Agenda item: 8

Cabinet – 7 September 2022

Treasury Management Annual Report 2021/22

Portfolio: Councillor Bird, Leader of the Council

Related portfolios: N/A

Service: Finance

Wards: All

Key decision: No

Forward plan: Yes

1. Aim

1.1 The council is required through regulations issued under the Local Government Act 2003 to produce a year end position statement reviewing treasury management activities and prudential and treasury indicator performance. The Treasury Management year end position statement at Appendix A provides Cabinet with these details, and meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2 The council is required to note the TM Annual Report is presented to provide assurance that TM performance is in line with budgeted expectations and within the above regulations and Codes that the authority is required to comply with.

2. Summary

2.1 This report sets out the council's 2021/22 year end position for treasury management activities (Appendix A).

2.2 Despite difficult market conditions and historically low interest rates of 0.10% for the first 8 months of the financial year the council achieved an average interest rate across all investments of 0.74% compared to budget of 0.68%. In monetary terms this equated to an overachievement against budget £0.070m.

2.3 This has taken considerable effort and negotiation from the treasury team to secure favourable rates when considering investment options, and through the review and identification of new opportunities for investment.

2.4 Capital expenditure for 2021/22 was £79.587m of which £15.847m will be funded from approved borrowing (Table 2, Appendix A).

2.5 The actual debt position for the Council as at 31 March 2022 is £328.971m, which is within both the operational and authorised limits for external debt approved by council on 25/02/21.

3. Recommendations

3.1 To note and forward to Council, for consideration and noting (in line with the requirements of the Treasury Management Code of Practice (2017)), the annual position statement for treasury management activities 2021/22 including prudential and local indicators (Appendix A).

4. Report detail - know

Context

4.1 The Treasury Management annual report at Appendix A provides Cabinet with these details, and meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

The following key points of interest have been extracted from the report:

- The annual report meets the requirement of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities.
- Capital expenditure was £79.587m of which £15.847m will be funded from approved borrowing (Table 2, Appendix A).
- The banking environment has shown signs of improvement. The Bank of England base rate increased from 0.10% to 0.75% between December 2021 and March 2022, which led to some improved investment returns by year end.
- Despite the situation of low interest returns throughout the financial year, the authority has continued to identify appropriate new areas of investment opportunity, reviewed counterparties and limits to reduce exposure to counterparty risk. Together these actions have led to an overachievement of investment income of £0.070m for the 2021/22 financial year.
- To note within the local indicators (Table 11) that the net borrowing cost as a percentage of net council tax requirement of 7.15% (3a) and the net borrowing cost as percentage of tax revenue of 4.60% (3b) are both within their target upper limits of 20% and 12.50% respectively.

Council Plan priorities

4.2 Sound financial management of the council's cash balances supports the delivery of council priorities within council's available resources.

Risk management

4.3 Treasury management activity takes place within a robust risk management environment, which enables the council to effectively maximise investment income and minimise interest payments without undue or inappropriate exposure to financial risk. It is recognised that the management of risk is as important as maximisation of performance and it is essential that the council has the right balance of risk and reward when making investment decisions. This is supported by treasury management policies which seek to manage the risk of adverse fluctuations in interest rates and safeguard the financial interests of the council.

4.4 The United Kingdom formally left the European Union on 31 January 2020 with a transition period that lasted until 31 December 2020 to enable both parties to negotiate their future relationship. These negotiations resulted in a trade agreement with the EU for goods only with negotiations continuing with respects to services. At present it is hard to quantify what the impact has been to the council due to the impact Covid-19 has had on the UK economy potentially masking any Brexit consequences. The Council has responded to these risks by reviewing counterparties for investments to minimise the risk to any one counter party or class of counter party.

Financial implications

4.5 Treasury management activity forms part of the council's financial framework and supports delivery of the medium term financial strategy. The review of treasury management performance and activity is reviewed through both the treasury management annual report and the mid-year performance review report.

Legal implications

4.6 The council is required to have regard to the Prudential Code under the duties outlined by the Local Government Act 2003. One requirement of the Prudential Code is that the council should comply with the CIPFA Code of Practice for Treasury Management. The council adopted the original treasury management code in 1992 and further revisions to the Code in 2002, 2010 and 2017.

Procurement Implications/Social Value

4.7 None directly relating to this report.

Property implications

4.8 None directly relating to this report.

Health and wellbeing implications

4.9 None directly relating to this report.

Staffing implications

4.10 None directly relating to this report.

Reducing Inequalities

4.11 None directly relating to this report.

Climate Change

4.12 None directly relating to this report.

Consultation

4.13 The report has been approved by the finance treasury management panel, an internal governance arrangement comprising the S151 Officer, Director of Finance, Corporate Landlord and Assurance and Head of Finance – Technical and Transactional.

5. Decide

5.1 In line with the Treasury Management Code of Practice (2017) there are a number of reports that are required to be produced and reported publicly each year. The Treasury Management Annual Report forms one of these requirements and as such is being reported to Cabinet for noting and forwarding onto Council for consideration.

6. Respond

6.1 This report is not seeking approval of a decision, in line with the Treasury Management Code of Practice (2017) it is required to be reported for noting and forwarding to Council for consideration.

7. Review

7.1 In line with Treasury Management Code of Practice (2017) this is a backward looking document looking at performance over the previous.

Background papers

Various financial working papers.

