

South Ayrshire Council

**Report by Head of Finance and ICT
to Leadership Panel
of 18 January 2022**

Subject: Treasury Management Mid-Year Report 2021/22

1. Purpose

- 1.1 The purpose of this report is to provide Members with a mid-year treasury management update for the financial year 2021/22.

2. Recommendation

- 2.1 It is recommended that the Panel approves the contents of this report.**

3. Background

Treasury Management

- 3.1 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned to meet expenditure commitments but also to invest surplus monies in low risk counterparties (organisations with which the Council has a financial relationship in terms of borrowings or investments), providing adequate liquidity initially before considering optimising investment return.
- 3.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer-term cash will involve arranging long or short term loans or using longer term cash flow surpluses. In addition, in certain interest rate environments debt previously drawn may be restructured to meet Council risk or cost objectives.
- 3.3 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).
- 3.4 The Audit and Governance Panel of 1 December 2021 considered the mid-year treasury management update and agreed that it be remitted to the Leadership Panel for approval.

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4. Proposals

4.1 This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and provides an update on activity in [Appendix 1](#) and [Appendix 2](#) on the following:

4.1.1 [Appendix 1](#) – *Economic Update and Interest rates*

Section	Description
1	Economics and Interest Rates
2	Interest Rates Forecast and Commentary Borrowing Strategy for 2021/22;

4.1.2 [Appendix 2](#) – *Treasury Activity*

Section	Description
1.1	The Council's Capital Expenditure plans and Capital Financing Requirement (CFR);
2.1	Borrowing Strategy for 2021/22;
3.1	Review of Investment Strategy and Performance
4.1	Review of compliance with Treasury and Prudential Limits for 2021/22;
5.1	Borrowing in advance; and
6.1	Debt Re-scheduling.
7.1	Other

4.2 The Panel is requested to approve the contents of this report in accordance with the requirements of the CIPFA Code.

4.3 The attached report incorporates the updated capital spending plan, as approved in the Review of Capital Estimates: General Services Capital Programme 2021-22 to 2030-31 report to Leadership Panel in October 2021 and information contained in the draft Period 6 General Services and HRA capital monitoring report due to be considered by the Leadership Panel on 23 November 2021.

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** - the Council budgeted for investment income of £0.114m in 2021/22, based on an estimate of the average revenue balances held during the year and an assumed interest rate return of 0.50% on these balances.

At September 2021 (Qtr2) the full year budgeted income is projected at £0.205m, a surplus of £0.091m.

- 6.1.2 **Capital Financing Costs** - the budget for loan charges in 2021/22 is £12.266m, comprising £5.249m for loan principal, £6.837m for interest costs and £0.180m for loans fund expenses.

The current projection for loans charges to the General Fund is an under-spend of £0.966m in interest and expenses.

6.2 ***Housing Revenue Account (HRA)***

- 6.2.1 **Interest on Revenue Balances** - the HRA budgeted for investment income of £0.050m in 2021/22, based on an estimate of the average revenue balances held during the year and an assumed interest rate return of 0.50% on these balances.

At September 2021 (Qtr2) the full year estimate for investment income earned is £0.075m resulting in a surplus of £0.025m.

- 6.2.2 **Capital Financing Costs** - the budget for HRA loan charges in 2021/22 is £3.767m, comprising £1.281m for loan principal, £2.423m for interest costs and £0.063m for loans fund expenses.

The current projection for HRA loan charges is an under spend of £0.248m in interest and expenses.

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 Should the recommendations be rejected, then the Council will not be in compliance with the CIPFA Code of Practice on Treasury Management.

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 3](#).

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.

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 Brian McGinley, Portfolio Holder for Resources and Performance, and the contents of this report reflect any feedback provided.

14. Next Steps for Decision Tracking Purposes

- 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 Leadership Panel in the 'Council and Leadership Panel Decision Log' at each of its meetings until such time as the decision is fully implemented:

<i>Implementation</i>	<i>Due date</i>	<i>Managed by</i>
No further action required	Not applicable	Not applicable

Background Papers CIPFA Code of Practice for Treasury Management in the Public Services

Report to South Ayrshire Council of 4 March 2021 – [Treasury Management and Investment Strategy 2021/22](#)

[Report to Audit and Governance Panel of 1 December 2021 – Treasury Management Mid-Year Report 2021/22](#)

Person to Contact Tim Baulk, Head of Finance and ICT
County Buildings, Wellington Square, Ayr, KA7 1DR
Phone 01292 612620
E-mail tim.baulk@south-ayrshire.gov.uk

