Agenda Item No. 8(d)

South Ayrshire Council

Report by Head of Finance and ICT to Cabinet of 30 August 2022

Subject: Treasury Management Annual Report 2021/22

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1. Purpose

1.1 The purpose of this report is to present, in line with the requirements of the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management, the annual report of treasury management activities for 2021/22 (as attached at Appendix 1) and seek Members' consideration of its contents.

2. Recommendation

2.1 It is recommended that the Panel approves the Annual Treasury Management Report 2021/22, as attached at Appendix 1.

3. Background

3.1 The Council is required through regulations issued under the Local Government in Scotland Act 2003 to produce an annual treasury report reviewing treasury management activities and prudential and treasury indicators. 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).

3.2 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.

3.3 The Head of Finance and ICT also confirms that the Council has complied with the requirements under the Code, to give prior scrutiny of treasury management reporting to the Council's Audit and Governance Panel prior to submitting the report to Cabinet.

3.4 Treasury management in this context is defined as:

'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.

3.5 The Audit and Governance Panel of 22 June 2022 considered the Annual Treasury Management Report 2021/22 (attached at **Appendix 1**) and agreed that it be remitted to the Cabinet for approval.

4. Proposals

4.1 The Treasury Management Annual Report for 2021/22 is submitted to Cabinet for approval in accordance with the requirements of the CIPFA Code of Practice on Treasury Management.

4.2 ***Executive Summary***

During 2021/22, the Council complied with its legislative and regulatory requirements. The key prudential indicators detailing the impact of capital expenditure activities during the year, with previous year comparators, are shown below.

Actual Prudential and Treasury Indicators	***2020/21 Actual £'000***	***2021/22 Actual £'000***
Capital Expenditure	**50,838**	**89,463**
Total Capital Financing Requirement (including other long-term liabilities)	350,040	398,971
PPP and Finance Lease	(99,567)	(95,777)
Underlying Borrowing Requirement	**250,473**	**303,194**
Gross External Debt	238,159	289,434
Under (Over) Borrowed	12,314	13,760
Cash/Investments	(73,390)	(72,105)
Net External Debt	**164,769**	**217,329**

4.3 The table above shows that the Council has an under-borrowed position on 31 March 2022 of £13.760m, c 4.5%. This means the Council has used some internal borrowing from cash/reserves to fund an element of its current capital expenditure requirements. It does not indicate that borrowing for the capital programme has not been undertaken; only that internal cash resource has been used as funding, opposed to external borrowing.

4.4 Although this is a prudent position in the current interest rate environment given the cost of external borrowing compared with cash investment rates, the Council's under-borrowed position is only 4.538% of its overall under-lying borrowing requirement and is therefore manageable within the current strategy. The strategy for 2022/23 is expected to maintain a marginal under-borrowed position whilst closely monitoring longer term PWLB and market rates in considering new borrowing.

4.5 Other prudential and treasury indicators are included in Appendix 1 to this report. The Head of Finance and ICT also confirms that any borrowing was only undertaken for capital purpose and the statutory borrowing limit (the authorised limit) was not breached during 2021/22.

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

5. Legal and Procurement Implications

5.1 There are no legal implications arising from this report.

5.2 There are no procurement implications arising from this report.

6. Financial Implications

6.1 General Services

6.1.1 ***Interest on Revenue Balances Held*** – the Council originally budgeted to receive £0.114m in interest income (based on a return of 0.50%) to the General Fund in 2021/22. Interest rates for investment remained low, however with the investment strategy outperforming both the budget and benchmark this resulted in an enhanced return.

Investment income to the General Fund out turned at £0.184m, a surplus of £0.70m. Interest was also received to the Council's Repairs and Renewals Fund, Insurance Fund and Capital Fund to the value of £0.021m.

6.1.2 ***Capital Financing Costs*** - the Council originally budgeted £12.266m for financing costs and expenses on debt for 2021/22. This budget consisted of £5.249m in loan principal, £6.837m in interest and £0.180m in expenses. During 2021/22, a pragmatic approach was taken when considering the borrowing requirements to fund capital expenditure. The borrowing strategy during 2021/22 resulted in savings as under-noted:

	Budget £'000	**Out-turn £'000**	**Variance £'000**
Principal	5,249	5,196	53
Interest	6,837	6,137	700
Expenses	180	205	(25)
Capital Financing costs	**12,266**	**11,557**	**728**
Investment income	**(114)**	**(184)**	**70**
Total Debt charges	**12,152**	**11,373**	**798**

The borrowing strategy undertaken in 2021/22 resulted in an overall saving to the General Services of £0.798m.

6.2 Housing Revenue Account (HRA)

6.2.1 ***Interest on HRA Revenue Balances Held*** – the HRA budgeted to receive investment income of £0.050m on its revenue balances in 2021/22 based on achieving an interest rate of 0.50%. Like the General Fund the investment strategy was able to out-perform both budget and benchmark resulting in a return of £0.67m in investment income a surplus of £0.017m.

