TEES VALLEY COMBINED AUTHORITY | TEES VALLEY MAYOR

AGENDA ITEM 10

REPORT TO THE TEES VALLEY COMBINED AUTHORITY CABINET

22nd JULY 2022

REPORT OF GROUP DIRECTOR OF FINANCE AND RESOURCES

TREASURY MANAGEMENT OUTTURN REPORT 2021/22

SUMMARY

This report informs Members of the 2021/22 performance against the treasury management and prudential indicators set in the Treasury Management Strategy approved by the Authority in January 2021.

RECOMMENDATIONS

It is recommended that Cabinet note the contents of the report.

INTRODUCTION

1. The Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports.

2. The Authority's treasury management strategy for 2021/22 was approved at Cabinet meeting on 29th January 2021. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk is therefore central to the Authority's treasury management strategy.

3. The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by Cabinet covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy, complying with CIPFA's requirement, was also approved by full Cabinet at the 29th January 2021 meeting.

4. As per of the Authorities borrowing strategy an annual limit is agreed with Treasury, currently £774 million. We are currently in negotiations with Treasury to agree this limit for the medium term. Within these we will be taking into account any revised requirements to deliver the investment plan along with the impact of the adoption of IFRS16 (Leases) on the borrowing limit requirements.

DETAIL

External Context

5. The continuing economic recovery from coronavirus pandemic, together with the war in Ukraine, higher inflation, and higher interest rates were major issues over the period.

6. Bank Rate was 0.1% at the beginning of the reporting period. April and May saw the economy gathering momentum as the shackles of the pandemic restrictions were eased. Despite the improving outlook, market expectations were that the Bank of England would delay rate rises until 2022 however persistent inflation changed that.

7. UK CPI was 0.7% in March 2021 but thereafter began to steadily increase. Initially driven by energy price effects and by inflation in sectors such as retail and hospitality which were re-opening after the pandemic lockdowns, inflation then was believed to be temporary. Thereafter price rises slowly became more widespread, as a combination of rising global costs and strong demand was exacerbated by supply shortages and transport dislocations. The surge in wholesale gas and electricity prices led to elevated inflation expectations. CPI for February 2022 registered 6.2% year on year, up from 5.5% in the previous month and the highest reading in the National Statistic series. Core inflation, which excludes the more volatile components, rose to 5.2% y/y from 4.4%.

8. The government's jobs furlough scheme insulated the labour market from the worst effects of the pandemic. The labour market began to tighten and demand for workers grew strongly as employers found it increasingly difficult to find workers to fill vacant jobs. Having peaked at 5.2% in December 2020, unemployment continued to fall and the most recent labour market data for the three months to January 2022 showed the unemployment rate at 3.9% while the employment rate rose to 75.6%. Headline 3-month average annual growth rate for wages were 4.8% for total pay and 3.8% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 0.1% while regular pay fell by 1.0%.

9. With the fading of lockdown – and, briefly, the 'pingdemic' – restraints, activity in consumer-facing sectors improved substantially as did sectors such as oil and mining with the reopening of oil rigs but materials shortages and the reduction in the real spending power of households and businesses dampened some of the growth momentum. Gross domestic product (GDP) grew by an upwardly revised 1.3% in the fourth calendar quarter of 2021 according to the final estimate (initial estimate 1.0%) and took UK GDP to just 0.1% below where it was before the pandemic. The annual growth rate was revised down slightly to 7.4% (from 7.5%) following a revised 9.3% fall in 2020.

10. Having increased Bank Rate from 0.10% to 0.25% in December, the Bank of England hiked it further to 0.50% in February and 0.75% in March. At the meeting in February, the Monetary Policy Committee (MPC) voted unanimously to start reducing the stock of its asset purchase scheme by ceasing to reinvest the proceeds from maturing bonds as well as starting a programme of selling its corporate bonds.

11. In its March interest rate announcement, the MPC noted that the invasion of Ukraine had caused further large increases in energy and other commodity prices, with the expectation that the conflict will worsen supply chain disruptions around the world and push CPI inflation to around 8% later in 2022, even higher than forecast only a month before in the February Monetary Policy Report. The Committee also noted that although GDP in January was stronger than expected with business confidence holding up and the labour market remaining robust, consumer confidence had fallen due to the squeeze in real household incomes.

12. GDP growth in the euro zone increased by 0.3% in calendar Q4 2021 following a gain of 2.3% in the third quarter and 2.2% in the second. Headline inflation remains high, with CPI registering a record 7.5% year-on-year in March, the ninth successive month of rising inflation. Core CPI inflation was 3.0% y/y in March, was well above the European Central Bank's target of 'below, but close to 2%', putting further pressure on its long-term stance of holding its main interest rate of 0%.

