COUNCIL

TUESDAY 27th SEPTEMBER 2022

REPORT OF THE PORTFOLIO HOLDER FOR FINANCE, RISK AND CUSTOMER SERVICES

ANNUAL REPORT ON THE TREASURY MANAGEMENT SERVICE AND ACTUAL PRUDENTIAL INDICATORS 2021/22

EXEMPT INFORMATION

None

PURPOSE

The Annual Treasury report is a requirement of the Council's reporting procedures. It covers the Treasury activity for 2021/22, and the actual Prudential Indicators for 2021/22.

The report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes in accordance with Regulations issued under the Local Government Act 2003. It also provides an opportunity to review the approved Treasury Management Strategy for the current year and enables Members to consider and approve any issues identified that require amendment.

RECOMMENDATIONS

That Council ;

1. **Approve the actual 2021/22 Prudential and Treasury Indicators within the report and shown at Appendix 1; and**

2. **Accept the Annual Treasury Management Report for 2021/22.**

EXECUTIVE SUMMARY

This report covers Treasury operations for the year ended 31st March 2022 and summarises:

- the Council's Treasury position as at 31st March 2022; and
- Performance Measurement

The key points raised for 2021/22 are:

1. The Council's Capital Expenditure and Financing 2021/22
2. The Council's Overall Borrowing Need
3. Treasury Position as at 31st March 2022
4. The Strategy for 2021/22
5. Borrowing Outturn for 2021/22

6. Investment Outturn for 2021/22
7. Performance Measurement
8. The Economy and Interest Rates
9. Property Funds
10. Other Issues

The Treasury Function has achieved the following favourable results:

- The Council has complied with the professional codes, statutes and guidance;
- There are no issues to report regarding non-compliance with the approved prudential indicators;
- The Council maintained an average investment balance externally invested of £75.3m and achieved an average return of 0.28% (budgeted at £34.484m and an average return of 0.25%).
- This result compares favourably with the Council's own Benchmarks of the average 7 day and the 3 month SONIA rates for 2021/22 of 0.139% and 0.0617%;
- The closing weighted average internal rate on borrowing is 4.05% (4.05% for 2020/21);
- The Treasury Management Function has achieved an outturn investment income of £212k compared to an original budget of £95k. Investment balances were higher than budgeted throughout the year, however average interest rates started to rise.
- We also received £269k in dividends from our property fund investments (£128k in 2020/21), compared to a budget of £300k. The net value of the investments has risen by £1.132m as at 31st March 2022. At the meeting on 14th December 2021, Members considered the Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review Report 2021/22. In October 2021, an additional £8.1m was invested in Property Funds; £4.05m as a capital fund, and £4.05m as a revenue fund.

During 2021/22 the Council complied with its legislative and regulatory requirements.

The Executive Director Finance confirms that there was no overall increase in borrowing within the year and the Authorised Limit was not breached.

At 31st March 2022, the Council's external debt was £63.060m (£63.060m at 31st March 2021) and its external investments, excluding property funds and bank account, totalled £68.299m (£57.002m at 31st March 2021).

RESOURCE IMPLICATIONS

There are no financial implications or staffing implications arising directly from the report.

LEGAL/RISK IMPLICATIONS BACKGROUND

The Council is aware of the risks of passive management of the Treasury Portfolio and with the support of Link Asset Services, the Council's current Treasury advisers, has proactively managed its debt and investments during the year.

EQUALITIES IMPLICATIONS

None

SUSTAINABILITY IMPLICATIONS

None

REPORT AUTHOR

If Members would like further information or clarification prior to the meeting please contact Joanne Goodfellow, telephone 01827 709242 or email joanne-goodfellow@tamworth.gov.uk

LIST OF BACKGROUND PAPERS

- Local Government Act 2003;
- Statutory Instruments: 2003 No 3146 & 2007 No 573;
- CIPFA Code of Practice on Treasury Management in Public Services;
- Treasury Management Strategy 2021/22 (Council 23rd February 2021);
- Treasury Management Mid-Year Review 2021/20 (Council 14th December 2021);
- Treasury Outturn Report 2020/21 (Council 21st September 2021).

APPENDICES

Appendix 1 – Prudential and Treasury Indicators

Appendix 2 – Borrowing and Investment Rates

Annual Treasury Management Review 2021/22

This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2021/22. 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 minimum reporting requirements were complied with:

- an annual treasury strategy in advance of the year (Council 23rd February 2021)
- a mid-year (minimum) treasury update report (Council 14th December 2021)
- an annual review following the end of the year describing the activity compared to the strategy (this report).