Date: 10 January 2022

1. Economics and Interest Rates (Information provided by Link Group)

1.1 Economics Update and commentary

- The **Monetary Policy Committee (MPC)** voted unanimously to leave Bank Rate unchanged at 0.10% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn; two MPC members voted to stop the last £35bn of purchases as they were concerned that this would add to inflationary pressures.
- There was a major shift in the tone of the MPC's minutes at this meeting from the previous meeting in August which had majored on indicating that some tightening in monetary policy was now forecast, but also not wanting to stifle economic recovery by too early an increase in Bank Rate. In his press conference after the August MPC meeting, Governor Andrew Bailey said, "the challenge of avoiding a steep rise in unemployment has been replaced by that of ensuring a flow of labour into jobs" and that "the Committee will be monitoring closely the incoming evidence regarding developments in the labour market, and particularly unemployment, wider measures of slack, and underlying wage pressures." In other words, it was highlighting a potential danger that labour shortages could push up wage growth by more than it expects and that, as a result, Consumer Price Index (CPI) inflation would stay above the 2% target for longer. It also discounted sharp increases in monthly inflation figures projected in late 2021 which were largely propelled by events a year ago e.g., the cut in VAT in August 2020 for the hospitality industry, and by temporary shortages which would eventually work their way out of the system: in other words, the MPC had been prepared to look through a temporary spike in inflation.
- In August MPC's words indicated there had been a marked increase in concern that more recent increases in prices, particularly the increases in gas and electricity prices in October and due again next April, are, indeed, likely to lead to faster and higher inflation expectations and underlying wage growth, which would in turn increase the risk that price pressures would prove more persistent next year than previously expected. Indeed, to emphasise its concern about inflationary pressures, the MPC pointedly chose to reaffirm its commitment to the 2% inflation target in its statement; this suggested that it was now willing to look through the flagging economic recovery during the summer to prioritise bringing inflation down next year. This is a reversal of its priorities in August and a long way from words at earlier MPC meetings which indicated a willingness to look through inflation exceeding the target for limited periods to ensure that inflation was 'sustainably over 2%'. Indeed, whereas in August the MPC's focus was on getting through a winter of temporarily high energy prices and supply shortages, believing that inflation would return to just under the 2% target after reaching a high around 4% in late 2021, now its primary concern is that underlying price pressures in the economy are likely to get embedded over the next year and elevate future inflation to stay significantly above its 2% target and for longer.
- Financial markets are now pricing in a first increase in Bank Rate from 0.10% to 0.25% in February 2022, but this looks ambitious as the MPC has stated that it wants to see what happens to the economy, and particularly to employment due to furlough ceasing at the end of September. At the MPC's meeting in February it will only have available the employment figures for November: to get a clearer picture of employment trends, it would need to wait until the May meeting when it would have

data up until February. At its May meeting, it will also have a clearer understanding of the likely peak of inflation.

- The MPC's forward guidance on its intended monetary policy on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows: -
 1. Placing the focus on raising Bank Rate as "the active instrument in most circumstances".
 2. Raising Bank Rate to 0.50% before starting on reducing its holdings.
 3. Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
 4. Once Bank Rate had risen to at least 1%, it would start selling its holdings.
- **COVID-19 vaccines.** These have been the game changer which have enormously boosted confidence that life in the UK could largely return to normal during the summer after a third wave of the virus threatened to overwhelm hospitals in the spring. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in hard hit sectors like restaurants, travel and hotels. The big question is whether mutations of the virus could develop which render current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread.

US. See comments below on US treasury yields.

EU. The slow roll out of vaccines initially delayed economic recovery in early 2021 but the vaccination rate has picked up sharply since then. After a contraction in GDP of -0.3% in Q1, Q2 came in with strong growth of 2%, which is likely to continue into Q3, though some countries more dependent on tourism may struggle. Recent sharp increases in gas and electricity prices have increased overall inflationary pressures but The European Central Bank (ECB) is likely to see these as being only transitory after an initial burst through to around 4%, so is unlikely to be raising rates for a considerable time.

German general election. With the Christian Democratic Union of Germany (CDU)/Christian Social Union in Bavaria (CSU) and Social Democratic Party (SDP) both having won around 24-26% of the vote in the September general election, the composition of Germany's next coalition government may not be agreed by the end of 2021. An SDP-led coalition would probably pursue a slightly less restrictive fiscal policy, but any change of direction from a CDU/CSU led coalition government is likely to be small. However, with Angela Merkel standing down as Chancellor as soon as a coalition is formed, there will be a gap in overall EU leadership which will be difficult to fill.

China. After a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in the rest of the year; this enabled China to recover all the initial contraction. During 2020, policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth. At the same time, China's economy benefited from the shift towards online spending by consumers in developed markets. These factors helped to explain its comparative outperformance compared to western economies during 2020 and earlier in 2021. However, the pace of economic growth has now fallen back after this initial surge of recovery from the pandemic and China is now struggling to contain the spread of the Delta variant through sharp local lockdowns - which will also depress economic growth. There are also questions as to how effective Chinese vaccines are proving. In addition, recent regulatory actions motivated by a political agenda to channel activities into officially approved directions, are also likely to reduce the dynamism and long-term growth of the Chinese economy.

Japan. 2021 has been a patchy year in combating Covid. However, after a slow start, nearly 50% of the population are now vaccinated and Covid case numbers are falling. After a weak Q3 there is likely to be a strong recovery in Q4. The Bank of Japan is continuing its very loose monetary policy but with little prospect of getting inflation back above 1% towards its target of 2%, any time soon: indeed, inflation was negative in July. New Prime Minister Kishida has promised a large fiscal stimulus package after the November general election – which his party is likely to win.

World growth. World growth was in recession in 2020 but recovered during 2021 until starting to lose momentum more recently. Inflation has been rising due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022. It is 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 to supply products, and vice versa. This is likely to reduce world growth rates from those in prior decades.