6.2.2 ***Capital Financing Costs*** - the HRA budgeted £3.768m for financing costs on debt for 2021/22. This consisted of £1.281m in loan principal, £2.423m in interest and £0.064m in expenses.

	Budget £'000	**Out-turn £'000**	**Variance £'000**
Principal	1,281	1,249	32
Interest	2,423	2,288	135
Expenses	64	76	(12)
Capital Financing costs	**3,768**	**3,620**	**155**
Investment income	**(50)**	**(67)**	**17**
	3,718	**3,659**	**172**

The borrowing strategy undertaken in 2021/22 resulted in an overall saving to the HRA of £0.172m.

6.3 In total, net debt financing costs were under spent by £0.883m, and when added to an over achievement in interest income of £0.087m resulted in an overall surplus of £0.970m which was reflected in the Council and HRA financial position at 2021/22.

7. Human Resources Implications

7.1 Not applicable.

8. Risk

8.1 ***Risk Implications of Adopting the Recommendations***

8.1.1 There are no risks associated with adopting the recommendations.

8.2 ***Risk Implications of Rejecting the Recommendations***

8.2.1 If the recommendations are rejected, then the Council will be non-compliant with the requirements contained in 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).

9. Equalities

9.1 The proposals in this report have been assessed through the Equality Impact Assessment Scoping process. There are no significant potential positive or negative equality impacts of agreeing the recommendations and therefore an Equalities Impact Assessment is not required. A copy of the Equalities Scoping Assessment is attached as Appendix 2.

10. Sustainable Development Implications

10.1 ***Considering Strategic Environmental Assessment (SEA)*** - This report does not propose or seek approval for a plan, policy, programme or strategy or document otherwise described which could be considered to constitute a plan, programme, policy, or strategy.

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11. Options Appraisal

11.1 An options appraisal has not been carried out in relation to the subject matter of this report.

12. Link to Council Plan

12.1 The matters referred to in this report contribute to Commitment 1 of the Council Plan: Fair and Effective Leadership/ Leadership that promotes fairness.

13. Results of Consultation

13.1 There has been no public consultation on the contents of this report.

13.2 Consultation has taken place with Councillor Ian Davis, Portfolio Holder for Finance, Human Resources and ICT, and the contents of this report reflect any feedback provided.

14. Next Steps for Decision Tracking

14.1 If the recommendations above are approved by Members, the Head of Finance and ICT will ensure that all necessary steps are taken to ensure full implementation of the decision within the following timescales, with the completion status reported to the Cabinet in the 'Council and Cabinet Decision Log' at each of its meetings until such time as the decision is fully implemented:

Implementation	Due date	Managed by
No further action required	Not applicable	Not applicable

Background Papers

CIPFA Code of Practice for Treasury Management in Local Authorities

Report to South Ayrshire Council of 4 March 2021 - Treasury Management and Investment Strategy 2021/22

Report to South Ayrshire Council of 18 January 2022 – Treasury Management Mid-Year Report 2021/22

Report to Audit and Governance Panel of 22 June 2022 – Treasury Management Annual Report 2021/22

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Appendix 1

South Ayrshire Council

Treasury Management Annual Report 2021/22

Introduction

In accordance with the requirements of the CIPFA Code of Practice on Treasury Management in the Public Services, this report covers the following:

- Section 1 - The Council's Capital Expenditure and Financing 2021/22.
- Section 2 – The Council's overall borrowing need.
- Section 3 – Treasury Position as of 31 March 2022.
- Section 4 – The Strategy for 2021/22.
- Section 5 – The Economy and Interest Rates
- Section 6 – Borrowing Rates in 2021/22.
- Section 7 – Borrowing Out-turn 2021/22; and
- Section 8 – Investment Rates and Out-turn 2021/22.
- Section 9 – Other Issues

Section 1 The Council's Capital Expenditure and Financing 2021/22

1.1 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 have no resultant impact on the Council's borrowing need; or

- if insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing requirement.

1.2 The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual expenditure, how this was financed and the resulting borrowing requirement.

Table 1

Item	***2020/21 Actual £'000***	***2021/22 Estimate per Strategy***	***2021/22 Actual***
General Fund capital expenditure	33,334	86,128	66,230
HRA capital expenditure	17,504	36,220	23,233
Total	**50,838**	**122,348**	**89,463**
Resourced by:			
Government Grant & Other	(14,651)	(13,269)	(10,040)
Other funding identified	(18,455)	(17,603)	(20,257)
Borrowing :	**17,732**	**91,476**	**59,166**

1.3 The reason for the movement between planned expenditure/funding and actual out-turns for 2021/22 can be found in the General Services and HRA 2021/22 capital monitoring reports presented to Leadership Panel throughout 2021/22. The largest examples (by value) of reprofiling of spend in to 2022/23 being:

- Early Learning & Childcare projects - £6.1m
- Sacred Heart Primary - £1.7m
- Craigie Additional Sporting Facility - £4.4m
- HRA Major component replacement programme - £5.9m

Section 2 The Council's overall Borrowing Need

2.1 The Council's underlying need to borrow for 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 (Table 1), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

2.2 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 manages the Council's cash position to ensure that sufficient cash is available to meet not only the capital plans but also to manage the daily cash flow requirements of funding its revenue commitments of payroll, suppliers, benefits etc.

