TREASURY MANAGEMENT ANNUAL REPORT 2022/23

Finance & Investment Advisory Committee – 5 September 2023

Report of: Deputy Chief Executive and Chief Officer - Finance & Trading

Status: For Decision

Also considered by:

- Cabinet – 19 September 2023

Key Decision: No

Executive Summary: This report provides the customary review of investment and borrowing activity during 2022/23 as required by the Council's Financial Procedure Rules. The report outlines the strategy adopted during the year, shows the position of the investment and debt portfolios at the beginning and the end of the year and gives details of how the investment fund performed in comparison with previous years and against various benchmarks.

This report supports the Key Aim of: Efficient management of the Council's resources.

Portfolio Holder: Cllr. Kevin Maskell

Contact Officer(s): Jessica Booth, Ext. 7436

Alan Mitchell, Ext. 7483

Recommendation to Finance & Investment Advisory Committee: That Cabinet be asked to approve the Treasury Management Annual Report for 2022/23.

Recommendation to Cabinet: That the Treasury Management Annual Report for 2022/23 be approved.

Reason for recommendation: As required by both the Council's Financial Procedure Rules and the CIPFA Code, an annual report of treasury management activity is to be presented to Members for approval.

Background

1 This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2022/23. 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).

2 During 2022/23 the minimum reporting requirements were that the full Council should receive the following reports:

a. an annual treasury strategy in advance of the year (Council xx/xx/2022)

b. a mid-year, (minimum), treasury update report (Council xx/xx/2022)

c. an annual review following the end of the year describing the activity compared to the strategy, (this report)

3 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.

4 This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Finance & Investment Advisory Committee before they were reported to the full Council. Member training on treasury management issues was last undertaken on 14/08/2018 in order to support members' scrutiny role.

Introduction

5 This annual treasury report covers:

a. Capital activity during the year;

b. Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);

c. The actual prudential and treasury indicators;

d. Overall treasury position identifying how much the Council has borrowed compared to its indebtedness and the impact on investment balances;

e. Summary of interest rate movements in the year;

f. Detailed debt activity and

g. Detailed investment activity.

The Council's capital expenditure and financing

6 The Council undertakes capital expenditure on long-term assets. These activities may either be:

a. Financed immediately though the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc) which has no resultant impact on the Council's borrowing need; or

b. If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

7 The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

	31/3/22 Actual (£000)	31/3/23 Actual (£000)
Capital expenditure	21,483	12,617
Financed in year	(13,785)	(9,632)
Unfinanced capital expenditure	7,698	2,985

The unfinanced capital expenditure was financed by internal borrowing.

The Council's overall borrowing need.

8 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 the resources used to pay for the capital spend. It represents the 2022/23 unfinanced capital expenditure (see above table), and prior years net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

9 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 organises the Council's cash position to ensure that sufficient cash is available. This may be sourced through borrowing from external bodies, (such as the Government, though the Public Works Loan Board {PWLB}, or the money markets), or utilising temporary cash resources within the Council.

10 **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 a revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from treasury management arrangements which ensure the 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.

11 The total CFR can also be reduced by

a. The application of additional capital financing resources, such as unapplied capital receipts; or

b. Charging more than the Minimum Revenue Provision (MRP) each year through a Voluntary Revenue Provision (VRP).

12 The Council's 2022/23 MRP policy, (as required by DLUHC Guidance) was approved as part of the Treasury Management Strategy Report for 2022/23 on 22/02/2022.

13 The Council's CFR for the year is shown below and represents a key prudential indicator.

	31/3/22 Actual (£000)	31/3/23 Actual (£000)
Opening CFR	41,284	48,657
Add unfinanced capital expenditure (as above)	7,698	2,986
Less MRP	(325)	(325)
Closing Balance	48,657	51,318

14 Borrowing activity is constrained by prudential indicators for gross borrowing and the CFR, and by the authorised limit.

15 Gross borrowing and the CFR – in order to ensure that borrowing levels are prudent over the medium term and only for capital purpose, the Council should ensure that gross eternal borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2022/23) plus the estimates of any additional capital financing requirement for the current (2023/24) and the next 2 financial years. This essentially meant that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility borrow in advance if its immediate capital needs. The table below highlights the Council's gross borrowing position against the CFR.

