## Audit and Governance Committee

**22nd July 2022**

**TREASURY MANAGEMENT ANNUAL REPORT**

| | |
|---|---|
| **Title of Report** | Treasury Management Annual Report 2021/22 |
| **Purpose of Report** | Each year the Council produces an Annual Report covering its Treasury Management activities for the previous year. The Annual Report is submitted each year to the Audit and Governance Committee in accordance with best practice as outlined in CIPFA's Code of Practice on Treasury Management. |
| **Recommendations** | To consider the Treasury Management Annual Report 2021/22 |
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# Treasury Management Annual Report 2021/22

## REPORT CONTENTS

### 1. Background

Gloucestershire County Council's (GCC's) treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management (the Code), which requires local authorities to produce annually a Treasury Management Strategy Statement (TMSS), and an Annual Report. The Prudential Code includes a requirement for GCC to produce a Capital Strategy, which covers capital expenditure and financing, treasury management and non-treasury investments.

The TMSS and Capital Strategy are agreed annually by full Council as part of the budget setting process. Scrutiny of these documents as well as a Mid Year Report and the Annual Report is delegated to the Audit and Governance Committee.

GCC has invested substantial sums of money during the year 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 are therefore central to GCC's treasury management strategy.

This report covers treasury activity and the associated monitoring and control of risk. A glossary is provided at Appendix A due to the technical terms and acronyms associated with treasury activity.

### 2. Economic Background

Treasury Management activities at GCC are driven by the prevailing economic conditions. A summary of these conditions over the financial year, provided by our Treasury Management advisors, is attached at Appendix B.

In summary, 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.

Bank Rate was 0.1% at the beginning of the reporting period. April and May saw the economy gathering momentum as the pandemic restrictions were eased. Despite the improving outlook, market expectations were that the Bank of England would delay rate rises until 2022. Rising, persistent inflation changed that, and rates were increased to 0.25% in December, to 0.50% in February and 0.75% in March.

### 3. Revised CIPFA Codes and Updated PWLB Lending Facility Guidance

In August 2021 HM Treasury significantly revised guidance for the PWLB lending facility with more detail and 12 examples of permitted and prohibited use of PWLB loans. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

CIPFA published its revised Prudential Code for Capital Finance and Treasury

Management Code on 20th December 2021. The key changes in the two codes are around permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments.

The principles of the Prudential Code took immediate effect although local authorities could defer introducing the revised reporting requirements, which requires monitoring and report performance against all forward-looking indicators at least quarterly, until the 2023/24 financial year. Officers are currently working through how best to implement these new reporting requirements from 2023/24.

To comply with the Prudential Code, authorities must not borrow to invest primarily for financial return. This Code also states that it is not prudent for local authorities to make investment or spending decision that will increase the CFR unless directly and primarily related to the functions of the authority. Existing commercial investments are not required to be sold; however, authorities with existing commercial investments who expect to need to borrow should review the options for exiting these investments. GCC does not have any existing commercial investments primarily for yield so these amendments to the Code do not apply.

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.

Unlike the Prudential Code, there is no mention of the date of initial application in the Treasury Management Code. The TM Code now includes extensive additional requirements for service and commercial investments, far beyond those in the 2017 version. These changes are not applicable to GCC at the current time; however these requirements will be kept under review to ensure that any new service or commercial investments are fully compliant with these new requirements and that the implications of taking these investment decisions are fully reviewed.

## 4. Borrowing and Debt Management

GCC has no requirements to borrow to invest primarily for commercial return, and so is unaffected by the changes to borrowing laid out in the new Prudential Code.

GCC has continued to borrow funds for specific capital schemes, and this year the total required was £14.387 million. This borrowing was arranged internally because prevailing borrowing rates exceed those that could be gained from investing funds. Although borrowing continues to be relatively cheap at the current time, it still makes more sense not to borrow due to the high cash balances that GCC has. The funding can however be externalised at any time should the need arise. The rest of the capital programme new schemes are funded in full from grants, revenue contributions, capital receipts or contributions.

As a result of the borrowing requirement for 2021/22, GCC's Capital Financing Requirement (CFR) – ie the total capital spend that has not yet been financed by capital receipts, capital grants or contributions from revenue income, increased - from £454.395 million to £457.553 million.