2.3 This borrowing for capital expenditure may be sourced through 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 (internal borrowing).

2.4 ***Reducing the CFR*** – the Council's 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 scheduled debt amortisation as a loan repayment, to reduce the CFR. This is effectively a repayment of the borrowing need and 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
- by charging more than the scheduled debt amortisation for loans repayment.

2.5 The Council's CFR for the year is shown below and represents a key prudential indicator. It includes PFI and leasing schemes on the balance sheet, which increase the Council's CFR, however no borrowing is required against these schemes as a borrowing facility is included in these contracts.

The undernoted table shows the Council's underlying borrowing requirement, inclusive of PPP and Finance lease arrangements, as of 31 March 2022.

Table 2

Capital Financing Requirement	**31 Mar 2021 £'000**	**31 Mar 2022 £'000**
Opening Balance	**341,749**	**350,040**
Add unfinanced capital expenditure	17,732	59,166
Add new OLTL obligations (PPP)	993	0
Less loans fund repayment	(6,789)	(6,445)
Less PPP/ finance lease repayment	(3,645)	(3,790)
Closing Balance	**350,040**	**398,971**

The borrowing activity is constrained by prudential indicators for gross borrowing, CFR, and by the authorised limit. The increasing CFR position reflects the Council's capital programme expenditure in 2021/22 and the resulting borrowing requirements to fund this investment.

2.6 ***Gross Borrowing and the CFR*** - 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 (2020/21) plus the estimates of any additional capital financing requirement for the current (2021/22) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure.

This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs.

The table below highlights the Council's gross borrowing position against the CFR.

Table 3

Item	***31 March 2021 £'000***	***31 March 2022 £'000***
Capital Financing Requirement (CFR)	350,040	398,971
Gross External Borrowing Position (including PPP and finance Lease)	337,726	385,211
Net Under/ (Over) Borrowed Position	**12,314**	**13,760**

The table above shows the CFR in an under-borrowed position on 31 March 2022 of £13.760m. This means the Council has used some internal borrowing from cash/ reserves to fund an element of its current capital expenditure requirements

This is a prudent position in the current interest rate environment given the cost of external borrowing compared with cash investment rates. The current strategy for 2022/23 is expected to maintain this under-borrowed position whilst closely monitoring longer term PWLB and market rates and consideration of potentially re-financing some of the temporary loan debt with longer term

2.7 ***Borrowing Prudential Indicators***

- **The Authorised Limit – Table 4** - the authorised limit is the maximum borrowing limit, beyond which the Council does not have the power to borrow.

Table 4 below demonstrates that during 2021/22 the Council has maintained gross borrowing within its authorised limit.

- **The Operational Boundary – Table 4** – the operational boundary is the expected borrowing position of the Council during the year with headroom for daily cash flow variations. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

  The operational boundary position will be reviewed and updated in 2022/23 treasury reporting.
- **Actual Financing Costs as a Proportion of Net Revenue Stream – Table 5 -** this indicator identifies the cost of capital (borrowing and other long-term obligation costs net of investment income) against the net revenue stream of the Council.

Table 4

Item	*2020/21 £'000*	*2021/22 £'000*
Authorised Borrowing Limit External Debt	**414,723**	**468,936**
Borrowing	238,159	289,434
Other Long Term Liabilities	99,567	95,777
Total	**337,726**	**385,211**
Operational Boundary External Debt	**377,726**	**425,211**
Borrowing	238,159	289,434
Other Long Term Liabilities	99,567	95,777
Total	**337,726**	**385,211**

Table 5

Ratio of Financing Costs to Net Revenue Stream	***Actual 2020/21***	***Actual 2021/22***
General Services	6.97%	5.65%
HRA	11.17%	10.91%
Total	**7.72%**	**6.33%**

Section 3 Treasury Position

3.1 The Council's debt and investment position is administered by the treasury management team 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, and through officer activity detailed in the Council's Treasury Management Practices.

