Appendix A

HARLOW COUNCIL
ANNUAL TREASURY MANAGEMENT REPORT 2021/22

Introduction

1. In December 2017 the Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Council to approve treasury management semi-annual and annual reports.

2. The Council's treasury management strategy for 2021/22 was approved at a meeting on 28th January 2021. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Council's treasury management strategy.

3. Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report.

4. The Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 28th January 2021.

External Context

5. **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.

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

7. UK CPI was 0.7% in March 2021 but thereafter began to steadily increase. Initially driven by energy price effects and by inflation in sectors such as retail and hospitality which were re-opening after the pandemic lockdowns, inflation

then was believed to be temporary. Thereafter price rises slowly became more widespread, as a combination of rising global costs and strong demand was exacerbated by supply shortages and transport dislocations. The surge in wholesale gas and electricity prices led to elevated inflation expectations. CPI for February 2022 registered 6.2% year on year, up from 5.5% in the previous month and the highest reading in the National Statistic series. Core inflation, which excludes the more volatile components, rose to 5.2% y/y from 4.4%.

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

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

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

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

the squeeze in real household incomes.

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

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

14. **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.

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

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

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

18. **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 Council's counterparty to 'stable', recognising their improved capital positions compared to 2020 and better economic growth prospects in the UK.

19. 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.

20. 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.

21. 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 Council's counterparty list recommended by Arlingclose remains under constant review.

<u>Revised CIPFA Codes, Updated PWLB Lending Facility Guidance</u>

22. 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.

23. 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.

24. 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. Harlow Council has chosen to defer reporting requirements until the 2023/24 financial year.

25. 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.

26. 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.

27. 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. Harlow Council will follow the same process as the Prudential Code: delaying changes in reporting requirements to the 2023/24 financial year.

Local Context

28. On 31st March 2022, the Council had net borrowing of £175.1m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.22 Actual £m
General Fund CFR	72.9
HRA CFR	196.3
Total CFR	**269.1**
Less: *Other debt liabilities	1.5
Borrowing CFR	**267.6**
External borrowing	211.8
Internal borrowing	**55.8**
Less: Usable reserves	76.8
Less: Working capital	11.8
Investments	**36.7**

* finance leases, PFI liabilities and transferred debt that form part of the Council's total debt

29. Lower official interest rates have lowered the cost of short-term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing. The Council pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal

borrowing, in order to reduce risk and keep interest costs low.

30. The treasury management position at 31st March 2022 and the change during the year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.21 Balance £m	**Movement £m**	**31.3.22 Balance £m**	**31.3.22 Rate**
Long-term borrowing	(211.8)	-	(211.8)	(3.3%)
Short-term borrowing	(3.0)	-	-	-
Total borrowing	**(214.8)**	**3.0**	**(211.8)**	**(3.3%)**
Long-term investments	4.4	(0.2)	4.2	11.2%*
Cash and cash equivalents	8.8	23.7	32.5	0.5%
Total investments	**13.2**	**23.5**	**36.7**	**2.9%**
Net borrowing	**(201.6)**	**26.5**	**(175.1)**	

* The return given for long term investments includes total return for the Council's investment in a property fund which were unusually high due to increasing property prices. These returns would not be expected to occur in the long term. Income returns were 2.0% which is a more accurate view as to long term returns.

Borrowing Update

31. The Council currently holds £1.4m in commercial investments that Harlow have owned for historical reasons, these were purchased prior to the change in the CIPFA Prudential Code. Before undertaking further additional borrowing the Council will review the options for exiting these investments. This review will include an option to sell them, although sale is not mandatory particularly if the market conditions are not desirable.

32. The Council is not planning to undertake any new borrowing to invest primarily for commercial return and so is otherwise unaffected by the changes to the Prudential Code.

Borrowing strategy

33. At 31st March 2022 the Council held £211.8m of loans from the PWLB, the same figure it held the previous financial year end (31st March 2021).

34. The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective. In keeping with these objectives no new borrowing was undertaken.

Other Debt Activity

35. Although not classed as borrowing, the Council also had £1.5m in vehicles which were funded via a finance lease as at 31st March 2022. This was a decrease on last year's figure of £1.7m.

Treasury Investment Activity

36. 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.

37. The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Council's investment balances ranged between £14.7m and £41.9m due to timing differences between income and expenditure. The investment position is shown in table 4 below.

38. During the 2021/22 financial year the Council received £13.3m in funding from central government to support small and medium businesses during the coronavirus pandemic. Of this £5.6m had been distributed by 21st March 2022.