Corporate budget plan and treasury management and investment strategy 2021/22 – Council 25/02/21.

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7 September 2022

Councillor Bird
Portfolio holder

7 September 2022

Appendix A

Annual Treasury Management Report 2021/22

Walsall Council
June 2022

Annual Treasury Management Report 2021/22

Purpose

This council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and prudential and treasury indicator performance. This document therefore reports this position for the 2021/22 financial year. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

During 2021/22 the following reports were produced:

- an annual treasury strategy in advance of the year (Council 25/02/2021)
- a mid-year (minimum) treasury update report (Cabinet 15/12/2021)
- an annual review of treasury management policies (Council 10/01/2022)
- an annual report following the year describing the activity compared to the strategy (this report to Cabinet)

In addition, this council's treasury management panel has received regular treasury management update reports throughout 2021/22.

The regulatory environment places an onus on members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the council's policies previously approved by members.

This council also confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by Cabinet before they were reported to the full Council.

Summary

During 2021/22, the council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Table 1 Actual prudential and treasury indicators	2020/21 Actual £m	2021/22 Original £m	2021/22 Revised £m	2021/22 Actual £m
Capital expenditure	102.837	103.760	235.854	79.587
Capital Financing Requirement:				
Including PFI and finance leases	370.108			374.500
Excluding PFI and finance leases	365.291			370.709
External Borrowing	347.366			328.971
Investments	219.860			256.925
Net borrowing	**127.506**			**72.046**

Other prudential and treasury indicators are to be found in the main body of this report. The Executive Director of Resources & Transformation (S151 Officer) confirms that borrowing is only undertaken for capital purposes or to support required in year cash-flow requirements, however no new borrowing was undertaken in 2021/22.

The challenging environment of low investment returns and uncertainty of counterparty risk has continued in 2021/22. 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. Counterparty risk has been continually reviewed throughout the financial year to ensure credit ratings exceed the minimum requirements set in Treasury Management policies, and cash was invested primarily in At-Call and Short Term accounts to ensure the council was able to meet unknown levels of expenditure resulting from Covid-19.

The original capital expenditure target of £103.760m for 2021/22 is based on the figure for the 2021/22 capital programme reported in the budget report presented to full Council on the 25 February 2021. This was revised within the financial year to a £235.854m target. The actual spend for 2021/22 is lower than the target due to slippage from 2020/21, and amendments to the original capital programme agreed during the year, of which spend will now be incurred in 2022/23.

1. Introduction and background

To set the context of the treasury management environment it is first necessary to provide a review of the economy and interest rates.

2021/22 continued with a challenging investment environment since the reduction of the Bank of England base rate down to 0.10% in March 2020, with namely low investment returns, although levels of counterparty risk have continued to subside. The expectation for interest rates within the treasury management strategy for 2021/22 was that Bank Rate would remain at 0.10% until it was clear to the Bank of England that the emergency level of rates introduced at the start of the Covid-19 pandemic were no longer necessitated. An economic summary is given at the beginning of the borrowing and investment sections.

2. The Council’s Capital Expenditure and Financing 2021/22

The council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc., which has no resultant impact on the council’s borrowing need); or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed. The amount to be funded from borrowing for 2021/22 will be £15.847m. It shows a decrease in capital expenditure funded from grants mainly due to a number of projects such as Growth Fund, for which Walsall is the accountable body for all the Black Country Districts coming to an end.

Table 2	**2020/21 Actual £m**	**2021/22 Original £m**	**2021/22 Actual £m**
Total capital expenditure	**102.840**	**103.760**	**79.587**
Resourced by:			
• Capital receipts	2.268	1.500	3.301
• Capital grants	77.648	46.710	57.884
• Capital Reserves and Revenue	1.915	0.020	2.555
• Approved Borrowing	21.006	55.530	15.847
	102.837	**103.760**	**79.587**

3. The Council’s Overall Borrowing Need

The council’s underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the council’s debt position. The CFR results from the capital activity of the council and which resources have been used to pay for the capital spend. It represents the 2021/22 capital expenditure funded by borrowing (see table 2), and prior years’ net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the council’s treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the council’s cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the council.

Reducing the CFR – the council’s underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The council is required to make an annual revenue charge, called the minimum revenue provision (MRP) to reduce the CFR. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a voluntary revenue provision (VRP).

Minimum Revenue Provision:

Under the Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2018, local authorities have a duty to produce an annual statement on its policy for making a minimum revenue provision (MRP).

For the financial years **2020/21** onwards the authority has adopted the following policies in determining the MRP:

1. For all existing capital expenditure balances within the Capital Financing Requirement (CFR) held as at 1 April 2020 MRP will be applied on an annuity basis with the write down period determined by asset lives up to the maximum allowable by the regulations set out above.

2. For all capital expenditure incurred from 1 April 2020 MRP will be applied on an annuity basis with the write down period determined by asset lives up to the maximum allowable by the regulations set out above.

3. The authority will treat the asset life as commencing in the year in which the asset first becomes operationally available. Noting that in accordance with the regulations the authority may postpone the beginning of the associated MRP until the financial year following the one in which the asset becomes operational, there will be an annual adjustment for Assets Under Construction.

4. If determined by the S151 Officer the annual instalment may be calculated by the equal instalment method or other appropriate methods dependant up on the nature of the capital expenditure.