In addition, Cabinet has received quarterly Treasury management updates as part of the Financial Healthcheck Reports.

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, 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 confirms that it has complied with the requirement under the Code to provide scrutiny of all of the above Treasury Management Reports to the Audit and Governance Committee. Member training on Treasury Management issues was provided in February 2022 and further training is planned during 2022/23.

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.

Prudential & Treasury Indicators	2020/21 Actual £m	2021/22 Estimate £m	2021/22 Actual £m
Capital Expenditure			
Non HRA	1.133	29.910	**7.823**
HRA	8.396	14.895	**9.993**
Total	9.529	44.805	**17.816**
Capital Financing Requirement			
Non HRA	3.612	4.736	**3.937**
HRA	69.893	70.396	**69.893**
Total	73.506	75.132	**73.831**
Gross Borrowing			
External Debt	63.060	63.060	**63.060**
Investments			
Longer than 1 year	3.643	-	**13.095**
Less than 1 year	57.972	27.197	**67.215**
Total	61.615	27.197	**80.310**
Net Borrowing	1.445	35.863	**-17.250**

It should be noted that **£30.5m** of Capital scheme spend has been re-profiled into 2022/23 (also including re-profiling from previous years) which has increased investment balances.

Other prudential and treasury indicators are to be found further in this report. The Executive Director Finance confirms that there was no overall increase in borrowing in year and the statutory borrowing limit (the authorised limit) was not breached.

The financial year 2021/22 continued the challenging investment environment of previous years, namely low investment returns.

1. 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 internal funds, the capital expenditure would 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.

General Fund	2020/21 Actual £m	2021/22 Estimate £m	2021/22 Actual £m
Capital Expenditure	1.133	29.910	**7.823**
Financed in year	0.933	28.928	**7.340**
Unfinanced capital expenditure	0.199	0.982	**0.483**
HRA	2020/21 Actual £m	2021/22 Estimate £m	2021/22 Actual £m
Capital Expenditure	8.396	14.895	**9.993**
Financed in year	7.035	14.820	**9.993**
Unfinanced capital expenditure	1.361	0.076	**-**

2. The Council's Overall Borrowing Need

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2021/22 unfinanced capital expenditure (see above table), 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 that 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 (non HRA) 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 is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing need (there is no statutory requirement to reduce the HRA 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 also 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).

The Council's 2021/22 MRP Policy (as required by DLUHC Guidance) was approved as part of the Treasury Management Strategy Report for 2021/22 on 23rd February 2021.

The Council's CFR for General Fund and the HRA for the year are shown below, and represent a key prudential indicator.

CFR: General Fund	31st March 2021 Actual £m	31st March 2022 Budget £m	31st March 2022 Actual £m
Opening balance	3.523	3.865	**3.612**
Add unfinanced capital expenditure (as above)	0.199	0.982	**0.483**
Less MRP/VRP	(0.110)	(0.187)	**(0.158)**
Less PFI & finance lease repayments	-	-	**-**
Closing balance	3.612	4.660	**3.937**

CFR: HRA	31st March 2021 Actual £m	31st March 2022 Budget £m	31st March 2022 Actual £m
Opening balance	68.532	70.396	**69.893**
Add unfinanced capital expenditure (as above)	1.361	0.076	**-**
Less MRP/VRP	-	-	**-**
Less PFI & finance lease repayments	-	-	**-**
Closing balance	69.893	70.472	**69.893**

Borrowing activity is constrained by prudential indicators for gross 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 and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2021/22) plus the estimates of any additional capital financing requirement for the current (20221/23) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2021/22. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

Gross borrowing and the CFR	31st March 2021 Actual £m	31st March 2022 Budget £m	31st March 2022 Actual £m
Gross borrowing position	63.060	63.060	63.060
CFR	73.506	75.132	73.831
Under / Over funding of CFR	-10.445	-12.072	-10.770

The lower than estimated CFR reflects re-profiling of spend within the capital programme to 2022/23 and lower than forecast borrowing.

The Authorised Limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2021/22 the Council has maintained gross borrowing within its authorised limit.

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 are acceptable subject to the authorised limit not being breached.

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.