Table 4: Treasury Investment Position

	31.3.21 Balance £m	Net Movement £m	31.3.22 Balance £m	31.3.22 Income Return	31.3.22 Weighted Average Maturity Days*
Banks & building societies (unsecured)	1.5	0.5	2.0	0.5%	1
Government (incl. local authorities)	-	10.5	10.5	0.5%	1
Money Market Funds	6.7	13.3	20.0	0.5%	1
Cash Plus Fund	2.0	2.0	2.0	0.2%	N/A
Property Fund	1.9	0.3	2.2	3.9%	N/A
Total investments	**12.1**	**24.6**	**36.7**	**0.7%**	

* The Council's cash plus and property fund do not have a set period to maturity period. Cash can be redeemed on request after a notice period is given. They are considered long term investments as there is price risk associated with needing to make a withdrawal at short notice.

39. Both the CIPFA Code and government guidance require the Council to invest

its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council'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.

40. Ultra low short-dated cash rates, which were a feature since March 2020 when Bank Rate was cut to 0.1%, prevailed for much of the 12-month reporting period which resulted in the return on sterling low volatility net asset value (LVNAV) Money Market Funds being close to zero even after some managers have temporarily waived or lowered their fees. However, higher returns on cash instruments followed the increases in Bank Rate in December, February and March. At 31st March, the 1-day return on the Council's MMFs ranged between 0.46% - 0.58%.

41. Similarly, deposit rates with the Debt Management Account Deposit Facility (DMADF) initially remained very low with rates ranging from 0% to 0.1%, but following the hikes to policy rates increased to between 0.55% and 0.85% depending on the deposit maturity. The average return on the Council's DMADF deposits was 0.2%.

42. Given the low returns from short-term cash investments, the Council has maintained its diversification in higher yielding asset classes as shown in table 4 above with £4.2m investment with a cash plus and property fund.

43. The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below.

Table 5: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return
31.03.2021 31.03.2022	5.05 4.28	A+ AA-	100% 68%	1 1	0.02% 0.52%
Similar LAs **All LAs** **(as at 31.03.2022)**	**4.37** **4.39**	**AA-** **AA-**	**61%** **60%**	**43** **14**	**0.46%** **0.46%**

44. **Externally Managed Pooled Funds:** £4.2m of the Council's investments are invested in externally managed pooled 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 an average total return of 11.2% comprising a 2.0% income return which is used to support services in year, and 9.2% of capital growth.

45. In the nine months to December improved market sentiment was reflected in equity, property and multi-asset fund valuations and, in turn, in the capital values of the Council's funds. In the January- March quarter the two dominant themes were tighter UK and US monetary policy and higher interest rates, and the military invasion of Ukraine by Russia in February, the latter triggering significant volatility and uncertainty in financial markets.

46. In light of Russia's invasion, Arlingclose contacted the fund managers of our funds and confirmed no direct exposure to Russian or Belarusian assets had been identified. Indirect exposures were immaterial. It should be noted that any assets held by banks and financial institutions (e.g. from loans to companies with links to those countries) within MMFs and other funds cannot be identified easily or with any certainty as that level of granular detail is unlikely to be available to the fund managers or Arlingclose in the short-term, if at all.

47. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's medium to long-term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three to five-year period total returns will exceed cash interest rates.

Non-Treasury Investments

48. The definition of investments in CIPFA's revised 2021 Treasury Management Code covers all the financial assets of the Council as well as other non-financial assets which the Council 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).

49. Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) also broadens the definition of investments to include all such assets held partially or wholly for financial return.

50. The Council also held £1.8m of investments made for services purposes. This included £1.3m of loans made to wholly owned subsidiaries HTS (Property and Environment) Ltd, HTS (Housing and Property) Ltd and Harlow Property Ltd as at 31st March 2022. Including an equity investment of £0.45m as at 31st March 2022 in HTS (Housing & Property) Ltd. Interest of £28k where received.

51. The Council held £1.4m of investments made for commercial purposes as at 31st March 2022. These consisted of four historically owned properties. These generated a small income of £81k in the 2021/22 financial year.

Treasury Performance

52. The Council's interest paid and received measured against its budget for the 2021/22 financial year is sown in table 6 below.

Table 6: Performance

		Interest Payable	**Interest Receivable**
General Fund	**Actual £**	246,000	(183,000)
	Budget £	805,000	(525,000)
	Over / (Under) £	(559,000)	(342,000)
	% Over / (Under)	(69.4%)	(65.1%)
HRA	**Actual £**	6,794,000	(110,000)
	Budget £	7,261,000	(32,000)
	Over / (Under) £	(467,000)	78,000
	% Over / (Under)	(6.4%)	243.8%

Compliance

53. The Chief Finance Officer reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

54. Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 7 below.

