the level of the net borrowing requirement. The reasons for this are to reduce credit risk, take pressure off the Council's lending list and also to avoid the cost of carry existing in the current interest rate environment. This has resulted in a decrease in our internal borrowing of £8.3M for 21/22 from £199.9M to £191.6M.

Table 1 – Balance Sheet Summary

	31-Mar-21 Actual £M	31-Mar-22 Strategy £M	31-Mar-22 Actual £M	31-Mar-22 Movement in year £M
General Fund CFR	337.18	351.14	339.15	1.97
Housing CFR	169.13	171.37	168.73	(0.40)
Total CFR	**506.31**	**522.51**	**507.88**	**1.57**
Less Other Debt Liabilities*	(64.44)	(60.62)	(60.62)	3.82
Loans CFR	**441.87**	**461.89**	**447.26**	**5.39**
Less External Borrowing**	(241.95)	(255.65)	(255.66)	(13.71)
Internal (over) Borrowing	**199.92**	**206.24**	**191.60**	**(8.31)**
Less Usuable Reserves	(208.52)	(144.01)	(165.47)	43.06
Less Working Capital	(58.29)	(58.29)	(38.20)	20.09
New Borrowing or (Investments)	**(66.89)**	**3.94**	**(12.06)**	**54.83**

** finance leases, PFI liabilities and Transferred debt that form part of the authority's total debt*
*** See Table 3 below*

NB – table includes rounded figures

3. The forecast movement in coming years is one of the Prudential Indicators (PIs). When the strategy was updated in February 2022, the CFR for 31 March 2022 was estimated at £522.51M, the Council's actual CFR at the end of the year was £507.88M. This decrease was due to slippage in borrowing on the capital programme, £11.99M on the General Fund and £2.64M on HRA, as shown in table 2 below.

   In addition, usable reserves were £43.06M higher than expected (but are expected to be utilised during 2022/23) resulting in internal borrowing being £36.37M more than expected when Strategy was set, thereby reducing borrowing costs.

   Actual Movement in year, between the revised strategy position and outturn, is shown in table 2 below.

Table 2 – Capital Financing Requirement Movement in year

Capital Financing Requirement	31/03/2021 Actual £M	31/03/2022 Forecast Revised Strategy £M	31/03/2022 Actual £M	Movement since last reported position £M
Balance Brought forward	339.58	337.18	337.18	0.00
New Borrowing	7.51	24.67	12.68	(11.99)
MRP	(6.50)	(6.89)	(6.89)	0.00
Appropriations (to) from HRA	0.00	0.00	0.00	0.00
Movement in Other Liabilities	(3.41)	(3.82)	(3.82)	0.00
Total General Fund Debt	**337.18**	**351.14**	**339.15**	**(11.99)**
HRA	169.13	171.37	168.73	(2.64)
Total CFR	**506.31**	**522.51**	**507.88**	**(14.63)**
Estimated Debt	306.39	367.27	316.27	(51.00)
Under / (Over) Borrowed	**199.92**	**155.24**	**191.61**	**36.37**

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.

Replacement of maturing debt was, in line with the council's strategy, deferred due to the increase in reserves and a corresponding reduction in our net borrowing need.

This is shown in tables 3 and 4 below together with activity in the year.

5. *Table 3: Borrowing and Investment Position*

	31-Mar-21 Actual £M	31-Mar-21 Average Yield / Rate %	31-Mar-22 Actual £M	31-Mar-22 Average Yield / Rate %	31-Mar-23 Estimated Balance £M
Long Term Borrowing					
Public Works Loan	222.59	2.88	246.30	2.88	359.60
LOBO Loans from Banks	9.00	4.89	9.00	4.89	9.00
	231.59	**2.95**	**255.30**	**2.95**	**368.60**
Short Term Borrowing					
Other Local Authorities	10.00	0.92	0.00	0.00	10.00
Other	0.36		0.36		
Total External Borrowing	**241.95**	**0.92**	**255.66**	**0.00**	**378.60**
Other Long Term Liabilities					
PFI Schemes	50.97	9.01	47.52	9.01	44.37
Deferred Debt Charges (HCC)	13.47	2.66	13.10	2.66	12.73
Total Gross External Debt	**306.39**	**3.87**	**316.28**	**3.87**	**435.71**
Investments:					
Managed In-House					
Cash (Instant access)	(30.13)	0.01	(54.50)	0.51	(10.00)
Short Term Investments	0.00	0.00	(24.41)	0.06	
Long Term Bonds & Shares	(3.17)	5.30	(1.06)	5.27	(1.00)
Managed Externally					
Pooled Funds (CCLA)	(27.29)	4.16	(27.25)	3.81	(27.20)
Total Investments	**(60.59)**	**4.26**	**(107.22)**	**3.46**	**(38.20)**
Net Debt	**245.80**		**209.06**		**397.51**