Borrowing Limits	GF £m	HRA £m	Total £m
Authorised limit	7.736	79.407	87.143
Maximum gross borrowing position	-	63.060	63.060
Operational boundary	-	63.060	63.060
Average gross borrowing position	-	63.060	63.060
Budgeted financing costs as a proportion of net revenue stream %	(0.17)	28.09	27.91
Actual financing costs as a proportion of net revenue stream %	(6.74)	28.16	21.42

3. Treasury Position as at 31st March 2022

The Council's debt and investment position is organised by the treasury management service 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 (excluding borrowing by finance leases) position was as follows:

General Fund	31st March 2021 Principal £m	Rate/ Return %	Average Life yrs	31st March 2022 Principal £m	Rate/ Return %	Average Life yrs
Total debt	**-**	**-**	**-**	**-**	**-**	**-**
CFR	***3.612***	**-**	**-**	***3.937***	**-**	**-**
Over / (under) borrowing	***(3.612)***	**-**	**-**	***(3.937)***	**-**	**-**
Investments:						
- in house	40.779	0.62	-	45.761	0.54	-
Total investments	***40.779***	***0.62***	**-**	***45.761***	***0.54***	**-**

HRA	31st March 2021 Principal £m	Rate/ Return %	Average Life yrs	31st March 2022 Principal £m	Rate/ Return %	Average Life yrs
Fixed rate funding:						
-PWLB	63.060	4.05	33.73	63.060	4.05	32.73
-Market	-	-	-	-		-
Variable rate funding:						
-PWLB	-	-	-	-	-	-
-Market	-	-	-	-	-	-
Total debt	***63.060***	***4.05***	***33.73***	***63.060***	***4.05***	***32.73***
CFR	***69.893***	**-**	**-**	***69.893***	**-**	**-**
Over / (under) borrowing	***(6.833)***	**-**	**-**	***(6.833)***	**-**	**-**
Investments:						
- in house	17.193	0.62	-	21.454	0.54	-
Total investments	***17.193***	***0.68***	**-**	***21.454***	***0.54***	**-**

Maturity Structures

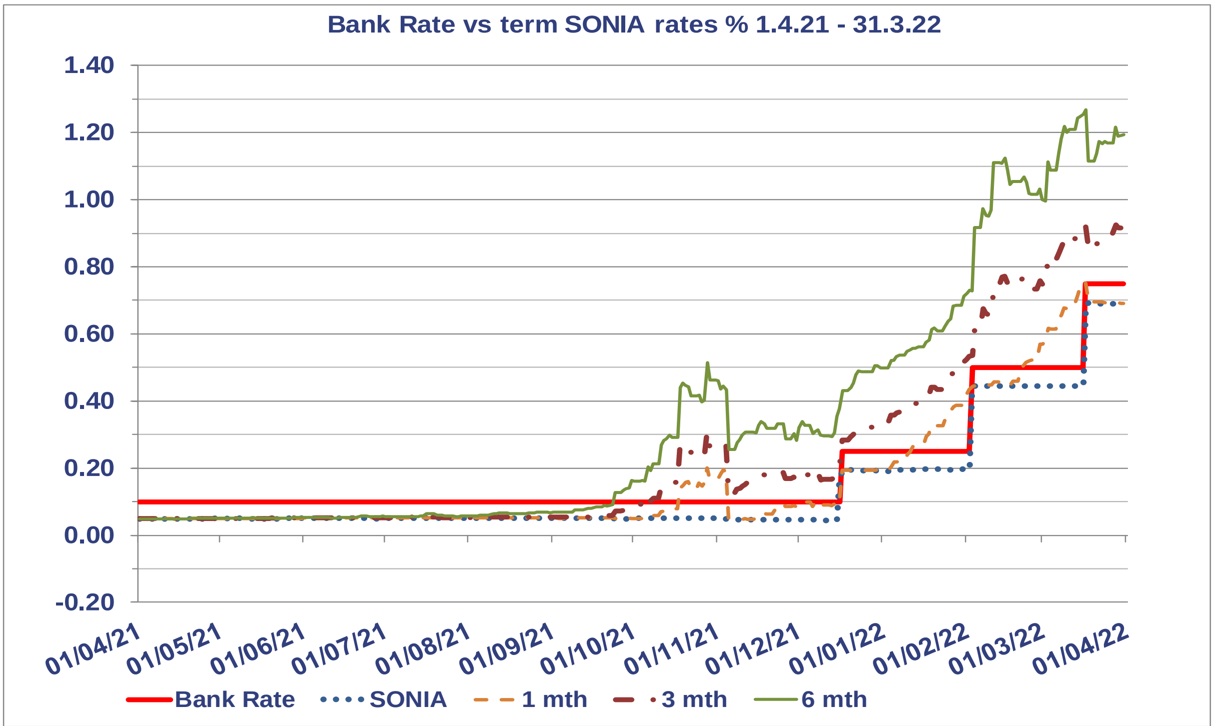
The maturity structure of the debt portfolio was as follows:

Duration	31st March 2021 Actual £m	2021/22 original limits %	31st March 2021 Actual £m
Under 12 months	-	20	**-**
12 months and within 24 months	-	20	**-**
24 months and within 5 years	-	25	**-**
5 years and within 10 years	-	75	**1**
10 years and within 15 years	5	100	**4**
15 years and within 50 years	58	100	**58**

All investments held by the Council were invested for up to one year, with the exception of £11.962m invested in property funds, which are held for the longer-term, 5 – 10 years.

4. The Strategy for 2021/22

4.1 Investment strategy and control of interest rate risk



	Bank Rate	SONIA	1 mth	3 mth	6 mth
High	0.75	0.69	0.75	0.93	1.27
High Date	17/03/2022	18/03/2022	16/03/2022	28/03/2022	17/03/2022
Low	0.10	0.05	0.05	0.05	0.05
Low Date	01/04/2021	15/12/2021	10/11/2021	14/04/2021	09/04/2021
Average	0.19	0.14	0.17	0.24	0.34
Spread	0.65	0.65	0.71	0.88	1.22

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 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 0.1% 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 the counterparty risk exposure, by having fewer investments placed in the financial markets.

4.2 Borrowing strategy and control of interest rate risk

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.

A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances and incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when the Council may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Executive Director Finance therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks

- if it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

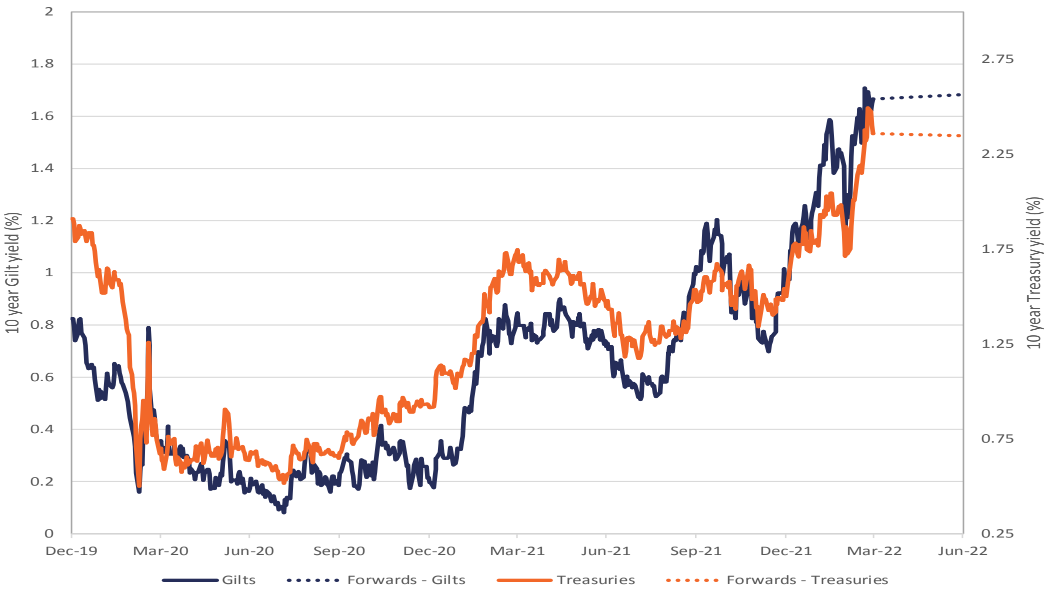
- if it had been felt that there was a significant risk of a much sharper RISE in long and short term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

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.

PWLB Borrowing Rates

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.