5. In all years, the CFR for the purposes of the MRP calculation will be adjusted for other local authority transferred debt, finance lease and Private Finance Initiative (PFI).

6. The S151 officer shall on an annual basis review the level of MRP to be charged, as calculated as per paragraphs 1, 2 and 3 above to determine if this is at a level, which is considered prudent. The amount of MRP charged shall not be less than zero in any financial year.

The council's CFR for the year 2021/22 is shown below in Table 3, and represents a key prudential indicator (PrI4). It includes Private Finance Initiative (PFI) and leasing schemes from the balance sheet which increase the council's borrowing need – although no borrowing is normally required against these schemes as a borrowing facility is included in the contract (if applicable). It shows that in 2021/22 the council's CFR has increased by £4.392m from £370.108m to £374.500m.

Table 3 CFR (£m)	31 March 2021 Actual £m	31 March 2022 Actual £m
Opening balance	**357.159**	**370.108**
Add capital expenditure funded from approved borrowing (as above)	21.006	15.847
Less MRP	(8.057)	(11.455)
Closing balance	**370.108**	**374.500**

The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term the council's external borrowing, net of investments, must only be for a capital purpose, or to fund expected in year cash-flow requirements. This essentially means that the council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR. Table 4 below highlights the council's net borrowing position £72.046m against the CFR excluding PFIs and Finance leases £370.709m because the debt liability for these are not in the net borrowing position of the council. The council has complied with this prudential indicator.

Table 4 Gross borrowing and the CFR (£m)	31 March 2021 Actual £m	31 March 2022 Actual £m
Gross Borrowing	**351.454**	**332.390**
Net borrowing position	**127.506**	**72.046**
CFR – excluding PFIs and Finance Leases	**365.291**	**370.709**
Long term Assets	**616.444**	**629.599**
Net Borrowing % of Long term Assets	**20.68%**	**11.44%**

Another measure of prudency is the proportion of net borrowing to long term assets. Table 4 shows that the net borrowing position of the council as at 31/03/22 is £72.046m which represents 11.44% of the value of the council's long term assets which are valued on the council's balance sheet at that date.

Other key Prudential Indicators are shown in Table 5 below:

Table 5 Prudential and Borrowing Limits	31 March 2021 Actual £m	31 March 2022 Actual £m
1. Authorised limit	**472.173**	**498.300**
2. Maximum gross borrowing in year	**351.454**	**351.454**
3. Operational boundary	**429.248**	**453.000**
4. Average gross borrowing	**327.489**	**341.922**
5. Financing costs as proportion of net revenue stream	**5.17%**	**7.23%**

1. **The authorised limit** - the authorised limit is the "affordable borrowing limit" set by the council as required by section 3 of the Local Government Act 2003. The council does not have the power to borrow above this level without the prior approval of full Council. Table 5 demonstrates that during 2021/22 the council's maximum gross borrowing was within its authorised limit.

2. **Maximum Gross borrowing** – is the peak level of borrowing in year.

3. **The operational boundary** – the operational boundary is the expected borrowing position of the council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached. In 2021/22 the council's average borrowing position was less than the operational boundary.

4. **Average Gross Borrowing** – is an estimate of the borrowing level in the year (see Table 7 for analysis of Borrowing).

5. **Actual financing costs as a proportion of net revenue stream** - this indicator identifies the trend in the cost of capital (borrowing and other long

term obligation costs net of investment income) against the net revenue stream. Net revenue stream is defined as Net Council Tax Requirement plus Standard Spending Assessment (previously Formula Grant).

4. Prudential Indicators

The following tables show performance against statutorily required prudential and local indicators.

Table 6 – Prudential Indicators		Actual 2020/21	Target 2021/22	Position 31-Mar-22	Variance to target	
		£m	£m	£m	£m	%
Prl 1	Capital Expenditure	102.837	235.854	79.587	(156.267)	(66%)
Prl 2	Ratio of financing costs to net revenue stream	5.17%	8.71%	7.23%	1.49	17%
Prl 3	Estimates of the incremental impact of new capital investment decisions on Council Tax	£28.49	£52.43	£52.43	0.00	0%
Prl 4	Capital Financing Requirement	380.886	417.360	374.500	(42.860)	(10%)
Prl 5	Authorised Limit for external debt	472.173	498.300	498.300	0.000	0%
Prl 6	Operational Limit for external debt	429.248	453.000	453.000	0.000	0%

Ref	Prudential Indicator	Actual 2020-21 £m	Target 2021/22 £m	Position 31-Mar-22 £m
Prl 7	Gross Borrowing exceeds capital financing requirement	No	No	No
Prl 8	Authority has adopted CIPFA Code of Practice for Treasury Management	Yes	Yes	Yes
Prl 9	Total principle sums invested for longer than 365 days must not exceed	15.0	55.0	35.0

Ref	Prudential Indicator	Upper Limit	Lower Limit	Actual 2021/22	Position 31 -Mar-22
Prl 10	Fixed Interest Rate Exposure	95%	40%	**94%**	**89%**
Prl 11	Variable Interest Rate Exposure	45%	0%	**6%**	**11%**
Prl 12	***Maturity Structure of Borrowing:***				
	Under 12 months	25%	0%	**10%**	**23%**
	12 months and within 24 months	25%	0%	**22%**	**11%**
	24 months and within 5 years	40%	0%	**20%**	**14%**
	5 years and within 10 years	50%	5%	**1%**	**2%**
	10 years and above	85%	30%	**47%**	**50%**

PRL 5 (authorised limit for external debt) and PRL 6 (operational limit for external debt) were approved by Council on the 25 February 2021 and the CIPFA Code of Practice only allows these limits to be changed by Council and therefore the actual limit and the target remain the same. The actual debt position for the Council as at 31 March 2022 is £332.390m.