6. *Table 4: Movement in Borrowing during the year*

Movement during the year	2020/21 Actual £M	Movement £M	2021/22 Actual £M	Average Life
Long-term borrowing Carried Forward	266.87		231.59	
Maturities in year	(35.28)		(9.29)	
New borrowing taken in year	0.00		33.00	
Net Long Term Borrowing	**231.59**	**23.71**	**255.30**	**24.7 Years**
Short-term borrowing Carried Forward	10.36		10.36	
Maturities in year	(40.00)		(10.36)	
New borrowing taken in year	40.00		0.36	
Net Short Term Borrowing	**10.36**	**(10.00)**	**0.36**	**12 Months**
Total Borrowing at 31st March	**241.95**	**13.71**	**255.66**	

Please note that these figures do not reflect the accounting convention of moving loans maturing in the year from long term to short term so will differ from the maturity analysis.

7. The maturity analysis of the Council's debt at 31 March 2022 is further analysed below, in table 5. 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*

Total Financial Liabilities	**Outstanding As at 31 March 2022**	**% of Total Portfolio**
Source of Loan	**£M**	**%**
Public Works Loan Board	246.30	96
Other Financial Institutions (borrowing)	9.00	4
	255.30	**100**
Analysis of Loans by Maturity		
Less than 1 Year	(7.10)	3
Between 1 and 2 years	(7.10)	3
Between 2 and 5 years	(21.30)	8
Between 5 and 10 years	(35.50)	14
Between 10 and 20 years	(35.45)	14
Between 20 and 40 years	(139.85)	55
Over 40	0.00	0
Uncertain Date**	(9.00)	4
	(255.30)	**100**

Borrowing Update

9. In August 2021 HM Treasury significantly revised guidance for the PWLB lending facility with more detail and 12 examples of permitted and prohibited use of PWLB loans. 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. CIPFA published its revised Prudential Code for Capital Finance and Treasury Management Code on 20th December 2021. The key changes in the two codes are around permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments. The principles of the Prudential Code took immediate effect although local authorities could defer introducing the revised reporting requirements until the 2023/24 financial year. Due to the timing of the revised code, there was limited time to do a full review to fit in with our committee cycle, so it was decided to defer, but key components such as the liability benchmark were included. . We will be assessing the new requirements during 2022/23 and introduce changes as appropriate. 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 decision that will increase the CFR unless directly and primarily related to the functions of the authority. Existing commercial investments are not required to be sold; however, authorities with existing commercial investments who expect to need to borrow should review the options for exiting these investments. Borrowing is permitted for cashflow 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. The Treasury Management Code now includes extensive additional requirements for service and commercial investments, far beyond those in the 2017 version. As with the Prudential Code SCC is taking the additional time available to review all processes before formal implementation in the 2023/24 financial year. Following a review of the capital programme the Authority is not planning to purchase any investment assets primarily for yield within the next three years and so is able to take advantage of PWLB borrowing. The Authority currently holds £27M in commercial investments that were purchased prior to the change in the CIPFA Prudential Code. Before undertaking further additional borrowing the Authority will review the benefits of retaining these investments against cost of future borrowing.
<u>Borrowing Strategy</u>	
10.	At 31st March 2022 the Authority held £255.66M of loans, (an increase of £13.71M since 31st March 2021), as part of its strategy for funding previous and current years' capital programmes. Outstanding loans are summarised in Table 4 and 5 above.
11.	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.
12.	In keeping with these objectives short term borrowing was kept to a minimum, while existing loans were allowed to mature without replacement. We have remained under our CFR limit and had internal borrowing of £191.60M at the end of the year.