The average cost of GCC's existing borrowing portfolio during 2020/21 was 4.62%. This rate is significantly higher than the rate of return achieved on investments but reflects the mix of long term fixed rate loans taken out historically to reduce the risk associated with short term interest rate volatility.

The opening and closing external borrowing portfolio (including the on balance sheet PFI liabilities) is summarised below:

| | Balance on 31/3/2021 | Debt Maturing | Debt Prematurely Repaid | New Borrowing | Balance on 31/3/2022 | Avg Rate |
|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | % |
| Fixed rate loans – PWLB | 220.773 | 15.145 | 0.000 | 0.000 | 205.628 | 4.67 |
| Variable rate loans – PWLB | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.00 |
| Fixed rate loans – LOBO | 33.050 | 0.000 | 0.000 | 0.000 | 33.050 | 4.24 |
| Fixed rate loans – Market | 8.000 | 0.000 | 0.000 | 0.000 | 8.000 | 5.00 |
| **TOTAL BORROWING** | **261.823** | **15.145** | **0.000** | **0.000** | **246.678** | **4.62** |
| Other Long Term Liabilities | 156.701 | 3.661 | 0.000 | 0.000 | 153.040 | |
| **TOTAL EXTERNAL DEBT** | **418.524** | **18.806** | **0.000** | **0.000** | **399.718** | |
| Internal Borrowing | 35.871 | (7.577) | | 14.387 | 57.835 | |
| **Total Borrowing Requirement** | **454.395** | | | | **457.553** | |
| Increase/ (Decrease) in Borrowing £m | | | | **3.158** | | |

**Notes to Table**

- **Market Loans (LOBOs) and Fixed Market Loans:** GCC holds £33.05m of LOBO loans where the lender has the option to propose an increase in the interest rate at set dates, following which GCC has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOs had options during the year, none of which were exercised by the lender. Previously a further £8 million of loans with Barclays were classified as LOBOs; however Barclays have since fixed the interest rates on these loans until maturity. These are classified as fixed rate market loans.
- **Public Works Loans Board (PWLB)**: The PWLB continued to operate a spread of approximately 1% between "premature repayment rate" and "new loan" rates so the premium charge for early repayment of PWLB debt remained relatively expensive for the loans in GCC's portfolio and therefore unattractive for debt rescheduling activity. No rescheduling activity was undertaken as a consequence.
- **Other Long Term Liabilities**: These liabilities are associated with GCC's PFI schemes and service concessions. Under current accounting regulations GCC must show these liabilities as part of the total debt of GCC. The schemes include a Fire Joint Training Centre, four Fire Stations, a Community Life Skills Centre and the Waste facility at Javelin Park.

The table below reconciles the opening and closing total borrowing position during 2021/22

| | £m |
|---|---|
| **Opening CFR** | **454.395** |
| **Plus New Borrowing** | 14.387 |
| **Waste Deferred Liability Contribution** | (2.484) |
| **Less MRP** | (8.745) |
| **Total** | **457.553** |
| **Closing CFR** | **457.553** |
| | |
| External Debt | 246.678 |
| Other long term liabilities | 153.040 |
| Internal Debt | 57.835 |
| **Total Debt** | **457.553** |

The minimum revenue provision (MRP) shown above of £8.745 million is a statutory minimum amount by which GCC must reduce debt. The internal debt of £57.835 million results from existing internal debt, the additional borrowing requirement of £14.387 million during 2021/22 and a temporary in year timing mismatch between MRP set aside in 2021/22 to repay maturing debt and actual debt maturing in year.

A graph of the maturity profile of our external loans is shown in Appendix C. Generally the maturity profile is well spread.

## 5. Investment Activity

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

GCC has held significant invested funds during the year, representing income received in advance of expenditure plus balances and reserves. During 2021/22 GCC's investment balances have varied – the average was £339.1 million. This generated interest of £4.8m which is equivalent to 1.41%. This return was achieved during a period when the bank rate was 0.10% for the majority of the year.

The table below summarises investment activity during the year;

| | |
|---|---|
| Total number of loans made to 31 March 2022 | 136 |
| Daily invested range | £0.059m to £28.151m |
| Total value of loans made to 31 March 2022 | £842.006m |
| Maximum value loan made (non call) | £5.0m |
| Maximum value of loans made (Call) | £28.151m |
| Periods | Overnight to 2 years |

All investments made during the year complied with GCC's agreed TMSS, Prudential Indicators, Treasury Management Practices and prescribed limits as approved by the County Council in February 2021. All maturing investments were repaid to GCC in full and in a timely manner.