Key variances are because of the following reasons:-

Prl 1 Total capital expenditure - variation of £156.267m

The original £103.760m target for 2021/22 is based on the figure for the 2021/22 capital programme reported in the budget report presented to full Council on the 25th February 2021. This was revised within the financial year to a £235.854m target. The actual spend for 2021/22 is lower than the target due to slippage from 2020/21, and amendments to the original capital programme agreed during the year, of which spend will now be incurred in 2022/23.

PRL 4 Capital Financing Requirement – variation of £42.860m

The Capital Financing Requirement is in line with capital expenditure, with the variation linked to capital slippage as above.

Prl 12 Maturity Structure of Borrowing

For the purpose of the maturity profile indicator the next call date on a LOBO loan is assumed; as it is the right of the lender to require repayment. However due to the low interest rate environment it is unlikely that in the medium term that any of the LOBO's will be called.

5. Treasury Position at 31st March 2021

The council's debt and investment position is organised by the treasury management team in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the summary, and through officer activity detailed in the council's treasury management practices. At the beginning and the end of 2021/22 the council's treasury position was as shown below in **Table 7**:

Table 7 Loans and Investments	Opening Balance £m	Average Rate At 31/03/21 %	Movement in Year £m	Closing Balance £m	Average Rate At 31/03/22 %
PWLB loans	195.613	3.38%	0.045	195.658	3.38%
Market Loans	95.000	4.49%	0.000	95.000	4.70%
Total Borrowing over 12 months excluding WMCC debt	**290.610**	**3.74%**	**0.045**	**290.658**	**3.81%**
Temporary Loans	47.961	0.87%	(17.000)	30.961	1.48%
Total borrowing excluding WMCC debt	**338.570**	**3.34%**	**(16.955)**	**321.620**	**3.59%**
WMCC Debt	12.880	6.50%	(2.110)	10.770	5.44%
Gross Borrowing	**351.454**	**3.45%**	**(19.065)**	**332.390**	**3.65%**
Waste Disposal & Cannock Chase Debtor	(4.088)	6.50%	0.670	(3.418)	5.44%
Borrowing	**347.366**	**3.42%**	**(18.395)**	**328.971**	**3.63%**
CFR less PFI finance & leases	365.291		5.418	370.709	
Under/(Over) Borrowing	17.925		(12.977)	41.738	
Debt as % of CFR	**95%**			**89%**	
Call Accounts	36.360	0.10%	11.565	47.925	0.09%
Short Term Investments	138.500	0.68%	35.500	174.000	0.39%
Long Term Investments	45.000	1.57%	(10.000)	35.000	1.11%
Total Investments	**219.860**	**0.59%**	37.065	**256.925**	**0.38%**
Net Borrowing Position	**127.510**		(55.460)	**72.046**	

The under borrowing position the council has represents additional external borrowing the council could choose to take if required, however this has currently been financed by internal borrowing – utilising the Council's accumulated cash reserves rather than taking out new external borrowing. This position will continue to be monitored and additional external borrowing may be undertaken if required for cash flow purposes.

The true under borrowed position at the beginning of the year was £64.931m, and at the end of the year was £71.738m. This is because the under/(over) positions in the table above include temporary loans taken to fund upfront pension payments made in April 2020 for the following 3 financial years, which should be removed to show the true under borrowed position.

6. The Borrowing Strategy for 2021/22 and Economic Context

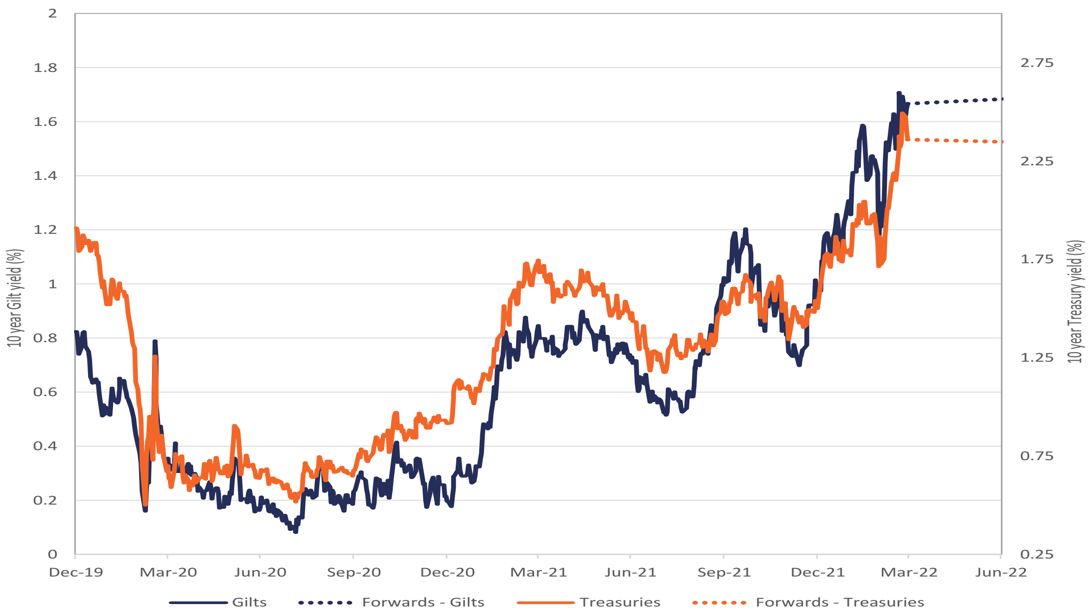
During 2021/22, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were very low and minimising counterparty risk on placing investments also needed to be considered.