	This strategy enabled the Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.
13.	The PWLB remained the Council's preferred source of long term borrowing given the transparency and control that its facilities continue to provide, however PWLB funding margins have lurched quite substantially and there remains a strong argument for diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields + 0.80%. This is kept under constant review, in consultation with our TM advisors.
14.	Due to the continued depressed markets and the 'cost of carry' associated with long term debt, the Council deferred long term borrowing and continued to use internal resources to finance the capital programme to minimise the cost of TM by keeping debt interest payments as low as possible without compromising the longer-term stability of the portfolio.
15.	During the year 3 loans have been taken from the PWLB; these have been in respect of the HRA for unfinanced debt as the 31 March 2021, as part of the HRA 40 year business plan. Rates have been monitored during the year and timing of loans was taken in consultation of our advisors to secure rates when rates dipped in the year. These loans provide some longer-term certainty and stability to the debt portfolio. Details are shown below:

Long Term Loans	Amount £M	Rate %	Period (Years)
PWLB EIP Loan 1	11.00	1.45%	20
PWLB EIP Loan 2	11.00	1.44%	20
PWLB Maturity Loan 1	11.00	1.50%	40
Total Borrowing	**33.00**		

16.	This will be kept under review during 2022/23 with the need to resource an increasing capital programme, which will be reported to Council in September and February as part of the capital review. In addition, given the rising costs of materials and of borrowing, the capital programme will be kept under regular review to ensure ongoing Value for Money and the phasing of capital works reviewed to ensure capital financing budgets follow the best estimate of the profile of borrowing needed The Authority with its advisor Arlingclose will evaluate and pursue options for lower cost solutions and opportunities, together with the 'cost of carry' and breakeven analysis.
17.	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 was maintained.

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

18.	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 it is likely that they would be replaced.

Other Debt Activity

19.	Although not classed as borrowing the Council has previously raised capital finance via Private Finance Initiative (PFI). The balance at the end of the year, after allowing for repayment in year of £3.14M is £47.52M.

20. In addition, the Authority holds debt in relation to debt transferred from Hampshire County Council on the 1 April 1997 when we became a unitary authority, of £13.46M. This is being repaid over 50 years at £0.37M per annum.

INVESTMENT ACTIVITY

21. CIPFA published a revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes on 20th December 2021. These define treasury management investments as investments that arise from the organisation's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

22. The Authority received central government funding to support small and medium businesses during the COVID-19 pandemic through grant schemes. This was invested in short-dated, liquid instruments such as call accounts and Money Market Funds until dispersed which led to higher investment balances throughout the year. The Council maintained its strategy of offsetting investment and borrowing to reduce treasury costs.

23. The council has held significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2021/22 the council's investment balances have ranged between £43.01M and £133.87M. Movement in year is summarised in table 6 below:

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

	Balance on 01/04/2021 £M	Investments Repaid £M	New Investments £M	Balance on 31/03/2022 £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)	256.64	(281.01)	(54.50)	(24.37)	on day notice
Government & Local Authority	0.00	320.80	(345.21)	(24.41)	(24.41)	53 days
Managed Externally (CCLA Pooled funds)	(27.29)	0.29	(0.25)	(27.25)	0.04	Unspecified
Total Investments	**(60.59)**	**579.84**	**(626.47)**	**(107.22)**	**(46.63)**	

25. Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or 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 investment income.

26. Ultra low short-dated cash rates, which were a feature from March 2020 when Bank Rate was cut to 0.1%, prevailed for much of the 12-month reporting period which resulted in the return on sterling low volatility net asset value (LVNAV) Money Market Funds being close to zero even after some managers temporarily waived or lowered their fees. However, higher returns on cash instruments followed the increases in Bank of England Base Rate in December, February and March. At 31st March, the 1-day return on the Authority's MMFs ranged between 0.45% - 0.54% and average 0.51%.