The opening and closing investment balances (principal positions) are summarised in the table below;

| Investments | Balance on 31/03/2021 £m | Investments Made £m | Maturities/ Investments Sold £m | Balance on 31/03/2022 £m | Avg Rate (%) |
|---|---|---|---|---|---|
| Short term Investments (call accounts, deposits) | | | | | |
| - Banks and Building Societies with ratings of A- or higher | 42.7 | 492.3 | -499.5 | 35.5 | 0.2 |
| - UK Government | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| - Local Authorities | 111.8 | 10.0 | -31.8 | 90.0 | 0.7 |
| - Housing Association | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| - Covered Bonds/ FRN (secured) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Long term Investments | | | | | |
| - Strategic Funds | 75.0 | 20.0 | 0.0 | 95.0 | 4.2 |
| - Housing Association | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| - Covered Bonds/ FRN (secured) | 1.4 | 0.0 | -1.4 | 0.0 | 1.5 |
| - Local Authorities | 36.1 | 60.0 | -61.1 | 35.0 | 0.6 |
| Money Market Funds | 60.0 | 264.7 | -282.9 | 41.8 | 0.1 |
| Pooled Funds | 5.0 | 10.0 | 0.0 | 15.0 | 0.5 |
| Other organisations (e.g. loans to small businesses) | 0.01 | 0.0 | -0.01 | 0.0 | 4.8 |
| **TOTAL INVESTMENTS** | **332.0** | | | **312.3** | |
| Increase/ (Decrease) in Investments £m | | | | -19.7 | |

**Notes to Table**

- **Other Organisations:** The money originally invested on the Funding Circle platform (£0.1m) was part of a commitment to economic development. This scheme was intended to assist small businesses in Gloucestershire, with GCC providing £2,500 per Gloucestershire business on the platform. 69 Gloucestershire businesses were assisted, however due to changes in the way the platform operated and the suspension of trading as a result of the Covid pandemic, all of the money on the platform has now been returned.

## Investment Objectives

Both the CIPFA Code and government guidance require GCC to invest its funds prudently and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield.

### *1) Security*

GCC'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. Despite the low interest rate environment over the year GCC has invested with other local authorities, up to a maximum duration of 2 years, and used MMF's and bank call and notice facilities.

In order to add value to the portfolio GCC has increased the use of strategic funds, adding £10 million to existing funds during the year. Following the Council motion to move away from fossil fuel exposure, GCC has worked with our treasury advisors to identify funds that meet the Economic, Social and Governance (ESG) objectives of the Council and has invested an additional £10 million in 2 ESG funds.

GCC receives regular correspondence from its Treasury Advisors on credit risk, which is taken into account before transactions are made. GCC used long term credit criteria during 2021/22, with minimum long-term counterparty credit rating determined for the 2021/22 treasury strategy being A-.

GCC's counterparty credit quality has been maintained over the year as demonstrated by the Credit Score Analysis summarised below. The table in Appendix D explains the credit score. Our rate of return increased between December 2021 and March 2022 after a general reduction during the year. The reason for this was that the base rate began to increase from December 2021, and bank duration also increased in line with recommendations from our Treasury Advisors.

| | Credit Score | Credit Rating | Bail-in Exposure | Weighted Average Maturity | Rate of Return % |
|---|---|---|---|---|---|
| 31.03.2021 | 4.53 | A+ | 31% | 203 | 1.51% |
| 30.06.2021 | 4.60 | A+ | 38% | 201 | 1.43% |
| 30.09.2021 | 4.71 | A+ | 43% | 153 | 1.44% |
| 31.12.2021 | 4.71 | A+ | 51% | 144 | 1.22% |
| 31.03.2022 | 4.69 | A+ | 31% | 192 | 1.56% |
| **Similar LAs** | **4.14** | **AA-** | **39%** | **1640** | **1.42%** |

*The Rate of Return shown in the table above is a quarterly position, so not directly comparable to the annual rate of return, achieved by GCC over the year.*

Risk is further reduced by ensuring a good mix of duration of deposits and mix of counterparties. The table below shows a comparison between years.