At the end of 2021/22 the Council 's treasury (excluding borrowing by PFI and finance leases) position was as follows:

Table 6

	Borrowing position as at 31 March 2021		Borrowing position as at 31 March 2022		Change in year
	£'000	*Average interest rate %*	*£'000*	*Average interest rate %*	*£'000*
Long Term Borrowing					
Public Works Loans Board	143,958	4.20	178,233	3.64	34,275
Market – Fixed	8,000	1.44	8,000	0.48	0
LOBO (Option Loans)	41,200	4.52	41,200	4.52	0
Total Long-Term Borrowing	**193,158**		**227,433**		**34,275**
Short Term Borrowing	45,000	0.42	62,000	0.21	17,000
Total External Borrowing	**238,158**	**2.65**	**289,433***	**2.21**	**51,275**
CFR (underlying borrowing need)	250,472		303,193		52,721
Over (Under) Borrowing	**(12,314)**		**(13,760)**		**1,446**
Investments	**(73,390)**	**0.53**	**(72,105)**	**0.64**	**1,285**

* The carrying amount of loans on the Council's balance sheet as of 31 March 2022 is £290.266m. The difference between this figure and the external borrowing shown in Table 6 above is £0.833m of equivalent interest rate accounting adjustments required by the Code of Practice on local authority accounting.

3.2 **Table 7** below details the profile of the Council's loan maturity periods as of 31 March 2022.

Table 7

Maturity analysis of Debt Outstanding at 31 March 2022	*PWLB £'000*	*Market £'000*	*LOBO (Option) £'000*	*Temp Borrowing*	*Total £'000*
Maturing within 1 year	2,049	0	0	62,000	64,049
Maturing 1 to 2 years	4,295	8,000	3,000	0	15,295
Maturing 2 to 5 years	4,909	0	0	0	4,909
Maturing 5 to 10 years	17,507	0	3,000	0	20,507
Maturing 10 to 20 years	31,803	0	5,500	0	37,303
Maturing 20 to 30 years	14,004	0	5,000	0	19,004
Maturing 30 to 40 years	53,666	0	5,000	0	58,666
Maturing 40 to 50 years	50,000	0	9,700	0	59,700
Maturing > 50 years	0	0	10,000	0	10,000
Total	***178,233***	***8,000***	***41,200***	***62,000***	***289,433***

3.3 **Loans fund -** where a local authority has a Housing Revenue Account, the HRA should be reported separately from the General Fund. The reporting on the commitment to repay loans fund advances is for repayments only and does not include any interest costs. The Loans Fund balances are set out in Table 8 and Table 8(a) below:

Table 8 – Loans Fund Advances to General Fund

Loans Fund	31 March 2021 (£'000)	31 March2022 (£'000)
Opening Balance	169,639	179,290
Add advances	15,158	52,109
Less repayments	(5,507)	(5,196)
Closing Balance	**179,290**	**226,203**

Table 8(a) – Loans Fund Advances to HRA

Loans Fund	31 March 2021 (£'000)	31 March2022 (£'000)
Opening Balance	67,501	68,793
Add advances	2,574	7,918
Less repayments	(1,282)	(1,249)
Closing Balance	**68,793**	**75,462**

Section 4 Strategy for 2021/2

4.1 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 continued 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 large amounts of cheap credit so that banks could help 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 demanded 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 counterparty risk exposure, by having fewer investments placed in the financial markets.

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4.2 In this scenario, the treasury strategy was to increase temporary borrowing from £45m to £62m to take advantage in the short-term market which offered cheap funding, particularly in the inter local authority markets and to also fund most of the Council and HRA additional borrowing requirements from long term external borrowing (PWLB).

Section 5 Economy and Interest Rates

5.1 **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, 0.75% in March 2022, 1.00% in May 2022 and to 1.25% in June 2022

The UK economy has had several setbacks 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 Monetary Policy Committee (MPC) to focus on tackling the second-round effects of inflation, now that the Consumer Price Index (CPI) measure has risen to 9.1%, highest level since March 1982.

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 move UK gilt yields higher. There is a strong correlation between the two factors. However, the impact 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 phones contract prices, are strong issues 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 drain 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 statement now seems very dated. Inflation is the main issue, 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. Comments from Federal Reserve System (Fed) officials following the mid-March Federal Open Market Committee (FOMC) meeting – including from Chair Jerome Powell himself – stating the 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. Jerome 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 European Central Bank (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. A positive note is 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 Gross Domestic Product (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.

Section 6 Borrowing Rates in 2021/22

6.1 *PWLB Borrowing Rates -*

PWLB rates are based on 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.