Supply shortages. The pandemic and extreme weather events have been highly disruptive of extended worldwide supply chains. At the current time there are major queues of ships unable to unload their goods at ports in New York, California and China. Such issues have led to mis-distribution of shipping containers around the world and have contributed to a huge increase in the cost of shipping. Combined with a shortage of semi-conductors, these issues have had a disruptive impact on production in many countries. Many western countries are also hitting up against a difficulty in filling job vacancies. It is expected that these issues will be gradually sorted out, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods on shelves.

2. Interest Rates Forecast and Commentary

2.1 The Council’s treasury advisor, Link Group, provided the following forecasts on 29th September 2021 Public Works Loan Board (PWLB) rates are certainty rates, gilt yields plus 80bps):

Date	Bank Rate	PWLB Rates			
		5 year	10 year	25 year	50 year
Dec 21	0.10%	1.40%	1.80%	2.20%	2.00%
Mar 22	0.10%	1.40%	1.80%	2.20%	2.00%
Jun 22	0.25%	1.50%	1.90%	2.30%	2.10%
Sep 22	0.25%	1.50%	1.90%	2.30%	2.20%
Dec 22	0.25%	1.60%	2.00%	2.40%	2.20%
Mar 23	0.25%	1.60%	2.00%	2.40%	2.20%
Jun 23	0.50%	1.60%	2.00%	2.40%	2.20%
Sep 23	0.50%	1.70%	2.10%	2.50%	2.30%
Dec 23	0.50%	1.70%	2.10%	2.50%	2.30%

- 2.2 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 the Bank Rate to 0.10%, it left the Bank Rate unchanged at its subsequent meetings.

As shown in the forecast table above, one increase in Bank Rate from 0.10% to 0.25% has now been included in quarter 2 of 2022/23 and a second increase to 0.50% in quarter 2 of 23/24.

Significant risks to the forecasts

- COVID vaccines do not work to combat new mutations and/or new vaccines take longer than anticipated to be developed for successful implementation.
- The pandemic causes major long-term scarring of the economy.
- The Government implements an austerity programme that suppresses Gross Domestic Product (GDP) growth.
- The MPC tightens monetary policy too early – by raising Bank Rate or unwinding Quantitative Easing (QE).
- The MPC tightens monetary policy too late to ward off building inflationary pressures.
- Major stock markets e.g. in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the “moral hazard” risks of having to buy shares and corporate bonds to reduce the impact of major financial market sell-offs on the general economy.
- Geo-political risks are widespread e.g. German general election in September 2021 produces an unstable coalition or minority government and a void in high-profile leadership in the EU when Angela Merkel steps down as Chancellor of Germany; on-going global power influence struggles between Russia/China/US.

2.3 The balance of risks to the UK

The overall balance of risks to economic growth in the UK is now to the downside, including residual risks from Covid and its variants - both domestically and their potential effects worldwide.

Forecasts for Bank Rate

Bank Rate is not expected to go up fast after the initial rate rise as the supply potential of the economy has not generally taken a major hit during the pandemic, so should be able to cope well with meeting demand without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the surge to around 4% towards the end of 2021. Three increases in Bank rate are forecast in the period to March 2024, ending at 0.75%. However, these forecasts may well need changing within a relatively short time frame for the following reasons: -

- There are increasing grounds for viewing the economic recovery slowing down during the summer and now into the autumn. This could lead into stagflation which would create a dilemma for the MPC as to which way to face.
- Will some current key supply shortages e.g., petrol and diesel, spill over into causing economic activity in some sectors to take a significant hit?
- Rising gas and electricity prices in October and next April and increase in other prices caused by supply shortages and increases in taxation next April, are

already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to slow inflation.

- On the other hand, consumers are sitting on around £200bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total?
- There were 1.6 million people who came off furlough at the end of September; how many of those did not have jobs on 1st October and will, therefore, be available to fill labour shortages in many sectors of the economy? So, supply shortages which have been driving up both wages and costs, could reduce significantly within the next six months or so and alleviate the MPC's current concerns.
- There is a risk that there could be further surprises on the Covid front, on top of the flu season this winter, which could depress economic activity.
- In summary, with the high level of uncertainty prevailing on several different fronts, it is likely that these forecasts will need to be revised again soon - in line with what the new news is.
- It also needs to be borne in mind that Bank Rate being cut to 0.10% was an emergency measure to deal with the Covid crisis hitting the UK in March 2020. At any time, the MPC could decide to simply take away that final emergency cut from 0.25% to 0.10% on the grounds of it no longer being warranted and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

Forecasts for PWLB rates and gilt and treasury yields

As the interest forecast table for PWLB certainty rates above shows, there is likely to be a steady rise over the forecast period, with some degree of uplift due to rising treasury yields in the US.

There is likely to be exceptional volatility and unpredictability in respect of gilt yields and PWLB rates due to the following factors: -

- How strongly will changes in gilt yields be correlated to changes in US treasury yields?
- Will the Federal Reserve Board (Fed) act to counter increasing treasury yields if they rise beyond a yet unspecified level?
- Would the MPC act to counter increasing gilt yields if they rise beyond a yet unspecified level?
- How strong will inflationary pressures turn out to be in both the US and the UK and so impact treasury and gilt yields?
- How will central banks implement their new average or sustainable level inflation monetary policies?
- How well will central banks manage the withdrawal of QE purchases of their national bonds i.e., without causing a panic reaction in financial markets as happened in the "taper tantrums" in the US in 2013?
- Will exceptional volatility be focused on the short or long-end of the yield curve, or both?

The forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within our forecasting period, despite the major challenges that are looming up, and that there are no major ructions in international relations, especially

between the US and China / North Korea and Iran, which have a major impact on international trade and world GDP growth.

Gilt and treasury yields

Since the start of 2021, there has been a lot of volatility in gilt yields, and hence PWLB rates. During the first part of the year, US President Biden's, and the Democratic party's determination to push through a \$1.9trn (equivalent to 8.8% of GDP) fiscal boost for the US economy as a recovery package from the Covid pandemic was what unsettled financial markets. However, this was in addition to the \$900bn support package already passed in December 2020 under President Trump. This was then followed by additional Democratic ambition to spend further huge sums on infrastructure and an American family plan over the next decade which are caught up in Democrat / Republican disagreements. Financial markets were alarmed that all this stimulus, which is much bigger than in other western economies, was happening at a time in the US when: -

- A fast vaccination programme has enabled a rapid opening up of the economy.
- The economy had already been growing strongly during 2021.
- It started from a position of little spare capacity due to less severe lockdown measures than in many other countries. A combination of shortage of labour and supply bottle necks is likely to stoke inflationary pressures more in the US than in other countries.
- And the Fed was still providing monetary stimulus through monthly QE purchases.

These factors could cause an excess of demand in the economy which could then unleash stronger and more sustained inflationary pressures in the US than in other western countries. This could then force the Fed to take much earlier action to start tapering monthly QE purchases and/or increasing the Fed rate from near zero, despite their stated policy being to target average inflation. It is notable that some Fed members have moved forward their expectation of when the first increases in the Fed rate will occur in recent Fed meetings. In addition, more recently, shortages of workers appear to be stoking underlying wage inflationary pressures which are likely to feed through into CPI inflation. A run of strong monthly jobs growth figures could be enough to meet the threshold set by the Fed of "substantial further progress towards the goal of reaching full employment". However, the weak growth in August, (announced 3.9.21), has spiked anticipation that tapering of monthly QE purchases could start by the end of 2021. These purchases are currently acting as downward pressure on treasury yields. As the US financial markets are, by far, the biggest financial markets in the world, any trend upwards in the US will invariably impact and influence financial markets in other countries. However, during June and July, longer term yields fell sharply; even the large non-farm payroll increase in the first week of August seemed to cause the markets little concern, which is somewhat puzzling, particularly in the context of the concerns of many commentators that inflation may not be as transitory as the Fed is expecting it to be. Indeed, inflation pressures and erosion of surplus economic capacity look much stronger in the US than in the UK. As an average since 2011, there has been a 75% correlation between movements in 10-year treasury yields and 10 year gilt yields. This is a significant UPWARD RISK exposure to our forecasts for longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.

There are also possible downside risk from the huge sums of cash that the UK populace have saved during the pandemic; when savings accounts earn little

interest, it is likely that some of this cash mountain could end up being invested in bonds and so push up demand for bonds and support their prices i.e., this would help to keep their yields down. How this will interplay with the Bank of England eventually getting around to not reinvesting maturing gilts and then later selling gilts.

The balance of risks to medium to long term PWLB rates: -

There is a balance of upside risks to forecasts for medium to long term PWLB rates.

A new era – a fundamental shift in central bank monetary policy

One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the Fed, the Bank of England and the ECB, to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target to bear down on so as to stop it going above a target rate. There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on 'achieving broad and inclusive "maximum" employment in its entirety' in the US before consideration would be given to increasing rates.

The Fed in America has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep under), so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time.

The Bank of England has also amended its target for monetary policy so that inflation should be 'sustainably over 2%' and the ECB now has a similar policy.

For local authorities, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.

Labour market liberalisation since the 1970s has helped to break the wage-price spirals that fuelled high levels of inflation and has now set inflation on a lower path which makes this shift in monetary policy practicable. In addition, recent changes in flexible employment practices, the rise of the gig economy and technological changes, will all help to lower inflationary pressures.

Governments will also be concerned to see interest rates stay lower as every rise in central rates will add to the cost of vastly expanded levels of national debt; (in the UK this is £21bn for each 1% rise in rates). On the other hand, higher levels of inflation will help to erode the real value of total public debt.

1.1 *The Council's Capital Expenditure and Prudential Indicators (Revised)*

- (1) The following section provides the information relating to the 2021/22 capital position and prudential indicators;
- The Council's capital expenditure plans;
 - How these plans are being financed;
 - The impact of the capital expenditure plans on the prudential indicators and the underlying need to borrow
- (2) The tables below draw together the main movement in terms of the capital expenditure plans compared to the original plan, highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements for capital expenditure. The borrowing element of Table 1 for both General Services and HRA below revises the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR).