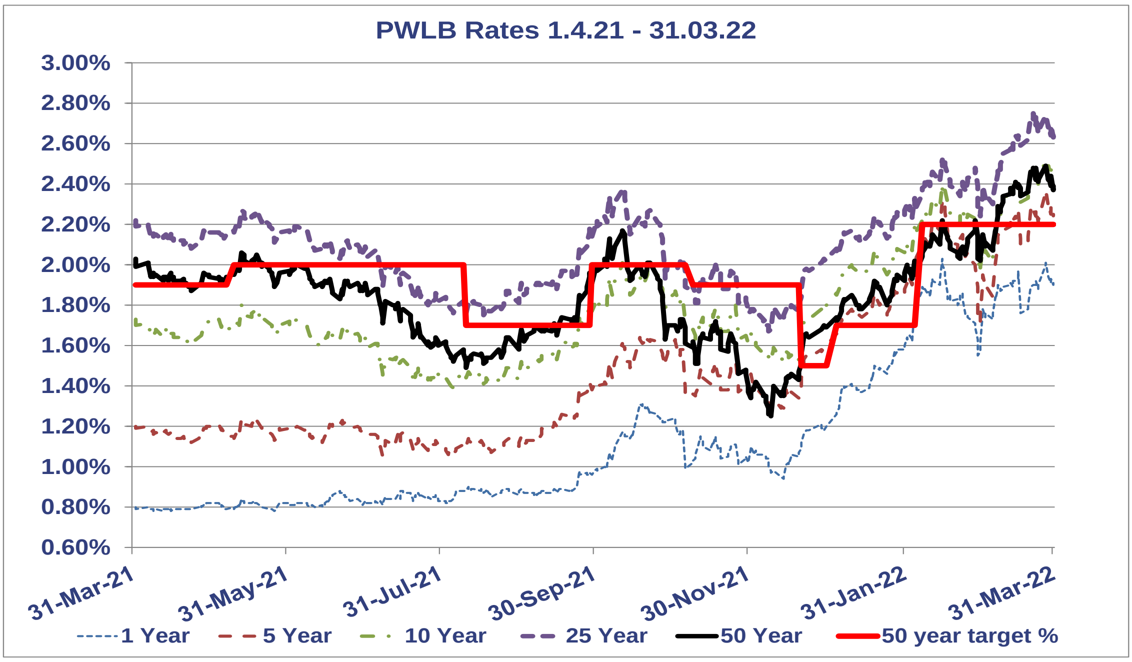
At the close of the day on 31 March 2022, all gilt yields from 1 to 5 years were between 1.11% – 1.45% while the 10-year and 25-year yields were at 1.63% and 1.84%.

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)
- **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB HRA Certainty Rate** is gilt plus 80bps (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.

The graph and tables for PWLB rates below and in Appendix 2 show, for a selection of maturity periods, the average borrowing rates, the high and low points in rates, spreads and individual rates at the start and the end of the financial year.



5. Borrowing Outturn for 2021/22

Treasury Borrowing
Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

Borrowing in Advance of Need
The Council has not borrowed more than, or in advance of, its needs, purely in order to profit from the investment of the extra sums borrowed.

Rescheduling
No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

6. Investment Outturn for 2021/22

Investment Policy – the Council's investment policy is governed by DLUHC investment guidance, which has been implemented in the annual investment strategy approved by the Council on 23rd February 2021. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc).

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

Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised the following:

Balance Sheet Resources General Fund	31st March 2021 £m	31st March 2022 £m
Balances	8.002	**9.155**
Earmarked Reserves	18.108	**15.505**
Provisions	2.637	**1.916**
Usable Capital Receipts	17.307	**13.23**
Capital Grants Unapplied	0.295	**0.420**
Total GF	46.349	**40.226**

Balance Sheet Resources HRA	31st March 2021 £m	31st March 2022 £m
Balances	5.611	**5.717**
Earmarked Reserves	11.251	**11.989**
Provisions	-	**-**
Usable Capital Receipts	2.68	**1.153**
Total HRA	19.542	**18.859**

Total Authority Resources	65.891	**59.085**

Investments held by the Council – the Council maintained an average balance of £75.3m of internally managed funds. The internally managed funds earned an average rate of return of 0.28%. The comparable performance indicator is the average 7-day SONIA rate which was 0.139%. This compared with a budget assumption of £34.484m investment balances earning an average rate of 0.25%.

7. Performance Measurement

One of the key requirements in the Code is the formal introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide (as incorporated in the table in section 3). The Council's performance indicators were set out in the Annual Treasury Management Strategy Statement.