13. The US economy expanded at a downwardly revised annualised rate of 6.9% in Q4 2021, a sharp in increase from a gain of 2.3% in the previous quarter. In its March 2022 interest rate announcement, the Federal Reserve raised the Fed Funds rate to between 0.25% and 0.50% and outlined further increases should be expected in the coming months. The Fed also repeated the plan to reduce its asset purchase programme which could start by May 2022.

14. The conflict in Ukraine added further volatility to the already uncertain inflation and interest rate outlook over the period. The Dow Jones started to decline in January but remained above its pre-pandemic level by the end of the period while the FTSE 250 and FTSE 100 also fell and ended the quarter below their pre-March 2020 levels.

15. Bond yields were similarly volatile as the tension between higher inflation and flight to quality from the war pushed and pulled yields, but with a general upward trend from higher interest rates dominating as yields generally climbed.

16. The 5-year UK benchmark gilt yield began the quarter at 0.82% before rising to 1.41%. Over the same period the 10 year gilt yield rose from 0.97% to 1.61% and the 20-year yield from 1.20% to 1.82%.

17. In the first half of FY 2021-22 credit default swap (CDS) spreads were flat over most of the period and are broadly in line with their pre-pandemic levels. In September spreads rose by a few basis points due to concerns around Chinese property developer Evergrande defaulting but then fell back. Fitch and Moody's revised upward the outlook on a number of UK banks and building societies on the Authority's counterparty to 'stable', recognising their improved capital positions compared to 2020 and better economic growth prospects in the UK.

18. The successful vaccine rollout programme was credit positive for the financial services sector in general and the improved economic outlook meant some institutions were able to reduce provisions for bad loans. However, in 2022, the uncertainty engendered by Russia's invasion of Ukraine pushed CDS prices modestly higher over the first calendar quarter, but only to levels slightly above their 2021 averages, illustrating the general resilience of the banking sector.

19. Having completed its full review of its credit advice on unsecured deposits, in September Arlingclose extended the maximum duration limit for UK bank entities on its recommended lending list from 35 days to 100 days; a similar extension was advised in December for the non-UK banks on this list. As ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remains under constant review.

Revised CIPFA Codes, Updated PWLB Lending Facility Guidance

20. 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.

21. 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.

22. 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 authorities to make investment or spending decision that will increase the CFR unless directly and primarily related to the functions of the authority.

23. 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.

24. The Authority is not planning to borrow to invest primarily for commercial return and so is unaffected by the changes to the Prudential Code.

Local Context

25. The treasury management position on 31st March 2022 and the change during the year is shown in Table 1 below.

Table 1: Treasury Management Summary

	31.3.21 Balance £m	**Movement £m**	**31.3.22 Balance £m**
Long-term borrowing	29.14	105.82	134.96
Short-term borrowing	0.00	15.00	15.00
Total Borrowing	**29.14**	**120.82**	**149.96**
Long-term investments	0.00	0.00	0.00
Short-term investments	5.00	(5.00)	0.00
Cash and cash equivalents	96.29	29.11	125.40
Total Investments	**101.29**	**24.11**	**125.40**
Net Investments / (Debt)	**72.15**	**(96.71)**	**(24.56)**

26. During the year the Authority became the first organisation to secure a loan from the new UK Infrastructure bank totalling £106.7m to construct the South Bank Quay for the offshore wind sector, providing opportunities for manufacturing, storage and mobilisation of wind technology.

27. The construction of the quay will take place over a period of time and therefore has contributed to the increase in funds held at the year end. During the year the Authority has expended some of the grants in advance of expenditure held at 31st March 2021 reducing the balance of funds held. Investments that are due to mature within 90 days are classified as cash and cash equivalents.

Borrowing Strategy

28. At 31st March 2022 the Authority held £135m of loans as part of its strategy for funding the capital programmes within the Investment Plan, outstanding loans on 31st March 2022 are summarised in Table 2 below.

Table 2: Borrowing Position

	31.3.21 Balance £m	Net Movement £m	31.3.22 Balance £m	31.3.22 Weighted Average Rate %	31.3.22 Weighted Average Maturity (years)
Public Works Loans Board	29.14	(0.88)	28.26	2.67	22.82
UK Infrastructure Bank	0.00	106.70	106.70	1.99	49.59
Total borrowing	**29.14**	**105.82**	**134.96**	**2.13**	**43.98**

29. 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.

30. The Authority has an increasing capital financing requirement due to the capital programme within the investment plan and an estimated borrowing requirement as determined by the Liability Benchmark which also takes into account usable reserves and working capital.