Table 1

	<i>2021/22 Original Estimate £'000</i>	<i>2021/22 Latest Estimate £'000</i>
Prudential Indicator – General Services		
Capital Expenditure	86,128	74,230
General Services - Financed By		
General and Specific Grant	10,050	9,073
Capital Receipts/Other	5,930	8,318
Borrowing	70,148	56,839
	86,128	74,230

Prudential Indicator – HRA		
Capital Expenditure	36,220	32,868
HRA - Financed By		
Borrowing	22,533	16,930
CFCR, Draw on surplus	9,930	14,489
Other Receipts/ Grants	3,757	1,449
	36,220	32,868

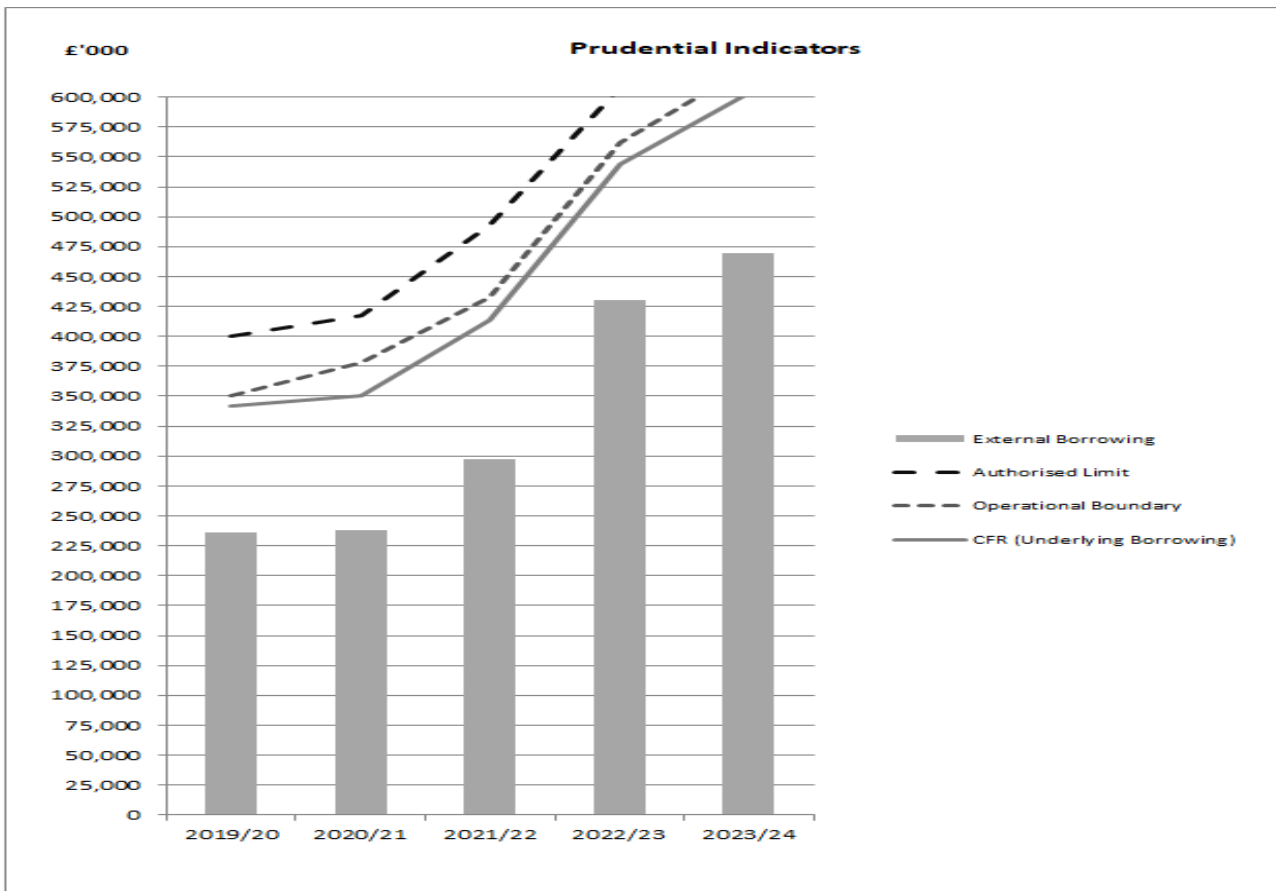
1.2 **Capital Financing Requirement, Debt Position and Operational Boundary Indicators**

- (1) Table 2 shows the CFR, which is the underlying need to incur borrowing for a capital purpose.

Table 2

<i>Prudential Indicator – CFR</i>	<i>2021/22 Original Estimate £'000</i>	<i>2021/22 Updated Estimate £'000</i>
Capital Financing Requirement – GS	349,570	328,776
Capital Financing Requirement – HRA	85,660	84,798
Total Capital Financing Requirement	435,230	413,574

(2) **Prudential Indicators Graph**



The graph shown at (2) above shows estimated key prudential indicators in graph format:

- **External Borrowing** – shows significant increase in the next two years as the Council utilises borrowing to fund capital investment

- **Capital Financing Requirement** – shows increases in CFR in line with external debt. The Council ended 2020/21 in an under borrowed position (CFR compared with external debt) of £12.312m. The current strategy will be to reflect an under-borrowed position in the short/medium term as reflected in the graph.
- **Operational Boundary** – this indicator is higher than external debt and CFR as it includes provision for other long term financing liabilities such as PPP and Finance leases, and short term cash flow variations.
- **Authorised Limit** – the limit which cannot be exceeded in terms of the Council’s debt position. This indicator is higher than the operational limit as provision is made for other cash flow variation and potential borrowing in advance.