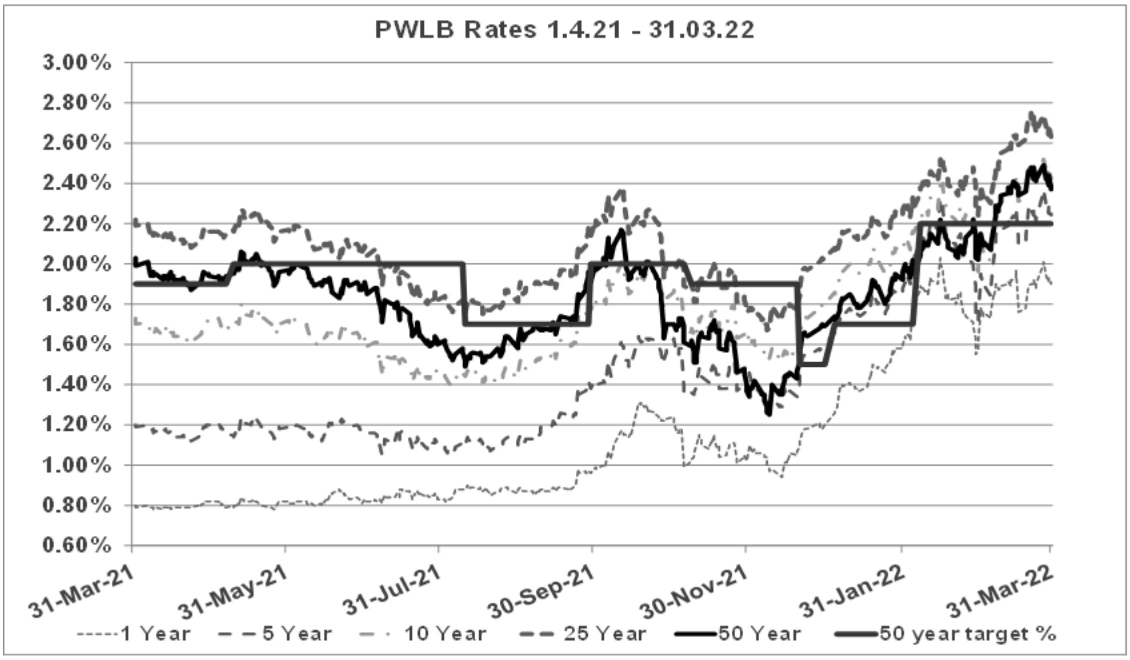
Gilt yields fell sharply from the spring of 2021 through to September and then spiked back up before falling again through December. However, by January sentiment had well and truly changed, as markets became focussed on the embedded nature of inflation, spurred on by a broader opening of economies post 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% in June, 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.



Link Group Interest Rate View 10.5.22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25
BANK RATE	1.25	1.50	1.75	2.00	2.00	2.00	2.00	2.00	1.75	1.75	1.75	1.75	1.75
3 month ave earnings	1.20	1.50	1.70	2.00	2.00	2.00	2.00	2.00	1.70	1.70	1.70	1.70	1.70
6 month ave earnings	1.60	1.90	2.10	2.20	2.20	2.20	2.20	2.10	2.00	1.90	1.90	1.90	1.90
12 month ave earnings	2.00	2.20	2.30	2.40	2.40	2.30	2.30	2.20	2.20	2.10	2.10	2.10	2.10
5 yr PWLB	2.50	2.50	2.60	2.60	2.60	2.60	2.60	2.60	2.50	2.50	2.50	2.50	2.50
10 yr PWLB	2.80	2.80	2.90	2.90	2.90	2.90	2.90	2.90	2.80	2.80	2.80	2.80	2.80
25 yr PWLB	3.00	3.10	3.10	3.20	3.20	3.20	3.10	3.10	3.00	3.00	3.00	3.00	3.00
50 yr PWLB	2.70	2.80	2.80	2.90	2.90	2.90	2.80	2.80	2.70	2.70	2.70	2.70	2.70

Section 7 Borrowing Out-turn for 2021/22

7.1 During 2021/22 the Council funded part of the capital borrowing requirement in the short-term market, increasing temporary borrowing to £62.000m, in March 2022. However, additional long-term borrowing (PWLB) of £35.000m was also undertaken, taking advantage of low interest rates and gaps in the borrowing maturity profile. The Council were in an under-borrowed position of £13,760m for 2021/22. The Council has not borrowed more than, or in advance of its needs, purely to profit from the investment of the extra sums borrowed.

7.2 During 2022/23 focus will be on monitoring longer term rates and looking to borrow longer term to meet the CFR and at the same time look to reduce the temporary borrowing of £62.000m on the short-term market.

7.2 During 2021/22 the actual borrowing and repayments of external debt transacted are shown in Table 10 below. This shows temporary borrowing being increased and longer term borrowing being undertaken, a prudent position in the current interest rate environment. The Council's policy is to ensure that not more than 25% of long-term loans are due to mature within any financial year. The indicator for maturing debt of 22% (within one year) is 3% below the maturity limit indicator.

Table 10

Loan Type	**Borrowed 2021/22**	**Repaid 2021/22**	**Net £'000**

	£'000	£'000	
PWLB	35,000	(725)	34,275
Market Loans	5,000	(5,000)	0
Temporary borrowing	78,000	(61,000)	17,000
	118,000	**(66,725)**	**51,275**

7.3 ***Debt Re-scheduling*** – no external debt was re-scheduled during 2021/22 as the average differential of 1% between PWLB new borrowing rates and premature redemption rates made early repayment of loans expensive and unviable due to the premiums that would be payable.