	31/3/22 Actual (£000)	31/3/23 Actual (£000)
CFR General Fund	48,657	51,318
Gross borrowing position	12,766	12,298
Over/(under) funding of CFR	(35,891)	(39,020)

16 The authorised limit is the "affordable borrowing limit" required by section 3 of the Local Government Act 2003. Once this has been set the Council does not have the power to borrow above this level. The table below demonstrates that during 2022/23 the Council has maintained gross borrowing within its authorised limit.

17 The operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

18 Actual financing costs as a proportion of net revenue stream – this indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream.

	2022/23 (£000)
Authorised limit	35,000
Maximum gross borrowing position during the year	12,766
Operational boundary	30,000
Average gross borrowing position	12,479
Financing costs as a proportion of net revenue stream	1.62%

Treasury position at the beginning and end of the financial year

19 The Council's treasury management debt and investment position is organised by the treasury management service in order 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 detailed in the summary, and through officer activity detailed in the Council's Treasury management Practice Notes. At the end of 2022/23 the Council's treasury position was as follows.

	31/3/22 Principal (£000)	Rate Return (%)	Average Life (Years)	31/3/23 Principal (£000)	Rate Return (%)	Average Life (Years)
Total debt	12,766	2.18	22.5	13,659	2.18	22.5
Capital Financing Requirement (CFR)	48,657	-	-	51,318	-	-
Over/(under) borrowing	(35,891)	-	-	(39,159)	-	-
Total investments	16,673	0.15	-	10,929		-
Net debt/ (investments)	**(3,907)**	**-**	**-**	**(3,907)**	**-**	**-**

20

21 The maturity structure of debt was as follows:

	31/3/22 Actual (£000)	31/3/23 Actual (£000)
Under 12 months	-	-

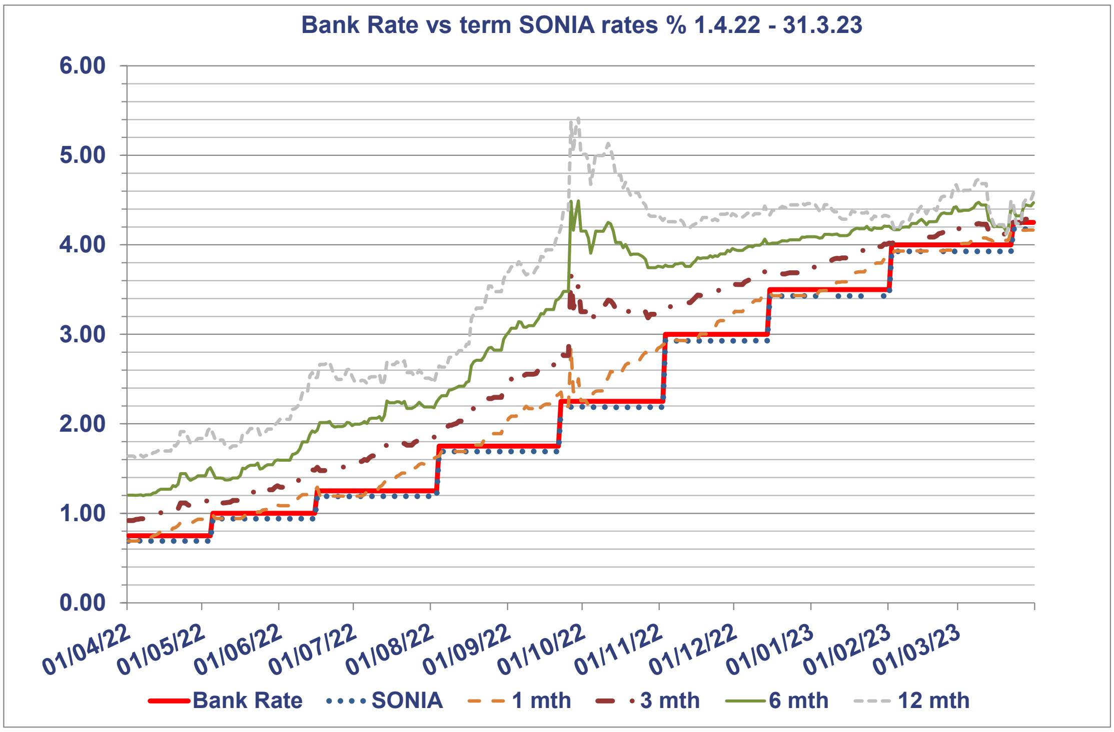
	31/3/22 Actual (£000)	31/3/23 Actual (£000)
12 months and over and within 20 years	8,000	7,661
20 years and over and within 30 years	4,766	4,637
30 years and over and within 50 years	-	-

22 The investment portfolio at the beginning and end of the financial year appears at Appendix A, whilst an analysis by maturity and repayment dates appears at Appendix B.