Table 3

<i>Prudential Indicators – Debt</i>	<i>2021/22 Original £'000</i>	<i>2021/22 Updated £'000</i>
Authorised Limit	488,000	479,000
Operational Limit	458,000	433,000
External Debt	322,434	297,434

2.1 **Borrowing Strategy 2021/22 (Update)**

- (1) The Council’s capital financing requirement (CFR) estimate for 2021/22 has been revised to £413,574 based on the revised capital spend projections, as shown at 1.1, (2) Table 1. The CFR denotes the Council’s underlying need to borrow for capital purposes. To fund the CFR the Council may borrow from the PWLB or the market (external borrowing) or fund from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions and availability of internal cash resources.
- (2) The original borrowing requirement for 2021/22 was set at £92.7m but has been revised to £73.8m. This drop is attributed to supply shortages caused by both the Covid-19 pandemic and BREXIT. This then resulted in the re balancing of the capital programme.
- (3) This has resulted in revising the external borrowing requirement from the original £85.0m to £65.0m which reflects the under-spend in loan charges outlined in the financial implications at Section 6 – Financial Implications.
- (4) The current strategy is to consider long term external borrowing in Qtr3 of £30.0m and Qtr. 4 of £15.0m. This will be PWLB borrowing. To date in Qtr. 2 £15.0m long term borrowing has been taken from PWLB securing low interest rates being offered. A further £5.0m of medium to long term borrowing was secured in Qtr. 1 from the other local authority market, again taking advantage of low interest rates being offered.

A pragmatic approach however is being taken in terms of the timing of new long term external borrowing given the current market uncertainties due to a number of factors such as Covid-19 pandemic, Brexit and interest rate fluctuations along with the pace of the spend in the Council's capital programme.

- (5) The table at 2.2.1 below shows the high and low rates available from the PWLB during the period April 21 – Aug 21.

Gilt yields and PWLB rates were on a falling trend between May and August. However, they rose sharply towards the end of September.

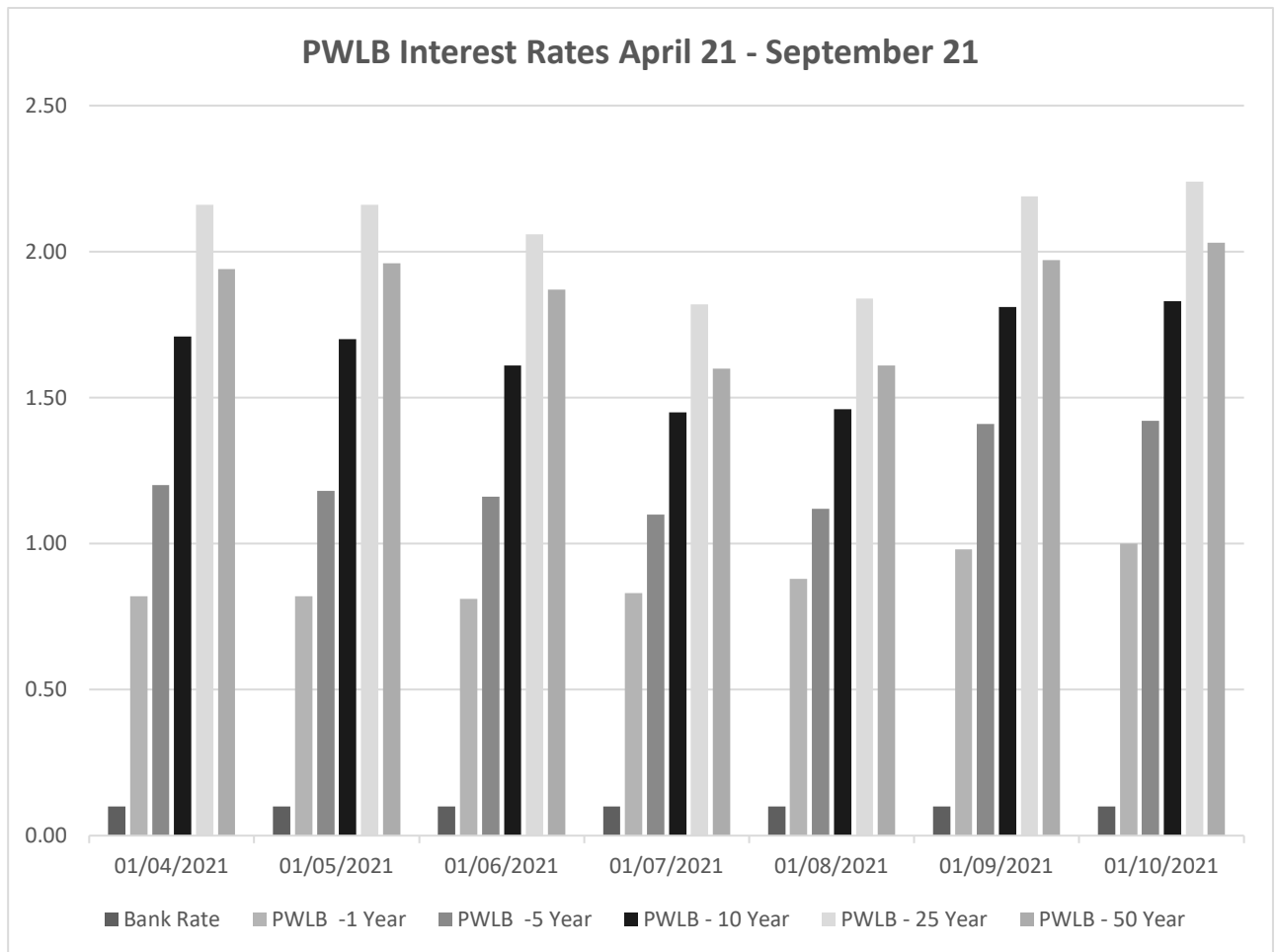
The 50-year PWLB target certainty rate for new long-term borrowing started 2021/22 at 1.90%, rose to 2.00% in May, fell to 1.70% in August and returned to 2.00% at the end of September after the MPC meeting of 23rd September.