Interest rate forecasts expected only gradual rises in medium and longer-term fixed borrowing rates during 2021/22 and the two subsequent financial years until the turn of the year, when inflation concerns increased significantly. Internal, variable, or short-term rates, were expected to be the cheaper form of borrowing until well in to the second half of 2021/22.

7. Borrowing Outturn commentary for 2021/22 provided by Link Asset Services (the councils external Treasury advisor)

PWLB rates are based on, and are determined by, gilt (UK Government bonds) yields through H.M.Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields. Inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation and the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. We have seen over the last two years, many bond yields up to 10 years in the Eurozone turn negative on expectations that the EU would struggle to get growth rates and inflation up from low levels. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. Recently, yields have risen since the turn of the year on the back of global inflation concerns.

Graph of UK gilt yields v. US treasury yields



Gilt yields fell sharply from the spring of 2021 through to September and then spiked back up before falling again through December. However, by January sentiment had well and truly changed, as markets became focussed on the embedded nature of inflation, spurred on by a broader opening of economies post the pandemic, and rising commodity and food prices resulting from the Russian invasion of Ukraine.

At the close of the day on 31 March 2022, all gilt yields from 1 to 5 years were between 1.11% – 1.45% while the 10-year and 25-year yields were at 1.63% and 1.84%.

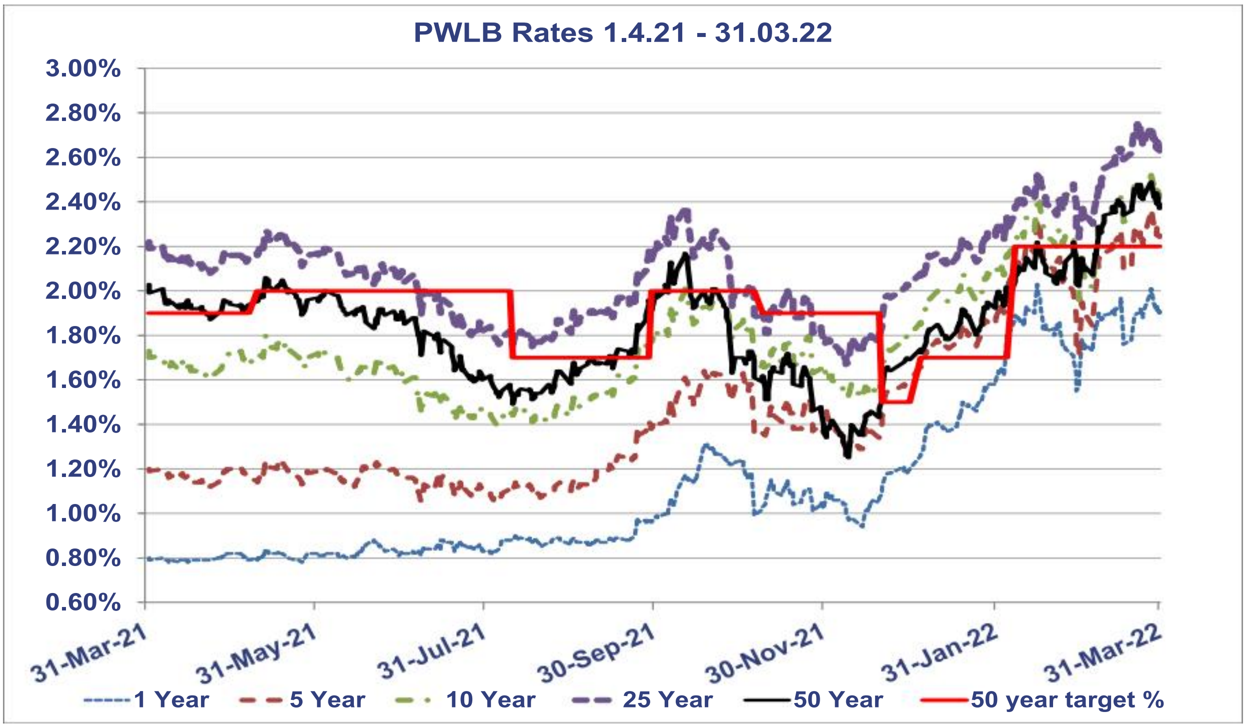
Regarding PWLB borrowing rates, the various margins attributed to their pricing are as follows: -

PWLB Standard Rate is gilt plus 100 basis points (G+100bps)

PWLB Certainty Rate is gilt plus 80 basis points (G+80bps)

Local Infrastructure Rate is gilt plus 60bps (G+60bps)

There is likely to be a further rise in short dated gilt yields and PWLB rates over the next three years as Bank Rate is forecast to rise from 0.75% in March 2022 to 1.25% later this year, with upside risk likely if the economy proves resilient in the light of the cost-of-living squeeze. Medium to long dated yields are driven primarily by inflation concerns but the Bank of England is also embarking on a process of Quantitative Tightening when Bank Rate hits 1%, whereby the Bank’s £895bn stock of gilt and corporate bonds will be sold back into the market over several years. The impact this policy will have on the market pricing of gilts, while issuance is markedly increasing, is an unknown at the time of writing.