| **Investments by type of institution** | | |
|---|---|---|
| | At 31/3/21 % | **At 31/3/21 %** |
| Covered Instruments | 0.4 | 0 |
| Non UK Banks | 0 | 1.6 |
| Other Local Authorities | 51.8 | 40.0 |
| Call Accounts | 8.3 | 0.2 |
| Money Market Funds (MMF's) | 12.4 | 18.2 |
| Strategic Funds | 22.6 | 30.4 |
| Notice Accounts | 4.5 | 9.6 |
| **Total** | **100** | **100** |

2) ***Liquidity***: In keeping with the MLUHC's Guidance on Investments, GCC maintained a sufficient level of liquidity through the use of MMFs, overnight deposits and call accounts.

| **Average Length of investments** | | |
|---|---|---|
| | At 31/3/21 % | **At 31/3/21 %** |
| Less than 1 month (including Call) | 20.7 | 18.3 |
| Between 1 to 3 months | 17.0 | 13.8 |
| Between 3 to 6 months | 5.6 | 9.6 |
| Between 6 to 12 months | 16.1 | 16.7 |
| Over 12 months | 40.6 | 41.6 |
| **Total** | **100** | **100** |

3) ***Yield***: GCC sought to optimise returns commensurate with its objectives of security and liquidity. Short term money market rates remained at very low levels which had a significant impact on investment income. Income earned on existing longer-dated deposits provided some cushion against the low interest rate environment. £95 million of GCC's investments are invested in externally managed strategic pooled (bond, equity, multi-asset, REIT and property) funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds generated a total return of £3.2 million (4.15%), which is used to support services in year. These funds have also had a 12.87% total return, as a result of capital growth, however GCC maintains a long dated outlook on these funds and recognises that the capital value will be variable.

## 6. Other Non-Treasury Holdings and Activity

The definition of investments in CIPFA's revised 2021 Treasury Management Code covers all the financial assets of GCC as well as other non-financial assets which GCC holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).

Investment Guidance issued by the DLUHC also broadens the definition of investments to include all such assets held partially or wholly for financial return.

GCC does not currently hold funds meeting this definition.

## 7. Compliance Report

All treasury management activities undertaken during 2021/22 complied fully with the CIPFA Code of Practice and GCC's approved Treasury Management Strategy set in February 2021 - (which can be accessed here).

In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during 2021/22. None of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield. Details can be found in Appendix E.

## 8. Investment Training

Training was undertaken for members in January 2022. This was provided by our Treasury Management advisors, Arlingclose. Officers ensure that they are kept up to date on treasury related matters and training and attendance at updates with GCC's advisors is undertaken as appropriate.

## GLOSSARY OF TERMS

**Basis Point**
A measure of percentage where 1 basis point is equivalent to 0.01%.

**Call Account**
A bank account with instant access to funds held on deposit.

**Capital Financing Requirement**
The total borrowing required by GCC to support the Capital programme. The CFR measures a vital component of an authority's capital strategy: the amount of capital spending that has not yet been financed by capital receipts, capital grants or contributions from revenue income. It measures the underlying need to borrow for a capital purpose, although this borrowing is unlikely to need to actually take place externally, given the generally positive net cash flow position of local authorities.

**Certificate of Deposit (CD)**
A savings certificate entitling the bearer to receive interest. A CD bears a maturity date, a specified fixed interest rate and can be issued in any denomination, although GCC only trades in sterling. A CD can be sold before maturity.

**CIPFA – Chartered Institute of Public Finance and Accountancy**
Leading professional accountancy bodies in the UK and the only one which specialises in the public services.

**Credit Default Swap (CDS)**
A credit default swap (CDS) is a financial swap agreement that the seller of the CDS will compensate the buyer in the event of a loan default or other credit event.

**Debt Management Office (DMO)**
An Executive Agency of Her Majesty's Treasury. The DMO's responsibilities include debt and cash management for the UK Government, lending to local authorities and managing certain public sector funds.

**Economic, Social and Governance (ESG)**
Funds that offer non financial factors as part of their analysis process to identify material risks and growth opportunities.