Table 7: Debt Limits

	2021/22 Maximum £m	**31.3.22 Actual £m**	**2021/22 Operational Boundary £m**	**2021/22 Authorised Limit £m**	**Complied?**
Borrowing	211.8	211.8			
Finance Leases	1.7	1.5			
Total debt	**213.5**	**213.3**	**305.5**	**315.5**	Yes

55. Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

Table 8: Investment Limits

	2021/22 Maximum £m	31.3.22 Actual £m	2021/22 Limit £m	Complied?
Any single organisation, except the UK Government		2.0	2.0 each	Yes
UK central government	18.8	10.5	Unlimited	Yes
Any group of organisations under the same ownership		2.0	2.0 per group	Yes
Any group of pooled funds under the same management	4.2	4.2	5.0 per manager	Yes
Negotiable instruments held in a broker's nominee account		-	5.0 per broker	Yes
Foreign countries		-	2.0 per country	Yes
Registered providers and registered social landlords		-	5.0 in total	Yes
Unsecured investments with building societies		-	2.0 in total	Yes
Loans to unrated corporates	1.4	1.4 *	2.0 in total	Yes
Money Market Funds	20	20.0	20.0 in total	Yes
Real Estate Investment Trusts		-	5.0 in total	Yes
FIBCA (Barclays Call Account)	4	2	4 in total	Yes

*Loans made to subsidiary companies?

Treasury Management Indicators

56. The Council measures and manages its exposures to treasury management risks using the following indicators.

57. **Interest Rate Exposures:** This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

Interest rate risk indicator	31.3.22 Actual	2021/22 Limit	Complied?

Upper limit on one-year revenue impact of a 1% rise in interest rates	(£192,000)	£113,641	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	£192,000	£113,641	No

58. The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at current rates.

59. **Maturity Structure of Borrowing:** This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	31.3.22 Actual	**Upper Limit**	**Lower Limit**	**Complied?**
Under 12 months	0%	25%	0%	Yes
12 months and within 24 months	0%	50%	0%	Yes
24 months and within 5 years	20%	100%	0%	Yes
5 years and within 10 years	20%	100%	0%	Yes
10 years and above	60%	100%	0%	Yes

60. Time periods start on the first day of each financial year.

61. **Principal Sums Invested for Periods Longer than a year:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2021/22	**2022/23**	**2023/24**
Actual principal invested beyond year end	£4.2m	£4.2m	£4.2m
Limit on principal invested beyond year end	£5m	£5m	£5m
Complied?	Yes	Yes	Yes

62. The £4.2m consists of the Council's investment in a cash plus fund and property fund. Although funds can be accessed within a year fund volatility means that these should be considered as long-term investments. £4.2m is the actual amount invested at 31st March 2022, it is assumed that this will not change for the sake of the indicator above.

Prudential Indicators

63. The Council ensures that it borrows prudently with the assistance of monitoring against the following indicators.

64. **Estimates of Capital Expenditure:** The Council's capital expenditure is summarised below.

	2020/21 actual	2021/22 actual	2022/23 budget	2023/24 budget	2024/25 budget
General Fund services	£11.0m	£11.5m	£18.6m	£13.2m	£16.1m
Council housing (HRA)	£27.7m	£21.6m	£30.2m	£38.9m	£40.0m
TOTAL	**£38.8m**	**£33.1m**	**£48.8m**	**£52.1m**	**£56.1m**

65. **Estimates of Capital Financing Requirement:** The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose.

	31.3.2021 actual	31.3.2022 actual	31.3.2023 budget	31.3.2024 budget	31.3.2025 budget
General Fund services	£75.8m	£72.8m	£77.2m	£83.8m	£91.8m
Council housing (HRA)	£198.4m	£196.3m	£204.7m	£222.6m	£239.5m
TOTAL CFR	**£268.0m**	**£269.1m**	**£281.9m**	**£306.4m**	**£331.3m**

66. **Gross Debt and the Capital Financing Requirement:** In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

	31.3.2021 actual	31.3.2022 actual	31.3.2023 budget	31.3.2024 budget	31.3.2025 budget
Debt (incl. PFI & leases)	£216.5m	£213.3m	£213.1m	£212.9m	£212.7m
Capital Financing Requirement	£268.0m	£267.1m	£281.9m	£306.4m	£331.3m

67. **Proportion of financing costs to net revenue stream:** This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

	2020/21 actual	2021/22 forecast	2022/23 budget	2023/24 budget	2024/25 budget
Financing costs	£6.9m	£6.8m	£7.3m	£7.9m	£8.5m

Proportion of net revenue stream	5.7%	5.7%	6.0%	6.5%	7.0%

Other

68. **IFRS 16:** The implementation of the new IFRS 16 Leases accounting standard was due to come into for force for local authorities from 1st April 2022. Following a consultation CIFPA/LASAAC announced an optional two-year delay to the implementation of this standard a decision which was confirmed by the Financial Reporting Advisory Board in early April 2022. Authorities can now choose to adopt the new standard on 1st April 2022, 1st April 2023 or 1st April 2024. The Council intends to adopt the new standard on 1st April 2024**.**