8. Investments in 2021/22 and Economic Context commentary provided by Link Asset Services (the councils external Treasury advisor)

Investment returns remained close to zero for much of 2021/22. Most local authority lending managed to avoid negative rates and one feature of the year was the continued growth of inter local authority lending. The expectation for interest rates within the treasury management strategy for 2021/22 was that Bank Rate would remain at 0.10% until it was clear to the Bank of England that the emergency level of rates introduced at the start of the Covid-19 pandemic were no longer necessitated.

The Bank of England and the Government also maintained various monetary and fiscal measures, supplying the banking system and the economy with massive amounts of cheap credit so that banks could help cash-starved businesses to survive the various lockdowns/negative impact on their cashflow. The Government also supplied huge amounts of finance to local authorities to pass on to businesses. This meant that for most of the year there was much more liquidity in financial markets than there was demand to borrow, with the consequent effect that investment earnings rates remained low until towards the turn of the year when inflation concerns indicated central banks, not just the Bank of England, would need to lift interest rates to combat the second-round effects of growing levels of inflation (CPI was 6.2% in February).

While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates as illustrated in the charts shown above and below. Such an approach has also provided benefits in terms of reducing counterparty risk exposure, by having fewer investments placed in the financial markets.

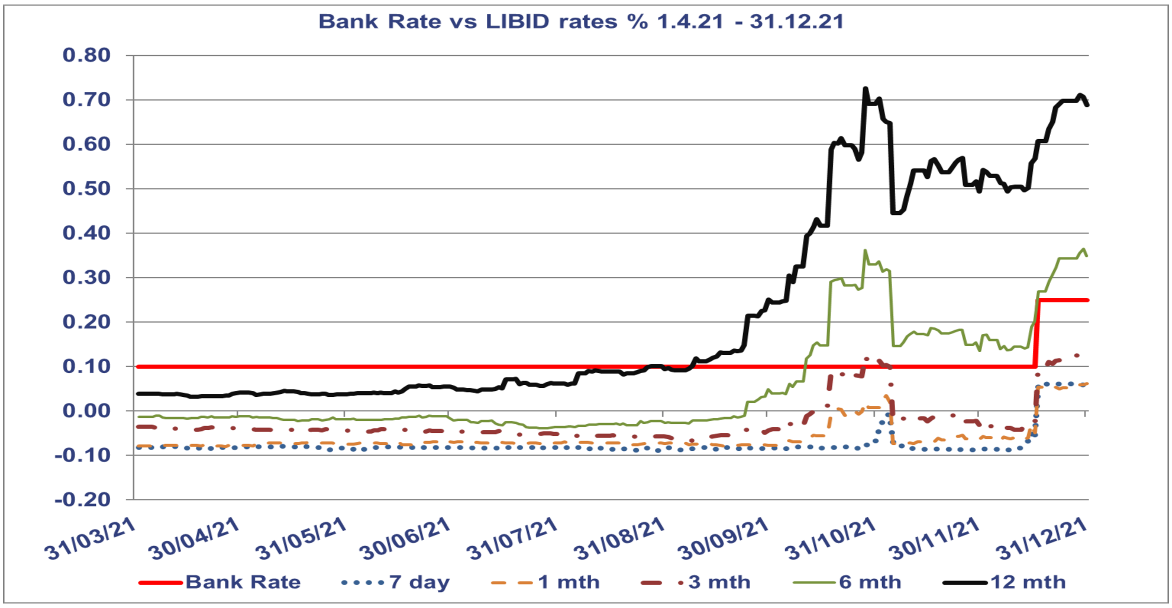


Table 9 within the report details the authority's investments by call, short and long term. The 7 day rate set out in the graph above (average of -0.08% across the year) is a fair comparator for at-call and the 12 month LIBID (average of 0.30% across the year) for short term investments.

Resources – the council's longer term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations.

Investment Policy – the council's investment policy is governed by central Government guidance, which was implemented in the Annual Investment Strategy approved by Council on 25th February 2021. This policy set out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by KPMG survey of Building Societies and an analysis of Common Equity Tier (CET1) levels. The investment activity during the year conformed to the approved Strategy, and the council had no liquidity difficulties.

At the end of 2021/22 Walsall's investment balance was £37.065m higher than that at the start of the year.

Table 8 below shows an age profile of the investments.

Table 8: Changes in Investments during 2021/22	Opening Balance £m	Closing Balance £m	Movement in Year £m

At Call accounts	36.360	47.925	11.565
Between 31 days and 365 days	138.500	174.000	35.500
Over 365 days	45.000	35.000	(10.000)
Total	**219.860**	**256.925**	**37.065**

Investments held by the council - the council maintained an average balance of £224m of internally managed funds. The internally managed funds earned an average rate of return of 0.38%.

Recognising the continuation of the stresses on the world banking system, enhanced priority has continued to be given to security and liquidity. To reduce counterparty risk to the maximum possible extent the investment portfolio was spread across a range of appropriately credit rated / analysed institutions. **Table 9** shows the outturn on investment income in 2021/22.