This service has set the following local performance indicator:

- *Average external interest receivable in excess of 3 month SONIA rate;*

  Whilst the assumed benchmark for local authorities is the 7 day SONIA rate, a higher target is set for internal performance.

  The actual return of 0.28% compared to the average 3 month SONIA of 0.0617% (0.218% above target).

8. The Economy and Interest Rates

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 GDP numbers have been robust (9% y/y Q1 2022) and sufficient for the MPC to focus on tackling the second-round effects of inflation, now that the 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 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 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.

9. Investment in Property Funds

Investment in property funds was included within the Commercial Investment Strategy, with the aim of generating improved returns of c.4-5% p.a. (plus asset growth) being long term investments of between 5 – 10 years (minimum) in order to make the necessary returns (after set up costs). Utilising the capital receipt proceeds of the sale of the Golf Course, a budget of £12m was allocated to long-term investment in a number of property funds. To date, the Council has invested £1.85m with Schroders UK Real Estate Fund, £6.057m with Threadneedle Property Unit Trust, and £4.057 with Hermes Federated Property Unit Trust. Total investment £11.962m.

Fund Valuations	Investment	Valuation 31/03/2020	Valuation 31/03/2021	Valuation 31/03/2022	Valuation 30/06/2022
Schroders UK Real Estate Fund	1,848,933	1,884,412	1,848,933	2,139,618	2,173,484
Valuation Increase / (reduction)		35,479	0	290,685	324,551
Threadneedle Property Unit Trust	2,000,249	1,836,032	1,794,439	2,068,632	2,181,714
Valuation Increase / (reduction)		(164,217)	(205,810)	68,383	181,465
Threadneedle Property Unit Trust	4,056,536	N/A	N/A	4,407,163	4,584,991
Valuation Increase / (reduction)				350,627	528,454
Hermes Federated Property Unit Trust	4,056,536	N/A	N/A	4,450,808	4,651,182
Valuation Increase / (reduction)				394,271	594,645
Total	11,962,255	3,720,444	3,643,372	13,066,221	13,591,371
Valuation Increase / (reduction)		(128,738)	(205,810)	1,103,966	1,629,116

The Council received £269k in dividends from its property fund investments in 2021/22 (£128k in 2020/21), £544k in total since 2018/19, in addition to the valuation increase of £1.104m over the same period.

10. Other Issues

International Financial Reporting Standard (IFRS) 9 – Financial Instruments.

The 2018/19 Accounting Code of Practice introduced changes in way investments are valued and disclosed in the Council's Statement of Accounts. Key considerations are:-

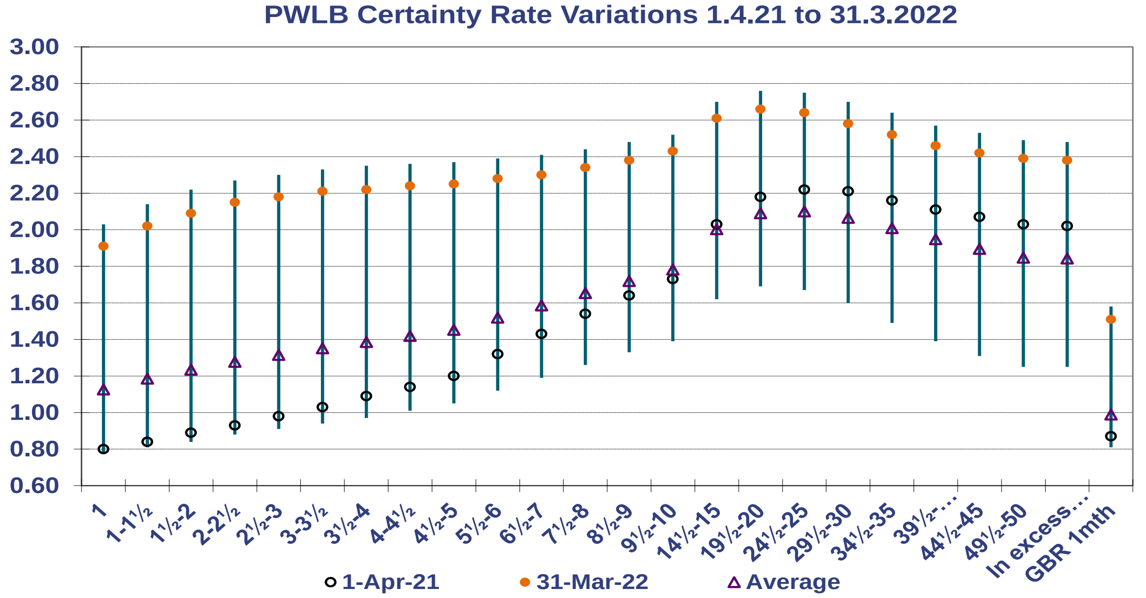
- Expected credit loss model. Whilst not material for vanilla treasury investments such as bank deposits, this does impact our investment in property funds
- The valuation of investments previously valued under the available for sale category e.g. equity related to the "commercialism" agenda, property funds, equity funds and similar, will be changed to **Fair Value through the Profit and Loss (FVPL).**