**GDP**
Gross Domestic Product.

**Gilt**
Long term fixed income debt security (bond) issued by the UK Government and traded on the London Stock Exchange

**LOBO (Lender's Option / Borrowers Option)**
Money Market instruments that have a fixed initial term (typically one to ten years) and then move to an arrangement whereby the lender can decide at pre-determined intervals to adjust the rate on the loan. At this stage the borrower has the option to repay the loan.

**Minimum Revenue Provision**
The minimum amount which must be charged to an authority's revenue account each year and set aside towards repaying borrowing

**Ministry for Levelling Up, Housing, and Communities MLUHC**
Formerly the Department for Housing, Communities and Local Government.

**Money Market**
The term applied to the institutions willing to trade in financial instruments. It is not a physical creation, but an electronic/telephonic one.

**PFI Liabilities**
A requirement under current accounting standards to include all Private Financing arrangements within the borrowing requirement, to reflect the additional liability on GCC from these schemes.

**Pooled Fund**
Investments are made with an organisation that pool together investments from other organisations and apply the same investment strategy to the portfolio. Pooled fund investments benefit from economies of scale, which allows for lower trading costs per pound, diversification and professional money management.

**Premium**
An additional sum - calculated on normal actuarial principles – which the authority pays to a lender if a loan is repaid early and if interest rates are presently lower than the loan rate. The premium reflects the loss to the lender of foregoing the remaining instalments of interest, and receiving funds which have to be re-invested at current interest rates.

**Prudential Indicator**
Indicators set out in the Prudential Code that calculates the financial impact and sets limits for treasury management activities and capital investment.

**PWLB** – **Public Works Loan Board**
An independent statutory body operated within the **DMO**, which is able to meet all of a local authority's needs for long-term borrowing. The PWLB is prepared to lend to authorities who act prudently and comply with all relevant legislation.

**RISK:**
**Credit and counterparty risk**
The risk of failure by a counterparty to meet its contractual obligations to the organisation under an investment, borrowing, capital, project or partnership financing, particularly as a result of the counterparty's diminished creditworthiness, and the resulting detrimental effect on the organisation's capital or current (revenue) resources.

**Liquidity risk**
The risk that cash will not be available when it is needed, that ineffective management of liquidity creates additional unbudgeted costs, and that the organisation's

**Interest Rate risk**
The risk that cash will not be available when it is needed, that ineffective management of liquidity creates additional unbudgeted costs, and that the organisation's business/service objectives will be thereby compromised.

**Refinancing risk**
The risk that maturing borrowings, capital, project or partnership financings cannot be refinanced on terms that reflect the provisions made by the organisation for those

refinancings, both capital and current (revenue), and/or that the terms are inconsistent with prevailing market conditions at the time.

**Legal Risk**
The risk that the organisation itself, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, and that the organisation suffers losses accordingly.

**Operational Risk**
The risk that an organisation fails to identify the circumstances in which it may be exposed to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings, and fails to employ suitable systems and procedures and maintain effective contingency management arrangements to these ends. It includes the area of risk commonly referred to as operational risk.

**Market Risk**
The risk that, through adverse market fluctuations in the value of the principal sums an organisation borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately.

**Stable Net Asset Value Money Market Funds**
The principle invested remains at its invested value and achieves a return on investment.

**Appendix B**

## Economic Update

The bullets below provided by our treasury advisors, are a summary of the economic climate over the financial year 2021/22 that has impacted on the treasury management environment of GCC:

**Economic background:**

- 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.

- 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. Rising, persistent inflation changed that.

- 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%.

- 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%.

- 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.

- 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.

- 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.

- 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%.

- 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 it plan to reduce its asset purchase programme which could start by May 2022.

- Financial markets: 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.

- 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.

- 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%.

- The Sterling Overnight Rate (SONIA) averaged 0.39% over the quarter.