	Similarly, deposit rates with the Debt Management Account Deposit Facility (DMADF) initially remained very low with rates ranging from 0% to 0.1% but following the hikes to policy rates increased to between 0.55% and 0.85% depending on the deposit maturity.
27.	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-

28.	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.
29.	The table below summarises the Council's investment portfolio as at 31 March 2022 by credit rating and confirms that all investments were made in line with the Council's approved credit rating criteria. The investment for Pooled funds includes the unrealised estimated gain of £3.89M.

Table 7: Credit ratings of Investments held at 31st March 2022

	Long Term		Short Term	
Credit Rating	**2021 £000**	**2022 £000**	**2021 £000**	**2022 £000**
AAA	1,009	1,008	2,142	52
AA+				
AA				24,410
AA-			12,000	
A+			18,028	46,750
A			102	7,753
A-				
Unrated local authorities				
Shares in unlisted companies	20	20		
Unrated pooled funds	26,281	30,893	292	253
Total Investments	**27,310**	**31,921**	**32,564**	**79,218**

30.	**Benchmarking:** Our advisors produce quarterly benchmarking which shows the breakdown of our investments and how we compare to their other clients and other English Unitary. Details can be seen in Appendix 3. It shows that on average the return on our internal investments at 0.54% is slightly higher than the average of 0.46% and our overall return including the Local Authority Property Fund (income only) is 1.47% compared to the average of 1.08%. This has been achieved without

	impacting on our average credit rating which at AA+ which is higher than the average for both other Local Authorities and Unitary Authorities at AA-. In addition, there has been a capital gain on the CCLA Strategic fund of 17.55% (see externally managed funds below for more details) which brings the total return on our investments to 6.37% for the year compared to the Unitary average of 3.19% and all Local Authorities average of 2.10%.
Liquidity Management	
31.	In keeping with the DLUHC's 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	
32.	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.
33.	In the nine months to December improved market sentiment was reflected in equity, property and multi-asset fund valuations and, in turn, in the capital values of the Authority's property fund. In the January- March quarter the two dominant themes were tighter UK and US monetary policy and higher interest rates, and the military invasion of Ukraine by Russia in February, the latter triggering significant volatility and uncertainty in financial markets. In light of Russia's invasion, Arlingclose contacted the fund managers and confirmed no direct exposure to Russian or Belarusian assets had been identified. Indirect exposures were immaterial. It should be noted that any assets held by banks and financial institutions (e.g. from loans to companies with links to those countries) within MMFs and other pooled funds cannot be identified easily or with any certainty as that level of granular detail is unlikely to be available to the fund managers or Arlingclose in the short-term, if at all.
34.	The market value has increased since last reported in December, £29.53M and at March 2022 had a value of £30.89M. An increase of £4.09M since the March 2021 value of £26.8M and is now £3.89M above the initial investment of £27M. The dividend for the year was £1.02M, 3.78% against the original investment. This is lower than 2020/21 which was boosted by a significant level of one-off receipts. The market value of the investment has continued to improve and at May 2022 was £32.09M, a further increase of £1.201M since end of year.
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.
Non – Treasury Investments	

36.	The definition of investments in CIPFA's revised 2021 Treasury Management Code covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e., management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).
37.	Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) and Welsh Government also broadens the definition of investments to include all such assets held partially or wholly 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). To date the authority has purchased 3 properties. Details of the properties purchased are shown in table 8 below. The rate of return on these investment in 2021/22 was 6.03% gross and 2.13% net (after borrowing costs of £1.16M were incurred), which therefore represents a contribution to the revenue account of around £0.63M.
39.	All of the properties remain fully let and the tenants are meeting their financial obligations under the leases and there are currently no concerns regarding the properties that have currently fallen in value below the debt outstanding on it (by £1.23M) due to the current financial environment and market conditions.
40.	**Table 8: Property Investment Fund**

Property	Actual	31.03.2021 Actual		31.03.2022 Actual		Outstanding Debt 31.03.2022
	Purchase Cost £M	Value in Accounts	Gain or (Loss) in Year	Value in Accounts	Gain or (Loss) in Year	£M
Property 1	6.47	5.21	(1.09)	4.88	(0.33)	5.86
Property 2	14.69	10.32	(0.48)	11.64	1.32	13.32
Property 3	8.53	8.73	0.34	9.16	0.43	7.73
	29.69	24.26	(1.23)	25.68	1.42	26.91