APPENDIX 1

FLINTSHIRE COUNTY COUNCIL

TREASURY MANAGEMENT

ANNUAL REPORT 2021/22

1.00 INTRODUCTION

The Council approved the Treasury Management Strategy 2021/22 (the Strategy) including key indicators, limits and an annual investment strategy on 16th February 2021.

The Strategy was produced based on the 2017 edition of the *CIPFA Treasury Management in the Public Services: Code of Practice*.

The purpose of this report is to review the outcomes from 2021/22 treasury management operations and compare these with the Strategy.

Treasury management comprises the management of the local authority's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

2.00 ECONOMIC & INTEREST RATE REVIEW 2021/22

This is provided by Arlingclose Ltd, the Council's treasury management advisors.

2.01 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 rates 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, 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 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 that further increases should be expected in the coming months. The Fed also repeated its plan to reduce its asset purchase programme which could start by May 2022.

2.02 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.

3.00 BORROWING REQUIREMENTS AND DEBT MANAGEMENT

3.01 PWLB (Public Works Loans Board) Certainty Rate

The Council qualified for the PWLB Certainty Rate, allowing the authority to borrow at a reduction of 20 basis points on the Standard Rate for a further 12 months from 14th May 2021.

3.02 Borrowing Activity in 2021/22.

The total long term borrowing outstanding, brought forward into 2021/22 was £289.02 million.

	Balance 01/04/2021 £m	Debt Maturing £m	New Debt £m	Balance 31/03/2022 £m
Capital Financing Requirement	**351.7**	(6.1)	7.0	**352.6**
Short Term Borrowing	58.0	(58.0)	10.0	10.0
Long Term Borrowing	289.0	(5.1)	10.7	294.6
TOTAL BORROWING	**347.0**	**(63.1)**	**20.7**	**304.6**
Other Long Term Liabilities	3.9	(0.6)	0.0	3.3
TOTAL EXTERNAL DEBT	**350.9**	**(63.7)**	**20.7**	**307.9**
Increase/(Decrease in Borrowing (£m)	-	-	(43.0)	

The Council's Capital Programme is financed by a combination of capital receipts and grants, capital expenditure charged to the revenue account (CERA) and borrowing. The borrowing strategy in recent years, in accordance with advice received from the Council's treasury management advisors, Arlingclose, has been to use existing cash balances and short term borrowing to confirm the long term borrowing requirement. This is to ensure that the Council does not commit to long term borrowing too early and borrow unnecessarily, which will be costly. This is balanced against securing low interest costs and achieving cost certainty over the period for which the funds are required so as not to compromise the long term stability of the portfolio.

Short term borrowing continued to be available throughout the year at much lower rates than long term borrowing and was utilised as far as possible without exposing the Council to excessive refinancing risk. The total short term (temporary) borrowing as at 31st March 2022 was £10m with an average rate of 0.16%.

The relative costs and benefits of internal / short term borrowing and long term borrowing were monitored closely, in conjunction with Arlingclose, throughout the year. The Council continues to have a long term borrowing requirement and as PWLB long term rates remained low during the year the following loans were taken out:

Start Date	Maturity Date	Amount	Rate	Loan Type
30 Apr 2021	30 Apr 2061	£0.582m	2.15%	Annuity
28 Jan 2022	28 Jan 2044	£10.0m	2.07%	EIP

The loan for £0.582m has been lent on to NEW Homes, the Council's wholly owned subsidiary, to fund the building of affordable homes in Flintshire.

At 31st March 2022, £270.9m of the Council's loans were in the form of fixed rate with the PWLB, £18.95m were variable rate in the form of LOBOs (Lender Option Borrower Option) and £4.8m were interest free loans from the Government, available for specific schemes. The Council's average rate for long term borrowing was 4.52%.

The Council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) as at 31st March 2022 was £352.6. The Council's total external debt was £307.9m.

3.03 Lender Option Borrower Option loans (LOBOs)

The Council holds £18.95m of LOBOs, loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOs had options during the year, none of which were exercised by the lender.

3.04 Debt Rescheduling

Options for debt rescheduling were explored in conjunction with our treasury management advisors. The premium charged for early repayment of PWLB debt remained relatively expensive for the loans in the Council's portfolio and therefore unattractive for debt rescheduling activity. As a consequence no rescheduling activity was undertaken.