Following the consultation undertaken by the Ministry of Housing, Communities and Local Government [MHCLG] on IFRS9, the Government has introduced a mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds. This was effective from 1st April 2018, and applies for five years from this date. Local authorities are required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve throughout the duration of the override in order for the Government to keep the override under review and to maintain a form of transparency.

PRUDENTIAL AND TREASURY INDICATORS APPENDIX 1

1. PRUDENTIAL INDICATORS	2020/21	2021/22	2021/22
Extract from budget and rent setting report	**Actual**	**Original**	**Actual**
Capital Expenditure	**£m**	**£m**	**£m**
Non - HRA	1.133	29.910	7.823
HRA	8.396	14.895	9.993
TOTAL	9.529	44.805	17.816
Ratio of financing costs to net revenue stream	**%**	**%**	**%**
Non - HRA	(5.44)	(0.17)	(6.74)
HRA	28.20	28.09	28.16
Gross borrowing requirement General Fund	**£m**	**£m**	**£m**
brought forward 1 April	3.523	3.865	3.612
carried forward 31 March	3.723	4.847	4.095
in year borrowing requirement	0.199	0.982	0.483
Gross borrowing requirement HRA	**£m**	**£m**	**£m**
brought forward 1 April	68.532	70.396	69.893
carried forward 31 March	69.893	70.472	69.893
in year borrowing requirement	1.361	0.076	-
	£m	**£m**	**£m**
Gross debt	63.060	63.060	63.060
Capital Financing Requirement	**£m**	**£m**	**£m**
Non – HRA	3.612	4.660	3.937
HRA	69.893	70.472	69.893
TOTAL	73.506	75.132	73.831
Annual change in Capital Financing Requirement	**£m**	**£m**	**£m**
Non – HRA	0.089	0.795	0.325
HRA	1.361	0.076	-
TOTAL	1.450	0.871	0.325

2. TREASURY MANAGEMENT INDICATORS	2020/21	2021/22	2021/22
	Actual	Original	Actual
	£m	£m	£m
Authorised Limit for external debt - General Fund			
borrowing	5.806	7.736	7.736
other long term liabilities	0.000	-	-
TOTAL	5.806	7.736	7.736
Authorised Limit for external debt - HRA			
borrowing	79.407	79.407	79.407
other long term liabilities	-	-	-
TOTAL	79.407	79.407	79.407
Operational Boundary for external debt - General Fund	£m	£m	£m
borrowing	-	-	-
other long term liabilities	-	-	-
TOTAL	-	-	-
Operational Boundary for external debt - HRA	£m	£m	£m
borrowing	63.060	63.060	63.060
other long term liabilities	-	-	-
TOTAL	63.060	63.060	63.060
Actual external debt	£m	£m	£m
	63.060	63.060	63.060



HIGH/LOW/AVERAGE PWLB RATES FOR 2021/22

	1 Year	5 Year	10 Year	25 Year	50 Year
01/04/2021	0.80%	1.20%	1.73%	2.22%	2.03%
31/03/2022	1.91%	2.25%	2.43%	2.64%	2.39%
Low	0.78%	1.05%	1.39%	1.67%	1.25%
Low date	08/04/2021	08/07/2021	05/08/2021	08/12/2021	09/12/2021
High	2.03%	2.37%	2.52%	2.75%	2.49%
High date	15/02/2022	28/03/2022	28/03/2022	23/03/2022	28/03/2022
Average	1.13%	1.45%	1.78%	2.10%	1.85%
Spread	1.25%	1.32%	1.13%	1.08%	1.24%