Treasury Strategy 2022/23

23 Investment strategy and control of interest rate risk

Investment Benchmarking Data – Sterling Overnight Index Averages (Term) 2022/23



24 Investment returns picked up throughout the course of 2022/23 as central banks, including the Bank of England, realised that inflationary pressures were not transitory, and that tighter monetary policy was called for.

25 Starting April at 0.75%, Bank Rate moved up in stepped increases of either 0.25% or 0.5%, reaching 4.25% by the end of the financial year, with the potential for a further one or two increases in 2023/24.

26 The sea-change in investment rates meant local authorities were faced with the challenge of pro-active investment of surplus cash for the first time in over a decade, and this emphasised the need for a detailed working knowledge of cashflow projections so that the appropriate balance between maintaining cash for liquidity purposes, and "laddering" deposits on a rolling basis to lock in the increase in investment rates as duration was extended, became an on-going feature of the investment landscape.

27 With bond markets selling off, equity valuations struggling to make progress and, latterly, property funds enduring a wretched Q4 2022, the more traditional investment options, such as specified investments (simple to understand, and less than a year in duration) became more actively used.

28 Meantime, through the autumn, and then in March 2023, the Bank of England maintained various monetary policy easing measures as required to ensure specific markets, the banking system and the economy had appropriate levels of liquidity at times of stress.

29 Nonetheless, 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 Great Financial Crisis of 2008/9. 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.

Borrowing strategy and control of interest rate risk

30 During 2022/23, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were initially low and minimising counterparty risk on placing investments also needed to be considered.

31 A cost of carry generally remained in place during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns. As the cost of carry dissipated, the Council sought to avoid taking on long-term borrowing at elevated levels (>4%) and has focused on a policy of internal and temporary borrowing, supplemented by short-dated borrowing (<3 years) as appropriate.

32 The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this has been kept under review to avoid incurring higher borrowing costs in the future when this Authority may not

be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

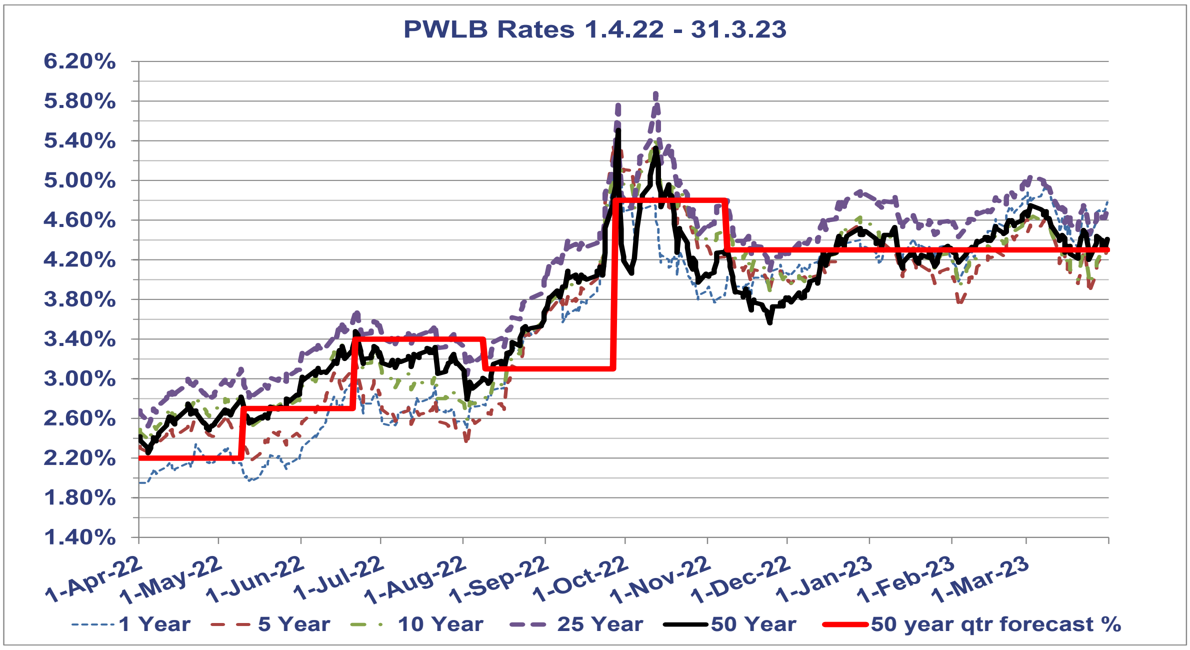
33 Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Deputy Chief Executive and Chief Officer – Finance & Trading therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks. Given the sharp rise in interest rates long term borrowing was postponed to enable lower rates to be achieved at a later date.