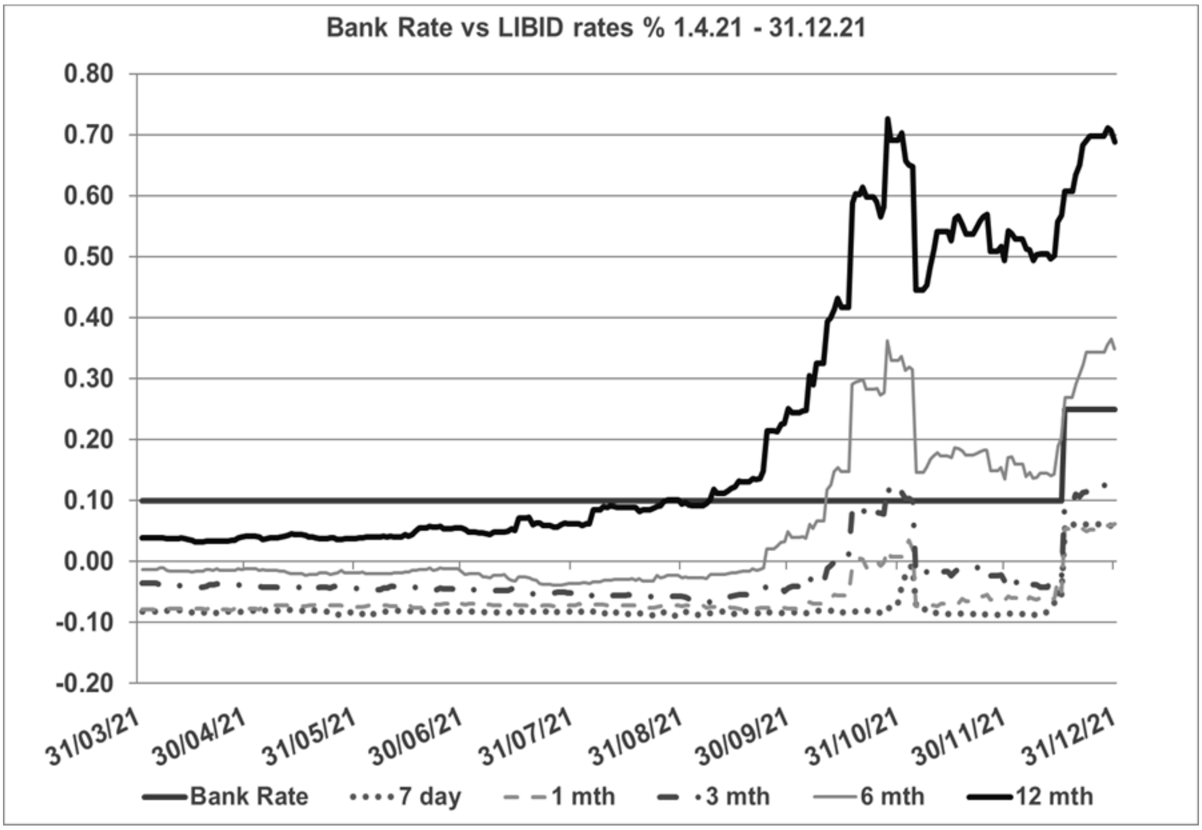
Section 8 Investment Rates, Out-turn, and Policy in 2021/22

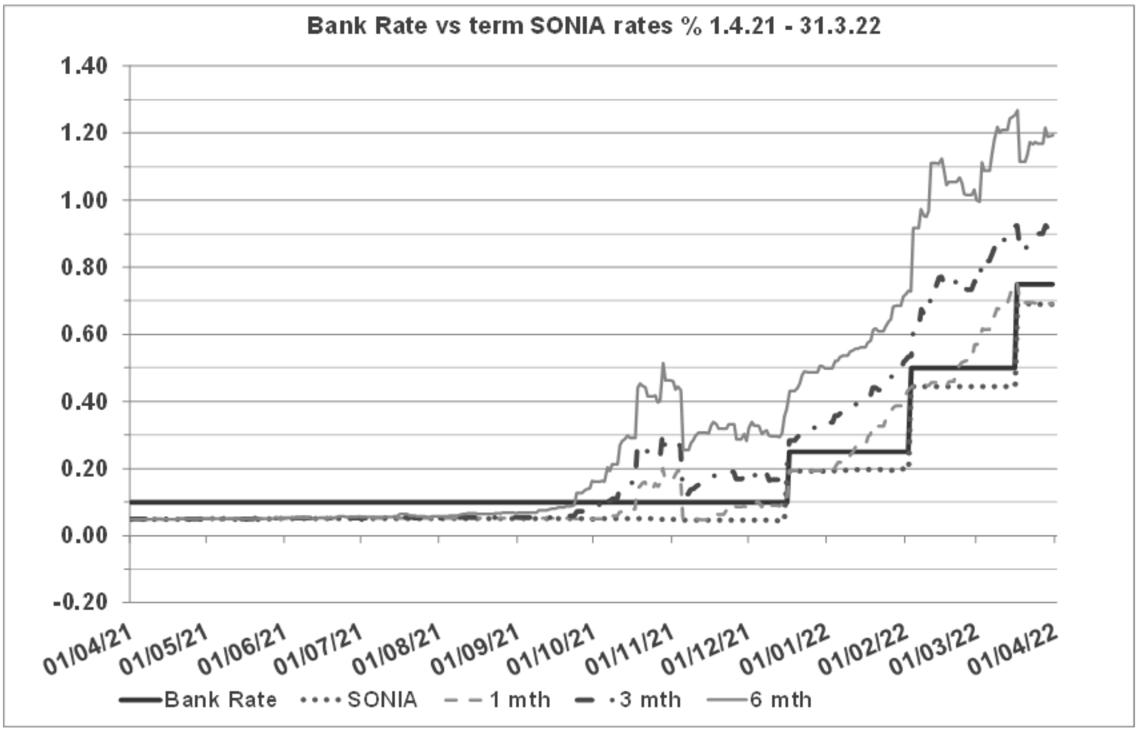
8.1 The Council's investment policy is governed by Scottish Government investment regulations, which have been implemented in the annual investment strategy approved by the Council on 4th March 2021. This policy sets out the approach for choosing investment counterparties and is based on credit ratings 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.