**Credit review:**

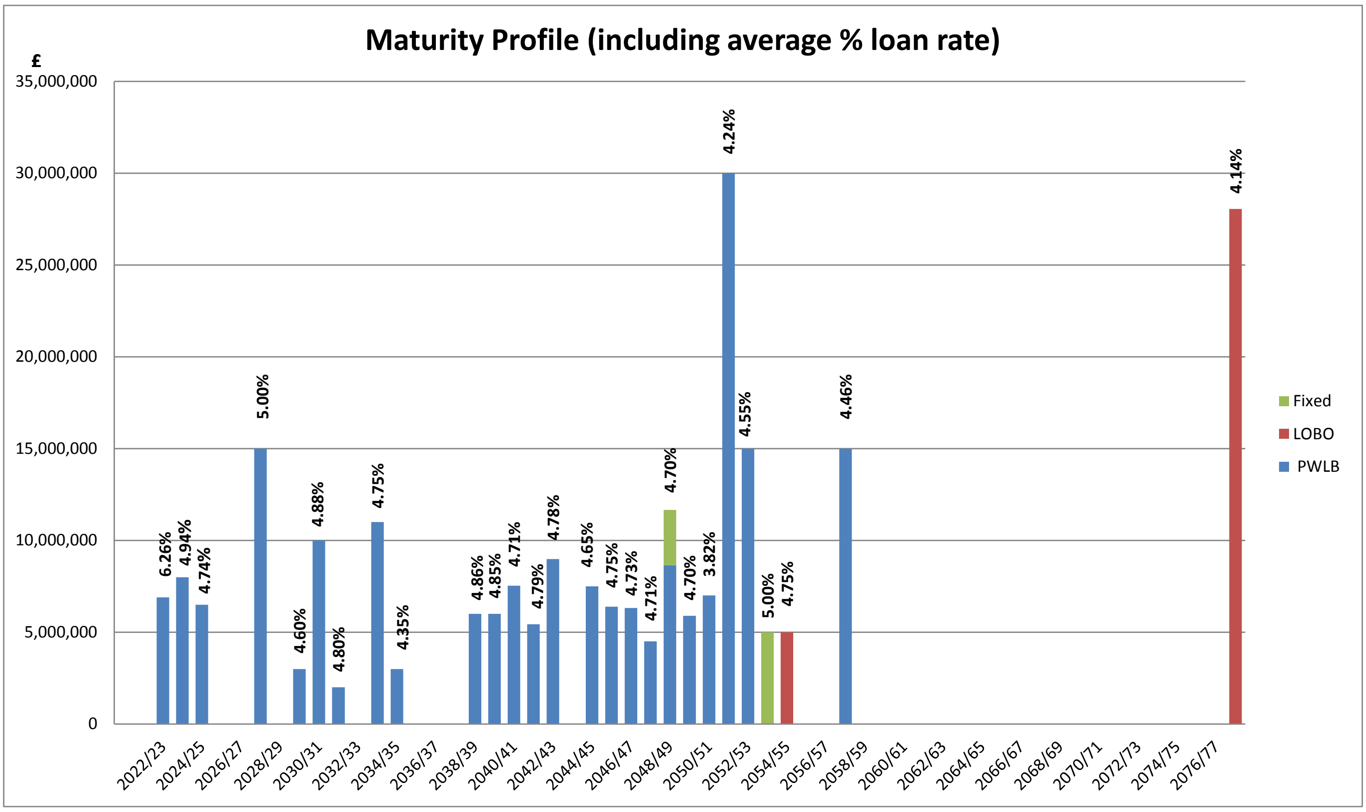
- In the first half of FY 2021-22 credit default swap (CDS) spreads were flat over most of period and are broadly in line with their pre-pandemic levels. In September spreads rose by a few basis points due to concerns around Chinese property developer Evergrande defaulting but then fell back. Fitch and 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.

- Fitch also revised the outlook for Nordea, Svenska Handelsbanken and Handelsbanken plc to stable. The agency considered the improved economic prospects in the Nordic region to have reduced the baseline downside risks it previously assigned to the lenders.

- The successful vaccine rollout programme 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.

- 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.

## Loan Profile




*Although the spread of borrowing is generally smooth there are a number of peaks. The peak in 2051/52 is because there are three loans maturing, one of which is for £15m. The peak in 2077/78 is the final date of maturity for a number of LOBOs loans. Note that LOBO loans are shown at maturity rather than the earliest call (option) date.*

## Appendix D

**Credit Score Analysis**

*Scoring:*

| **Long-Term Credit Rating** | **Score** |
|---|---|
| AAA | 1 |
| AA+ | 2 |
| AA | 3 |
| AA- | 4 |
| A+ | 5 |
| A | 6 |
| A- | 7 |
| BBB+ | 8 |
| BBB | 9 |
| BBB- | 10 |

The value weighted average reflects the credit quality of investments according to the size of the deposit. The time weighted average reflects the credit quality of investments according to the maturity of the deposit

GCC aimed to achieve a score of 7 or lower, to reflect GCC's overriding priority of security of monies invested and the minimum credit rating of threshold of A- for investment counterparties.