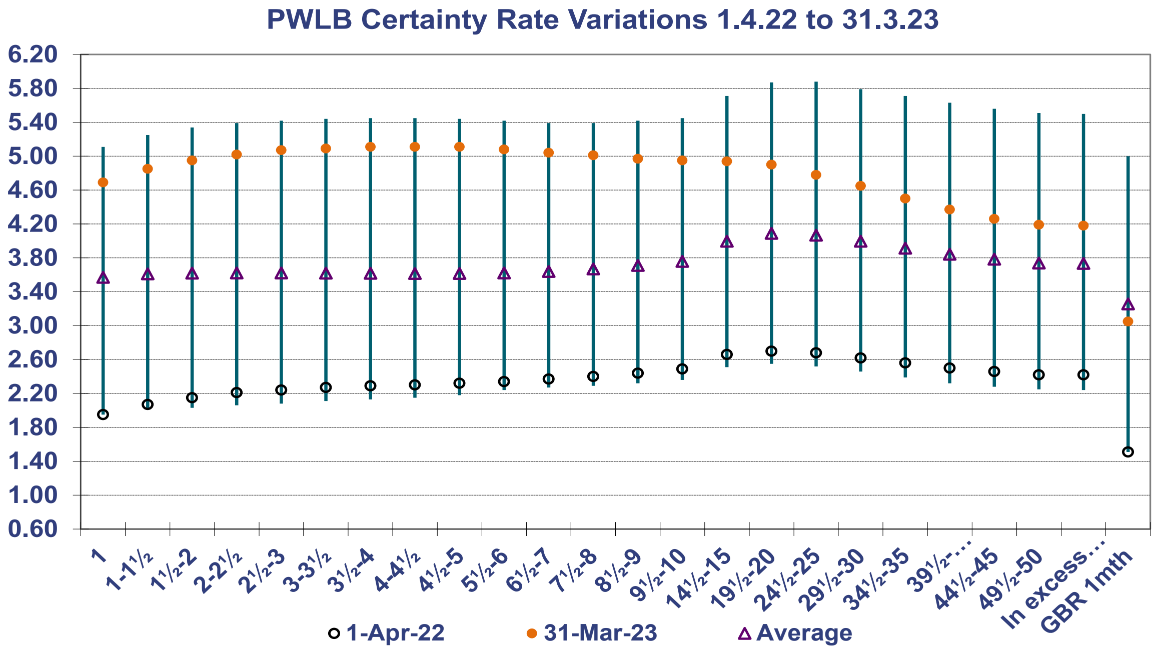
34 Interest rate forecasts were initially suggesting only gradual rises in short, medium and longer-term fixed borrowing rates during 2022/23 but by August it had become clear that inflation was moving up towards 40-year highs, and the Bank of England engaged in monetary policy tightening at every Monetary Policy Committee meeting during 2022, and into 2023, either by increasing Bank Rate by 0.25% or 0.5% each time. Currently the CPI measure of inflation is still above 10% in the UK but is expected to fall back towards 4% by year end. Nonetheless, there remain significant risks to that central forecast.

35 Forecasts at the time of the approval of the treasury management strategy report for 2022/23 were as follows

Link Group Interest Rate View 20.12.21														
	Dec-21	Mar-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
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.20	0.30	0.50	0.50	0.60	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.00	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.10	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.40	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00
10 yr PWLB	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30
25 yr PWLB	1.80	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.50	2.50
50 yr PWLB	1.50	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30

PWLB Rates 2022/23





High/Low Average PWLB Rates for 2022/23

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.95%	2.18%	2.36%	2.52%	2.25%
Date	01/04/2022	13/05/2022	04/04/2022	04/04/2022	04/04/2022
High	5.11%	5.44%	5.45%	5.88%	5.51%
Date	28/09/2022	28/09/2022	12/10/2022	12/10/2022	28/09/2022
Average	3.57%	3.62%	3.76%	4.07%	3.74%
Spread	3.16%	3.26%	3.09%	3.36%	3.26%

36 PWLB rates are based on gilt (UK Government bonds) yields through HM 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. Indeed, in recent years many bond yields up to 10 years in the Eurozone turned 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.