Fig 2 and 3 below shows the bank rate and average of short-term rates generally available in the market for investment period up to 1 year.

Fig 2





Money Market Investment Rates 2021/22

Fig 3

	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
High	0.25	0.06	0.06	0.14	0.36	0.73
High Date	17/12/2021	29/12/2021	31/12/2021	31/12/2021	30/12/2021	28/10/2021
Low	0.10	-0.09	-0.08	-0.07	-0.04	0.04
Low Date	01/07/2021	27/08/2021	17/09/2021	08/09/2021	27/07/2021	08/07/2021
Average	0.11	-0.07	-0.05	-0.01	0.09	0.31
Spread	0.15	0.15	0.14	0.20	0.40	0.68

	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

8.3 **Investment Out-turn –** the Council maintained an average balance of £71.9 of internally managed investment funds. The internally managed funds earned an average rate of return of 0.32%.

The comparable performance indicator is the average 3-Month SONIA uncompounded rate which was 0.24%.

Table 11

	Average Value of Investments Held	*Rate of Return*	*Benchmark Return**
Investments	£71.971	0.32%	0.24%

**The benchmark return used is the 3 month SONIA uncompounded rate of 0.24%. This represents the average rate that would be realised if deposits were placed on the inter-bank money market for continuing periods of 3 months throughout 2021/22.*

8.4 **Investment Policy** – the Council's investment policy is governed by Scottish Government investment regulations which have been implemented in the Annual Investment strategy approved by the Council on 4 March 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 met with the approved strategy, and the Council had no liquidity difficulties.

8.5 **Current Council Investments held on 31 March 2022.**

Table 12

Class	Type	Start Date	Maturity Date	Counterparty	Profile	Rate	Principal £000
Deposit	Fixed	06/08/2021	05/08/2022	Warrington Borough Council	Maturity	0.12	5,000
Deposit	Fixed	11/08/2021	10/08/2022	Slough Borough Council	Maturity	0.10	5,000
Deposit	Fixed	27/08/2021	26/08/2022	Blackpool Borough Council	Maturity	0.10	5,000
Deposit	Fixed	06/09/2021	05/09/2022	London Borough of Croydon	Maturity	0.30	5,000
Deposit	Fixed	01/10/2021	30/09/2022	London Borough of Croydon	Maturity	0.30	5,000
Deposit	Fixed	09/10/2020	10/10/2022	Rotherham Metropolitan Borough Council	Maturity	0.90	5,000
Deposit	Fixed	10/01/2022	09/01/2023	Thurrock Council	Maturity	0.75	5,000
Deposit	Fixed	25/01/2022	24/01/2023	Liverpool City Council	Maturity	0.25	5,000
Deposit	Fixed	01/02/2022	31/01/2023	Thurrock Council	Maturity	0.75	5,000
Deposit	Fixed	15/02/2022	15/08/2022	Slough Borough Council	Maturity	1.10	5,000
Deposit	Fixed	30/03/2022	30/09/2022	Spelthorne Borough Council	Maturity	0.90	5,000
Fixed Total							**55,000**
Deposit	Variable	10/05/2016	-	Bank of Scotland (Call A/c)	Variable	0.70	7,105
Deposit	Variable	11/08/2020	-	Santander (95d)	Variable	0.45	7,000
Deposit	Variable	11/08/2020	-	Santander (95d)	Variable	0.25	3,000
Call Total							**17,105**
Overall Total							**72,105**

Section 9 Other Issues

9.1 **Sources of borrowing** - Although PWLB remains a low-risk source of long term borrowing due to recent rate changes and the ongoing consultation with local authorities on the future of PWLB borrowing other borrowing institutions may be looked at to remove the reliance on PWLB for long term borrowing needs.