Treasury Investment Activity

31. The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances fluctuated due to timing differences between income and expenditure. The investment position at the end of March 2022 is shown in table 3 below.

Table 3: Treasury Investment Position

Counterparty	Amount	Start	Maturity
	£	Date	Date
Natwest SIBA	510,000	n/a	Call Account
UK Government DMO	16,000,000 15,000,000	28-Mar-22 31-Mar-22	11-Apr-22 31-May-22
Blackrock	15,000,000	07-Dec-16	Money Market Fund
Aberdeen Standard	14,500,000	06-Oct-16	Money Market Fund
Federated	15,000,000	06-Oct-16	Money Market Fund
Legal & General	15,000,000	06-Oct-16	Money Market Fund
Insight	15,000,000	07-Dec-16	Money Market Fund
Redcar & Cleveland Council	10,000,000	02-Dec-21	02-Jun-22
Santander	5,000,000	20-Dec-21	Notice
Lloyds	5,000,000	20-Dec-21	Notice
	126,010,000		

32. 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.

33. The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 4 below.

Table 4: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	**Credit Rating**	**Bail-in Exposure**	**Weighted Average Maturity (days)**	**Rate of Return %**
31.03.2019	4.23	AA-	42%	52	0.79
31.03.2020	4.30	AA-	92%	11	0.50
31.03.2021	4.63	A+	75%	10	0.02
31.03.2022	4.13	AA-	38%	3	0.01
Similar LAs	4.42	AA-	49%	63	0.27
All LAs	4.39	AA-	60%	14	0.46

Non-Treasury Investments

34. The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

35. The Authority can lend money to its subsidiaries, constituent Local Authorities and local businesses to support delivery of the Strategic Economic Plan and stimulate local economic growth. Loans are not issued by the Authority for purely financial return, they are provided if the proposal meets the priorities set out in the Investment Plan and related strategies. Loans may be given in order to comply with state aid regulations, or alternatively it may be that the applicant has the ability to repay the support via increased revenues as a result of the investment.

36. As at the end of March 2022 also held £172.5m of such investments in;
- loans to subsidiaries £159.1m
- loans to constituent local authorities £8.8m
- loans to local businesses £4.6m

Compliance

37. The Group Director of Finance and Resources reports that all treasury management activities undertaken during complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 5 below.

Table 5: Debt Limits

	Maximum in Year	31.3.22 Actual	2021/22 Operational Boundary	2021/22 Authorised Limit	Complied? Yes/No
Borrowing	£149.96m	£149.96m	£460.38m	£552.46m	Yes

38. Compliance with specific investment limits is demonstrated in table 6 below.

Table 6: Investment Limits

	Maximum in Year	31.3.22 Actual	2021/22 Limit	Complied? Yes/No
Any single organisation, except the UK Central Government	£15m	£10m	£15m per organisation	Yes
UK Central Government	£118.5m	£31m	Unlimited	Yes
Any group of organisations under the same ownership	£0	£0	£15m per organisation	Yes
Any group of pooled funds under the same management	£0	£0	£37.5m	Yes
Negotiable instruments held in a broker's nominee account	£0	£0	£37.5m	Yes
Foreign countries	£0	£0	£15m	Yes
Registered providers and registered social landlords	£0	£0	£37.5m	Yes
Unsecured investments with building societies	£0	£0	£15m	Yes

Loans to unrated corporates	£0	£0	£15m	Yes
Money Market Funds	£75m	£74.5m	£75m	Yes
Real estate investment trusts	£0	£0	£37.5m	Yes

39. The Authority measures and manages its exposures to treasury management risks using the following indicators.

40. Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing are set out in table 7 below.

Table 7: Borrowing Maturity

	31.3.22 Actual	**Upper Limit**	**Lower Limit**	**Complied?**
Under 12 months	0%	100%	0%	Yes
12 months and within 24 months	0%	100%	0%	Yes
24 months and within 5 years	0%	100%	0%	Yes
5 years and within 10 years	0%	100%	0%	Yes
10 years and above	100%	100%	0%	Yes

41. Principal Sums Invested for Periods Longer than a year: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments.

Table 8: Long Term Investments

	2021/22	**2022/23**	**2023/24**
Actual principal invested beyond year end	£0	£0	£0
Limit on principal invested beyond year end	£15m	£10m	£5m
Complied?	Yes	Yes	Yes

FINANCIAL IMPLICATIONS

42. None

LEGAL IMPLICATIONS

43. None

CONSULTATION & COMMUNICATION

44. None

Name of Contact Officer: Gary Macdonald
Post Title: Group Director of Finance and Resources
Telephone Number: 01642 526527
Email Address: gary.macdonald@teesvalley-ca.gov.uk