- The current PWLB rates are set as margins over gilt yields 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)

2.2.1 PWLB certainty rates 1 April 2021 to 31 August 2021

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.78%	1.05%	1.39%	1.75%	1.49%
Date	08/04/2021	08/07/2021	05/08/2021	17/08/2021	10/08/2021
High	0.98%	1.42%	1.81%	2.27%	2.06%
Date	24/09/2021	28/09/2021	28/09/2021	13/05/2021	13/05/2021
Average	0.84%	1.16%	1.60%	2.02%	1.81%
Spread	0.20%	0.37%	0.42%	0.52%	0.57%

2.2.2 PWLB Interest Rates – Apr 21 – Sep 21/



3.1 **Investment Strategy**

The Treasury Management Strategy Statement (TMSS) for 2021/22, which includes the Annual Investment Strategy, was approved by the Council on 4th March 2021. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- security of capital;
 - liquidity; and
 - yield
- (2) The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. In the current economic climate, it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness.

3.2 **Investment Performance 2021/22**

- (1) As shown by the interest rate forecasts in section 2.2, it is now impossible to earn the level of interest rates commonly seen in previous decades as all short-term money market investment rates have only risen weakly since Bank Rate was cut to 0.10% in March 2020 until the MPC meeting on 24th September 2021 when 6- and 12-month rates rose in anticipation of Bank Rate going up in 2022. Given this environment and the fact that Bank Rate

may only rise marginally, or not at all, before mid-2023, investment returns are expected to remain low.

- (2) The Council's average level of funds available for investment purposes in the first half of the year 2021/22 was **£57.6m**. These funds are available on a temporary basis and are dependent on a number of factors including cash flows, reserve balances, borrowing strategy, etc. As these funds are linked to Council reserves earmarked for specific purposes, they are not available to spend on additional services and represent the current 'cash' position.
- (3) The following table summarises the Council's performance on investments against the benchmark performance indicator (3-month LIBID) in the current financial year:

Table 5

Benchmark	Budgeted Return	Benchmark Return	Council Performance
3-month LIBID	0.50%	0.07%	0.39%

- (4) Although percentage wise it would appear the council performance is below budgeted return 0.50% compared to 0.39%, for average value return the budget is £200,000 and performance for the year to date is £226,147 so overperformed. This is due to higher value investments but lower average investment interest rate.

LIBOR and LIBID rates will cease from the end of 2021. Work is currently progressing to replace LIBOR with a rate based on SONIA (Sterling Overnight Index Average). In the meantime, benchmark return is based on expected average earnings by local authorities for 3 to 12 months.

- (5) The Head of Finance and ICT confirms that the approved investment strategy was not breached in the first half of the financial year 2021/22.
- (6) The Council continues to lend to other local authorities in order to diversify its investment portfolio and to provide the highest level of security in delivering the objectives of security, liquidity and yield in its investment portfolio. Interest rates as previously stated are very low and do not expect to recover any time soon, because of this some forward planning has been undertaken to try and secure the best rates available. Also, to ensure some form of liquidity advantage has been taken of notice call accounts and investments with other banking authorities such as Goldman Sachs and Standard Chartered Bank.

The following table summarises the Council's investments as at 30 September 2021.

Table 6/

Table 6

Counterparty	Type	Principal £'000	Interest Rate	Maturity	Colour Code (Based on credit information)
Bank of Scotland	Liquidity	18,175	0.05%	N/a	Orange
Santander Bank Plc (95d)	Notice	10,000	0.40%	N/a	Red
Slough Borough Council	Maturity	5,000	0.10%	10/08/2022	N/A
London Borough of Croydon	Maturity	5,000	0.30%	05/09/2022	N/A
Rotherham Metropolitan Borough Council	Maturity	5,000	0.90%	10/10/2022	N/A
Liverpool City Council	Maturity	5,000	0.25%	08/12/2021	N/A
Derbyshire County Council	Maturity	5,000	0.25%	04/01/2022	N/A
Warrington Borough Council	Maturity	5,000	0.10%	01/02/2022	N/A
Warrington Borough Council	Maturity	5,000	0.12%	05/08/2022	N/A
Standard Chartered Bank	Maturity	5,000	0.11%	11/02/2022	Red
Blackpool Borough Council	Maturity	5,000	0.10%	26/08/2022	N/A
Total Investment		73,175	0.22%		

4.1 *Review of Compliance with Treasury and Prudential Limits for 2021/22*

- (1) The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

Table 7 below shows that the 2021/22-year end projected total debt position of £393,211 is below the projected CFR of £413,574 which indicates that external borrowing is only being used for capital purpose.