**<u>Appendix E</u>**

## <u>Compliance Statement: Prudential Indicators</u>

### Capital Financing Requirement

The Capital Financing Requirement is the total amount required by GCC to fully fund the Capital Programme. The outturn position for GCC's cumulative maximum external borrowing requirement for 2021/22 is shown in the table below:

| | **31/03/2022 Actual £m** |
|---|---|
| CFR | 457.553 |
| Less:<br>Existing Profile of Borrowing | 246.678 |
| Less:<br>Other Long Term Liabilities* | 153.040 |
| **Cumulative Maximum External Borrowing Requirement** | **57.835** |
| Useable Reserves ** | (300.209) |
| **Cumulative Net Borrowing Requirement/(investments)** | **(242.374)** |

**Other long term liabilities are GCC's PFI schemes and the Energy from Waste contract. The PFI schemes include a Fire Joint Training Centre, and 4 Fire Stations and a Community Life Skills Centre. Under current accounting regulations GCC must show these liabilities as part of the total debt of GCC.*

***Reserves shown here may differ slightly to those shown in the final Statement of Accounts following approval by Cabinet for carry forwards, which may increase the final reserves amount.*

## <u>Prudential Indicator Compliance</u>

### Authorised Limit and Operational Boundary for External Debt

GCC is required to set an affordable Authorised Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached. GCC's Authorised Borrowing Limit is £510 million.

This limit represents a worse case scenario for debt required and is calculated as the total capital financing requirement (including lease liabilities), plus the minimum revenue provision, plus maturing debt and capital receipts. Added to this is an allowance to cover the possibility of not being able to make monthly salary payments. This allows GCC flexibility with its total borrowing requirement.

The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit.

It should be noted that both the Authorised Limit and the Operational Boundary were revised within the approved 2022/23 Budget, approved February 2022. The reason for this was following the 2020/21 external audit of the Council's accounts it was identified that the deferred liability for the Waste lease liability should form part of the CFR.

| | 2021/22 Maximum | 31.3.22 Actual | 2021/22 Operational Boundary | 2021/22 Authorised Limit |
|---|---|---|---|---|
| Borrowing | 261.82 | 246.68 | 336.96 | 353.30 |
| PFI and Finance Leases | 156.70 | 153.04 | 153.04 | 156.70 |
| **Total debt** | **418.52** | **399.72** | **490.00** | **510.00** |

**Maturity Structure of Fixed Rate Borrowing**

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates. The table below shows the principal position.

| Maturity Structure of Fixed Rate Borrowing | Upper Limit | Lower Limit | Actual Fixed Rate £m Borrowing as at 31/03/22 | Actual Fixed Rate £m Borrowing as at 31/03/22 | Actual Fixed Rate £m Borrowing as at 07/09/21 | Fixed Rate Borrowing as at 31/03/22 | Compliance with Set Limits? |
|---|---|---|---|---|---|---|---|
| | % | % | LOBO* | Market | PWLB | % | |
| under 12 months | 25 | 0 | 33.050 | | 6.900 | 16.2 | Yes |
| 12 months and within 24 months | 25 | 0 | | | 8.000 | 3.2 | Yes |
| 24 months and within 5 years | 50 | 0 | | | 6.500 | 2.6 | Yes |
| 5 years and within 10 years | 75 | 0 | | | 30.000 | 12.2 | Yes |
| 10 years and within 20 years | 100 | 0 | | | 38.968 | 15.8 | Yes |
| 20 years and within 30 years | 100 | 0 | | 3.000 | 85.260 | 35.8 | Yes |
| 30 years and within 40 years | 100 | 0 | | 5.000 | 30.000 | 14.19 | Yes |

## Treasury Management Indicators

GCC measures and manages its exposures to treasury management risks using the following indicators.

GCC has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment as shown by Appendix D and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

The target set in the Treasury Strategy is A-, and the target achieved was A+.

**Total principal sums invested for periods longer than 364 days**

This indicator allows GCC to manage the risk inherent in investments longer than 364 days. The limit for 2021/22 was set at £200m. At its peak sums invested for longer than 365 days, including strategic funds, totalled £157 million.