9.2 **Changes in risk appetite** - The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. South Ayrshire Council has a low risk appetite and as such would look at all aspects before making any changes to the current strategy and members would be made fully aware of any such changes.

9.3 **IFRS 16** - The implementation of IFRS 16 bringing currently off-balance sheet leased assets onto the balance sheet has had an additional delay and not now due to be implemented till 2024/25. Work had been progressed in this area throughout 2021/22 which should make future requirements easier to implement.

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Appendix 2

South Ayrshire Council
Equality Impact Assessment
Scoping Template

Equality Impact Assessment is a legal requirement under the Public Sector Duty to promote equality of the Equality Act 2010. Separate guidance has been developed on Equality Impact Assessment's which will guide you through the process and is available to view here: https://www.south-ayrshire.gov.uk/equalities/impact-assessment.aspx

Further guidance is available here: https://www.equalityhumanrights.com/en/publication-download/assessing-impact-and-public-sector-equality-duty-guide-public-authorities/

The Fairer Scotland Duty ('the Duty'), Part 1 of the Equality Act 2010, came into force in Scotland from 1 April 2018. It places a legal responsibility on Councils to actively consider ('pay due regard to') how we can reduce inequalities of outcome caused by socio-economic disadvantage, when making strategic decisions. FSD Guidance for Public Bodies in respect of the Duty, was published by the Scottish Government in March 2018 and revised in October 2021. See information here: https://www.gov.scot/publications/fairer-scotland-duty-guidance-public-bodies/

1. Policy details

Policy Title	Treasury Management Annual Report 2020/21
Lead Officer (Name/Position/Email)	Tim Baulk, Head of Finance and ICT – tim.baulk@south-ayrshire.gov.uk

2. Which communities, groups of people, employees or thematic groups do you think will be, or potentially could be, impacted upon by the implementation of this policy? Please indicate whether these would be positive or negative impacts

Community or Groups of People	Negative Impacts	Positive impacts
Age – men and women, girls & boys	No	No
Disability	No	No
Gender Reassignment (Trans/Transgender Identity)	No	No
Marriage or Civil Partnership	No	No
Pregnancy and Maternity	No	No
Race – people from different racial groups, (BME) ethnic minorities and Gypsy/Travellers	No	No
Religion or Belief (including lack of belief)	No	No
Sex – (issues specific to women & men or girls & boys)	No	No
Sexual Orientation – person's sexual orientation i.e. LGBT+, lesbian, gay, bi-sexual, heterosexual/straight	No	No

Community or Groups of People	Negative Impacts	Positive impacts
Thematic Groups: Health, Human Rights & Children's Rights	No	No

3. What likely impact will this policy have on people experiencing different kinds of social disadvantage i.e. The Fairer Scotland Duty (This section to be completed for any Strategic Decisions). Consideration must be given particularly to children and families.

Socio-Economic Disadvantage	Negative Impacts	Positive impacts
Low Income/Income Poverty – cannot afford to maintain regular payments such as bills, food, clothing	No	No
Low and/or no wealth – enough money to meet Basic living costs and pay bills but have no savings to deal with any unexpected spends and no provision for the future	No	No
Material Deprivation – being unable to access basic goods and services i.e. financial products like life insurance, repair/replace broken electrical goods, warm home, leisure/hobbies	No	No
Area Deprivation – where you live (rural areas), where you work (accessibility of transport)	No	No
Socio-economic Background – social class i.e. parent's education, employment and income	No	No

4. Do you have evidence or reason to believe that the policy will support the Council to:

General Duty and other Equality Themes **Consider the 'Three Key Needs' of the Equality Duty**	**Level of Negative and/or Positive Impact** **(High, Medium or Low)**
Eliminate unlawful discrimination, **harassment and victimisation**	Low Impact
Advance equality of opportunity between people who share a protected characteristic and those who do not	Low Impact
Foster good relations between people who share a protected characteristic and those who do not. (Does it tackle prejudice and promote a better understanding of equality issues?)	Low Impact
Increase participation of particular communities or groups in public life	Low Impact
Improve the health and wellbeing of particular communities or groups	Low Impact
Promote the human rights of particular communities or groups	Low Impact
Tackle deprivation faced by particular communities or groups	Low Impact

5. Summary Assessment

Is a full Equality Impact Assessment required?	~~**YES**~~

(A full Equality Impact Assessment must be carried out if impacts identified as **Medium and/or High**)	**NO**
Rationale for decision: **This report presents to the Panel the annual report of treasury management activities for 2020/21. Their decision on this has no specific equality implications**	
Signed : Tim Baulk **Head of Service** **Date:** 18 July 2022	