The Corporate Finance Manager, in conjunction with the Council's treasury management advisors, will continue to review any potential opportunities for restructuring the Council's debt in order to take advantage of potential savings as interest rates change and to enhance the balance of the long term portfolio (amend the maturity profile and/or the balance of volatility).

3.05 Revised CIPFA Codes, 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 until the 2023/24 financial year if they wish. The Councils changes are to be included in the 2023/24 financial year. However, the view is that we are largely compliant with the revised Code.

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

Borrowing is permitted for cash flow 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 Treasury Management Code now includes extensive additional requirements for service and commercial investments, far beyond those in the 2017 version.

The Council will follow the same process as the Prudential Code.

4.00 INVESTMENT ACTIVITY

4.01 Guidance

The Welsh Government's Investment Guidance gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

4.02 Investment Activity in 2021/22

Summary of investments as at 31st March 2022.

Country	Total	<1 month	1 –12 months	>12 months
	£m	%	£m	£m
UK BANKS	3.8	3.8		
UK BUILDING SOCIETIES				
OVERSEAS				
MMF's	26.7	26.7		
LOCAL AUTHORITIES	3.0	3.0		
DMO	16.7	11.7	5.0	
TOTAL	**50.2**	**45.2**	**5.0**	**0.0**

The investment for £5m was classified as a short term investment in the Council's Balance Sheet. The remainder of the investments had maturities of less than 3 months, so were classified as cash.

Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Strategy for 2021/22. Investments during the year included:

- Deposits with the Debt Management Office
- Deposits with other local authorities
- Investments in AAA-rated Low Volatility Net Asset Value (LVNAV) money market funds
- Call accounts and deposits with banks and building societies

4.03 Credit Risk

The Council assessed and monitored counterparty credit quality with reference to credit ratings, credit default swaps, GDP of the country in which the institution operate, the country's net debt as a percentage of GDP, and share price. The minimum long-term counterparty credit rating determined by the Council for the 2021/22 treasury strategy was A-/A-/A3 across rating agencies Fitch, S&P and

Moody’s.

4.04 Counterparty Update

In the first half of 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 list 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.

4.05 Liquidity

In keeping with the WG’s Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of money market funds and call accounts.

4.06 Yield

The UK Bank Rate increased from 0.10% to 0.25% in December 2021, to 0.50% in February 2022 and to 0.75% in March 2022. Short term money market rates remained at very low levels which continued to have a significant impact on investment income. The low rates of return on the Council’s short-dated money market investments reflect prevailing market conditions and the Council’s objective of optimising returns commensurate with the principles of security and liquidity.

The Council's budgeted investment income for the year had been prudently estimated at £10k. The average investment balance was £42.2m during the period and interest earned was £29.1k, at an average interest rate of 0.07%.

4.07 Loans to NEW Homes

The loans to NEW Homes do not meet the definition of an investment and are not therefore included in the Council's investment figures. They are classed as capital expenditure.

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5.00 COMPLIANCE

The Council can confirm that it has complied with its Prudential Indicators for 2021/22. These were approved by Council as part of the Treasury Management Strategy on 16th February 2021.

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 taking in relation to investment activity with priority being given to security and liquidity over yield.

The treasury function operated within the limits detailed in the Treasury Management Policy and Strategy Statement 2021/22.