Table 9 Investments Interest – Gross Income	2021/22 Approved Cash Limit £m	Outturn at 31 March 2022 £m	Over /(under) achieved cash limit £m	% Target Rate	% Average Rate achieved
Call Account investments	0.008	0.056	0.048	0.05%	0.09%
Short Term Investments	0.518	0.682	0.164	0.25%	0.39%
Long Term Investments	0.120	0.113	(0.007)	0.80%	1.11%
Property Fund	1.169	1.034	(0.135)	3.82%	3.45%
Total	**1.815**	**1.885**	**0.070**	**0.68%**	**0.74%**

9. Performance Measurement

One of the key requirements in the CIPFA Code of Practice on Treasury Management is the formal introduction of performance measurements relating to investments, debt and capital financing activities. **Table 10** below shows that Walsall has consistently achieved a higher average return on it's investments and has reduced it's average rate it pays for its borrowing. The figures for 2011/12 to 2014/15 are derived from the the CIPFA treasury management benchmarking club. For 2015/16 onwards, as a number of authorities no longer participate in this benchmarking exercise, the figures set out are based on a review of reports issued by the authorities statistical neighbours. Comparative figures for 2021/22 are not yet available.

Table 10 Comparison of Walsall with other councils Average Interest Rates	Walsall Rate Received %	Average Rate Received %	Walsall Rate Paid %	Average Rate Paid %
2011/12	1.80	1.20	4.53	4.53
2012/13	2.14	1.11	4.47	4.52

2013/14	1.29	0.85	4.51	4.26
2014/15	1.09	0.77	4.61	4.14
2015/16	1.08	0.76	4.54	4.18
2016/17	0.86	0.76	3.99	4.34
2017/18	1.32	0.73	3.42	4.06
2018/19	1.37	1.10	3.83	4.15
2019/20	1.50	1.00	3.34	4.05
2020/21	0.59	0.24	3.42	3.70
2021/22	0.38		3.63	

Council approved the following local performance indicators, the majority of which were complied with during the year, **Table 11** provides the indicators for March 2022.

Table 11 - Local Indicators		Actual 2020/21	Target 2021/22	Position 31-Mar-22	Variance to target	
		£m	£m	£m	value	%
L1	Full compliance with Prudential Code.	YES	YES	YES	N/A	N/A
L2	Average length of debt. (Years)	16.23	Lower Limit 15 Years, Upper Limit 25 Years	16.44	N/A	N/A
L3a	Net borrowing costs as % of net council tax requirement.	7.02%	20.00%	7.15%	(12.85%)	(64.27%)
3b	Net borrowing costs as % of Tax Revenue.	4.44%	12.50%	4.60%	(7.90%)	(63.23%)
L4	Net actual debt vs. operational debt.	80.92%	85.00%	72.62%	(12.38%)	(14.56%)
L5	Average interest rate of external debt outstanding excluding OLA.	3.46%	3.30%	3.59%	0.29%	8.67%
L6	Average interest rate of external debt outstanding including OLA.	3.54%	3.46%	3.65%	0.19%	5.57%
L7	Gearing effect of 1% increase in interest rate.	3.92%	5.00%	3.69%	(1.31%)	(26.20%)
L8	Average interest rate received on STI vs. At Call rate	580.00%	374.00%	280.00%	(94%)	(25.13%)
L9	Average interest rate received:					
L9a	At Call investments.	0.10%	0.05%	0.09%	0.04%	80.00%
L9b	Short Term Investments.	0.68%	0.25%	0.39%	0.14%	56.00%
L9c	Long Term Investments.	1.57%	0.80%	1.11%	0.31%	38.75%
L9d	Property Fund Investments	4.10%	3.82%	3.45%	(0.37%)	(9.69%)
L10	Average interest rate on all ST investments (ST and At Call).	0.46%	0.24%	0.29%	0.05%	22.41%

L11a	Average rate on all investments (excluding property fund)	0.59%	0.27%	0.38%	0.11%	39.43%
L11b	Average Rate on all investments (including property fund)	1.01%	0.68%	0.74%	0.06%	8.87%
L12	% daily bank balances within target range.	100%	99%	100%	1.00%	1.01%

Key variances are because of the following reasons:-

L3a - Net borrowing costs as % of net council tax requirement (variance of -64.27%). The target figure of 20.00% represents an upper limit of affordable net borrowing costs as a percentage of the net council tax requirement for the authority. The actual level of net borrowing costs is currently less than the upper limit, which in the main is linked to the work undertaken by the service to seek to secure favourable rates on investments and reduced costs on borrowing, thus reducing the overall net borrowing costs.

L3b - Net borrowing costs as % of Tax Revenue (variance of -63.23%). The target figure of 12.50% represents an upper limit of affordable net borrowing costs as a percentage of tax revenues for the authority. The actual level of net borrowing costs is currently less than the upper limit, which in the main is linked to the work undertaken by the service to seek to secure favourable rates on investments and reduced costs on borrowing, thus reducing the overall net borrowing costs.

L5 & L6 – The targets set at the beginning of the year factored in borrowing at lower rates for capital expenditure. This borrowing was not required to be taken out during this financial year which has impacted upon this variance adversely as the rate for this year would have included the new borrowing at lower rates.