Table 7/

Table 7

	2020/21 Actual £'000	2021/22 Borrowing as @ 30/9/21 £'000	2021/22 Projection £'000
Long Term Borrowing – PWLB	143,958	158,890	203,234
Long Term Borrowing - LOBO	41,200	41,200	41,200
Long Term Borrowing - Market	8,000	8,000	8,000
Short Term Borrowing – Market	45,000	45,000	45,000
External Debt	238,158	253,090	297,434
Other Long-Term Liabilities	99,567	95,777	95,777
Total Debt	337,725	348,867	393,211
Capital Financing Requirement (CFR)	350,037	438,648	413,574
(Under) Over borrowed	(12,312)	(89,781)	(20,363)

- (2) A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government in Scotland Act 2003.

Table 8 below shows the authorised limit amended from the original 2021/22 indicator.

Table 8

Prudential Indicator – Authorised Limit for External Debt	2021/22 Original Indicator £'000	2021/22 Revised Indicator £'000
Borrowing	385,000	383,000
Other Long-Term Liabilities	100,000	96,000
Authorised Limit	485,000	479,000

5.1 **Borrowing in Advance of Need**

The Local Government Investment Regulations (Scotland) 2010 requires the Council to set out its strategy and approach to borrowing in advance of need, which is defined as any borrowing undertaken which will result in the total external debt exceeding the CFR for the following twelve-month period. The Council has not borrowed in advance of need during the six months to 30 September 2021.

6.1 **Debt Rescheduling**

Debt rescheduling opportunities have been very limited in the current economic climate and following the various increases in the margins added to gilt yields which have impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

7.1 **Other Current Issues**

Sources of Borrowing – regarding ESG (Environmental, Social and Governance)

While the prime considerations when investing surplus funds is security, liquidity, and yield, it is recognised that consideration must be given to other factors such as climate change, environmental, social, and good governance (ESG), to support a policy of sustainability. The only way to determine the exact nature of how investments are used would be if the investment were a specific bond or product for a defined purpose.

Most of South Ayrshire Council's investments are currently placed with other Local authorities who will take into consideration the three main elements of security, liquidity, and yield. However, several local authorities are also now looking at ESG principles when securing funding and it is an area which is considered will increase in prominence in future years.

On contacting a representative from the CIPFA Scottish Treasury Management Forum the organisation below was highlighted as a good reference to ascertain if an investment organisation (not other Local authorities) meets ESG principles.

The organisation, Principles for Responsible Investment (PRI), have a high number of large well established investment organisations as signatories.

The PRI is the world's leading proponent of responsible investment. It works:

- to understand the investment implications of environmental, social and governance (ESG) factors;
- to support its international network of investor signatories in incorporating these factors into their investment and ownership decisions.

On the basis that this organisation is known to and recommended by other Local authorities as a good reference guide, it is intended that the Council will review information provided by PRI prior to future investing to ensure the proposed investment organisation is currently a signatory. If the proposed investment organisation is not currently a signatory, it must have its own policy on ESG which meets South Ayrshire Council's expectations of supporting sustainability but still meets the three main considerations of security, liquidity, and yield.

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: [Equality Impact Assessment including Fairer Scotland Duty](#)

Further guidance is available here: [Assessing impact and the Public Sector Equality Duty: a guide for public authorities \(Scotland\)](#)

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. See information here: [Interim Guidance for Public Bodies](#) in respect of the Duty, was published by the Scottish Government in March 2018.

1. Policy details

Policy Title	Treasury Management Mid-Year Report 2021/22
Lead Officer (Name/Position/Email)	Denise Love, Senior Accountant (Capital/ Treasury – denise.love2@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	-	-
Disability	-	-
Gender Reassignment (Trans/Transgender Identity)	-	-
Marriage or Civil Partnership	-	-
Pregnancy and Maternity	-	-
Race – people from different racial groups, (BME) ethnic minorities and Gypsy/Travellers	-	-
Religion or Belief (including lack of belief)	-	-
Sex – gender identity (issues specific to women & men or girls & boys)	-	-
Sexual Orientation – person's sexual orientation i.e. LGBT+, lesbian, gay, bi-sexual, heterosexual/straight	-	-
Thematic Groups: Health, Human Rights & Children's Rights	-	-

3. What likely impact will this policy have on people experiencing different kinds of social disadvantage? (Fairer Scotland Duty). 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	-	-
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	-	-
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	-	-
Area Deprivation – where you live (rural areas), where you work (accessibility of transport)	-	-
Socio-economic Background – social class i.e. parent’s education, employment and income	-	-

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
Advance equality of opportunity between people who share a protected characteristic and those who do not	Low
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
Increase participation of particular communities or groups in public life	Low
Improve the health and wellbeing of particular communities or groups	Low
Promote the human rights of particular communities or groups	Low
Tackle deprivation faced by particular communities or groups	Low

5. Summary Assessment

<p>Is a full Equality Impact Assessment required? (A full Equality Impact Assessment must be carried out if impacts identified as Medium and/or High)</p>	<p>YES</p> <p>NO</p>
<p>Rationale for decision:</p> <p>This report provides Members with a mid-year treasury management update for the financial year 2021/22. Their decision on this has no specific equality implications</p>	
<p>Signed : Tim Baulk Head of Service</p> <p>Date: 27 October 2021</p>	