6.00 OTHER ITEMS

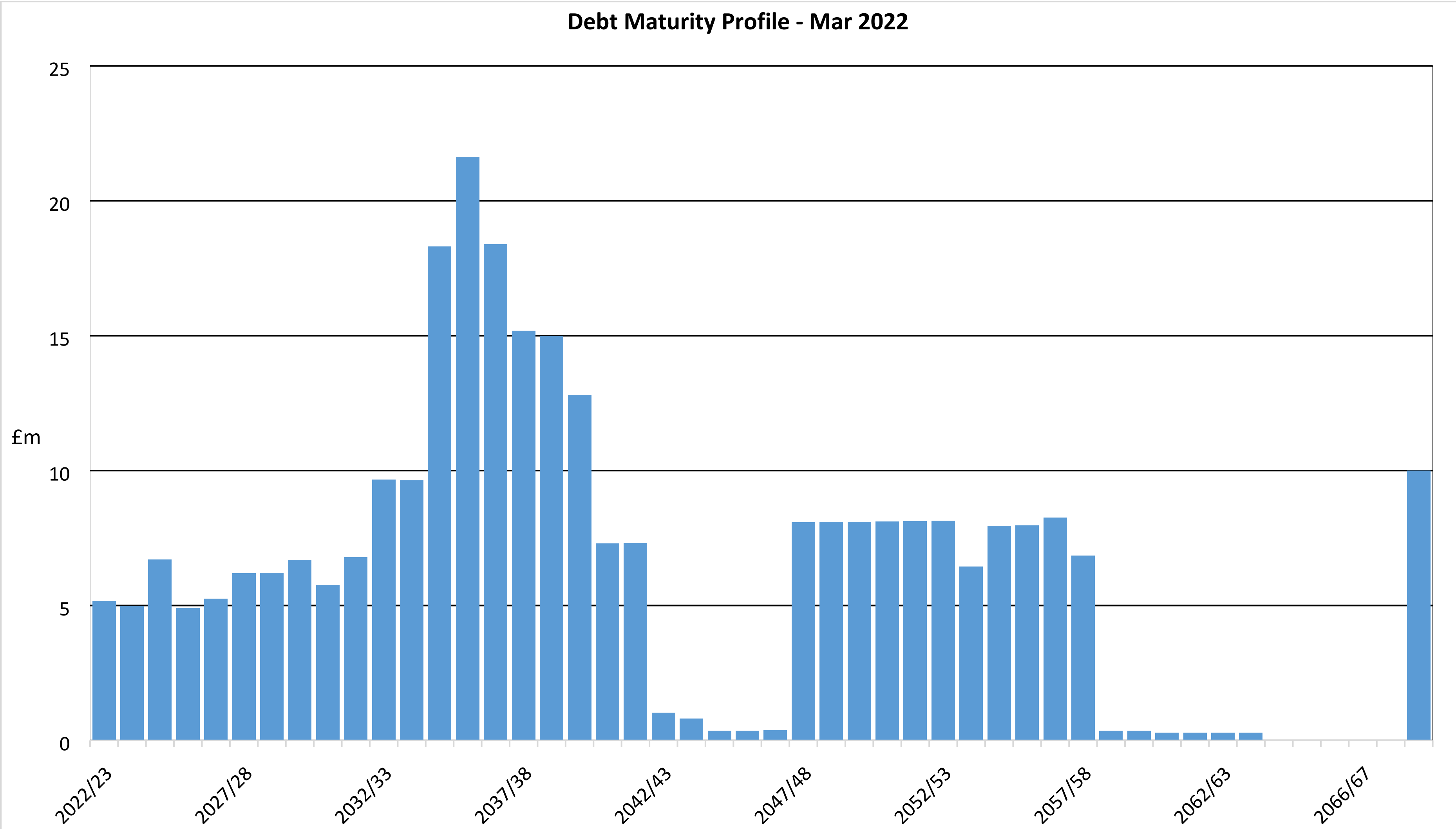
The following were the main treasury activities during 2021/22

- The Council's Governance and Audit Committee received a Mid-Year Report on 17th November 2021.
- Quarterly update reports were presented to the Governance and Audit Committee.
- The 2022/23 Investment Strategy Statement was approved by Council on 15th February 2022.
- The Council's cash flow was managed on a daily basis. During the year the Council acted both as a borrower and as a lender and was a net borrower over the year in question. The maximum investments the Authority had on deposit at any one time were £68.1m and the maximum long-term borrowing at any one time was £296.3m.

7.00 CONCLUSION

The treasury management function has operated within the statutory and local limits detailed in the 2021/22 Treasury Management Strategy.

The Treasury Management Policy was implemented in a pro-active manner with security and liquidity as the primary focus.


Debt Maturity Profile - Mar 2022
£m
25
20
15
10
5
0
2022/23
2027/28
2032/33
2037/38
2042/43
2047/48
2052/53
2057/58
2062/63
2066/67