L8 – Average rate achieved on Short Term Interest vs At Call Rate – The target is to achieve a 50% better rate on short term investments vs the current At Call rate (i.e. do nothing other than leave all cash in overnight At Call accounts). Improvements in At-Call rates at the end of financial year due to bank rate increases meant that the difference between At-Call and Short Term rates was reduced, as short term rates were locked in whereas At-Call rates increased immediately. Short term rates are still a 280.00% improvement on At-Call rates but below the target of 374.00%

L9d – Property Fund investment rates – The valuation of the property fund has increased this financial year leading to investment gains, however the dividend paid for this financial year is below the expected budgeted returns.

10. The Economy and Interest Rates commentary provided by Link (the councils external Treasury advisor)

UK. Economy. 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.

The UK economy has endured several false dawns through 2021/22, but with most of the economy now opened up and nearly back to business-as-usual, the Gross Domestic Product (GDP) numbers have been robust (9% year/year Q1 2022) and sufficient for the Monetary Policy Committee (MPC) to focus on tackling the second-round effects of inflation, now that the Consumer Price Index (CPI) measure has already risen to 6.2% and is likely to exceed 8% in April.

Gilt yields fell towards the back end of 2021, but despite the war in Ukraine gilt yields have shot higher in early 2022. At 1.38%, 2-year yields remain close to their recent 11-year high and 10-year yields of 1.65% are close to their recent six-year high. These rises have been part of a global trend as central banks have suggested they will continue to raise interest rates to contain inflation.

Historically, a further rise in US Treasury yields will probably drag UK gilt yields higher. There is a strong correlation between the two factors. However, the squeeze on real household disposable incomes arising from the 54% leap in April utilities prices as well as rises in council tax, water prices and many phone contract prices, are strong headwinds for any economy to deal with. In addition, from 1st April 2022, employees also pay 1.25% more in National Insurance tax. Consequently, inflation will be a bigger drag on real incomes in 2022 than in any year since records began in 1955.

Average inflation targeting. This was the major change in 2020/21 adopted by the Bank of England in terms of implementing its inflation target of 2%. The key addition to the Bank's forward guidance in August 2020 was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and *achieving the 2% target sustainably*". That mantra now seems very dated. Inflation is the "genie" that has escaped the bottle, and a perfect storm of supply side shortages, labour shortages, commodity price inflation, the impact of Russia's invasion of Ukraine and subsequent Western sanctions all point to inflation being at elevated levels until well into 2023.

USA. The flurry of comments from Fed officials following the mid-March (Federal Open Market Committee (FOMC) meeting – including from Chair Jerome Powell himself – hammering home the hawkish message from the mid-March meeting, has had markets pricing in a further 225bps of interest rate increases in 2022 on top of the initial move to an interest rate range of 0.25% - 0.5%.

In addition, the Fed is expected to start to run down its balance sheet. Powell noted that the rundown could come as soon as the next meeting in May.

The upward pressure on inflation from higher oil prices and potential knock-on impacts on supply chains all argue for tighter policy (CPI is estimated at 7.8% across Q1), but the hit to real disposable incomes and the additional uncertainty points in the opposite direction.

More recently, the inversion of the 10y-2y Treasury yield spread at the end of March led to predictable speculation that the Fed's interest rate hikes would quickly push the US economy into recession. Q1 GDP growth is 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 is only 3.8%.

EU. With euro-zone inflation having jumped to 7.5% in March it seems increasingly likely that the ECB will accelerate its plans to tighten monetary policy. It is likely to end net asset purchases in June – i.e., earlier than the Q3 date which the European Central Bank (ECB) targeted in March. And the market is now anticipating possibly three 25bp rate hikes later this year followed by more in 2023. Policymakers have also hinted strongly that they would re-start asset purchases if required. In a recent speech, Christine Lagarde said "we can design and deploy new instruments to secure monetary policy transmission as we move along the path of policy normalisation."

While inflation has hit the headlines recently, the risk of recession has also been rising. Among the bigger countries, Germany is 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 is expected to be 0.3% q/q with the y/y figure posting a healthy 5.2% gain. Finishing on a bright note, 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 the recent outbreak of Covid-19 in large cities, such as Shanghai, near-term economic performance is likely to be subdued. Official GDP numbers suggest growth of c4% y/y, but other data measures suggest this may be an overstatement.

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 is expected to have risen only 0.5% y/y with Q4 seeing a minor contraction. The policy rate has remained at -0.1%, unemployment is currently only 2.7% and inflation is sub 1%, although cost pressures are mounting.

World growth. World growth is estimated to have expanded 8.9% in 2021/22 following a contraction of 6.6% in 2020/21.

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 Russia's recent invasion of Ukraine, has 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 sharp retrenchment of economies into two blocs of western democracies v. autocracies. It is, therefore, likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China (and to a much lesser extent Russia) to supply products and vice versa. This is likely to reduce world growth rates.

Central banks' monetary policy. During the pandemic, the governments of western countries have provided massive fiscal support to their economies which has resulted in a big increase in total government debt in each country. It is therefore very important that bond yields stay low while debt to GDP ratios slowly subside under the impact of economic growth. This provides 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 have already changed their policy towards implementing their existing mandates on inflation, (and full employment), to hitting an average level of inflation. Greater emphasis could also be placed on hitting subsidiary targets e.g. full employment before raising rates. Higher average rates of inflation would also help to erode the real value of government debt more quickly.