37 However, since early 2022, yields have risen dramatically in all the major developed economies, first as economies opened post-Covid; then because of the inflationary impact of the war in Ukraine in respect of the supply side of many goods. In particular, rising cost pressures emanating from shortages of energy and some food categories have been central to inflation rising rapidly. Furthermore, at present the FOMC, ECB and Bank of England are all being challenged by persistent inflation that is exacerbated by very tight labour markets and high wage increases relative to what central banks believe to be sustainable.

Borrowing Outturn

38 No new loans were taken out during the year. The loans outstanding are as follows.

Lender	Principal	Type	Interest Rate	Maturity
PWLB	£5.25m	Fixed interest rate - Annuity	2.66%	30 years to 3/11/2047
PWLB	£8m	Fixed interest rate - Annuity	1.70%	20 years to 25/11/2041

39 The Council has not borrowed more than, or in advance of its need, purely in order to profit from the investment of the extra sums borrowed.

40 There were no repayments or rescheduling of debt during 2022/23.

Investment outturn for 2022/23 and performance

41 The Council's investment policy is governed by Department for Levelling Up, Housing & Communities (DLUHC) guidance, which has been implemented in the annual investment strategy approved by the Council on 22 February 2022. 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).

42 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

43 Appendix C shows the performance of the fund during 2022/23 both in table and graphical form. The table shows the average percentage return on the fund, both monthly and for the whole year and compares them with the average 7-day and 3-month London Interbank Bid (LIBID) rates and the corresponding SONIA rates. The average return achieved by each broker is only a very basic measure of performance, because returns will depend on the number and length of each investment they are asked to carry out. If a particular broker is only asked to place short term investments, they may well not achieve the same overall rate as a broker who predominantly handles longer term investments for us.

44 The graph shows actual monthly receipts for 2020/21, 2021/22 and 2022/23 plus budgeted monthly receipts for 2022/23. The monthly interest budget has been profiled in line with the previous year's monthly weighted average principal.

45 Over the course of the year interest receipts amounted to £518,300 compared with a budget of £188,000, equating to a return of 2.63%. Balances available for investment continued to be reduced during the year owing to ongoing internal borrowing and the funding of the capital programme. However performance was positively affected by both rising interest rates and the investment in multi-asset income funds in the early part of 2022/23. These funds have the potential for greater revenue income, but also have the potential for capital loss as well as capital growth. For these reasons, they are viewed with a minimum 5 year investment horizon which, in theory, evens out capital loss and growth.

46 Our treasury management advisers recommend the SONIA figures as a benchmark. The 3-month rate reflects a more realistic neutral investment position for core investments with a medium term horizon and a rate which is more stable with less fluctuation caused by market liquidity. Historically (but not in 2021/22), this rate has been slightly higher than the 7-day rate and therefore more challenging a comparator, but one which does not necessitate a significantly increased level of risk. The figures calculated by our advisers for these benchmarks are as follows:

- 7-day SONIA compounded 2.1893%
- 90-day SONIA compounded 1.3804%

47 The Council operates to approved prudential indicators for treasury management as contained in the Treasury Management Strategy Statement (TMSS). The TMSS for 2022/23 was part of the annual treasury strategy reported to Council on 22 February 2022. The approved limits exist to regulate short-term borrowing for operational cash flow fluctuations, as well as long-term borrowing for financing capital investments. Additionally, the limits aim is to mitigate against fluctuations in interest rates.

Key Implications

Financial

The management of the Council's investment portfolio and cash-flow generated balances plays an important part in the financial planning of the authority. The security of its capital and liquidity of its investments is of paramount importance.

Legal Implications and Risk Assessment Statement.

Under Section 151 of the Local Government Act 1972, the Section 151 Officer has statutory duties in relation to the financial administration and stewardship of the authority, including securing effective arrangements for treasury management.

This annual review report fulfils the requirements of The Chartered Institute of Public Finance & Accountancy's Code of Practice on Treasury Management 2017.

Treasury management has two main risks:

- Fluctuations in interest rates can result in a reduction in income from investments; and
- A counterparty to which the Council has lent money fails to repay the loan at the required time.

Consideration of risk is integral in our approach to treasury management. However, this particular report has no specific risk implications as it is not proposing any new actions, but merely reporting performance over the last year.

Equality Assessment

The decisions recommended through this paper have a remote or low relevance to the substance of the Equality Act. There is no perceived impact on end users.

Net Zero Implications

The decisions recommended through this paper have a remote or low relevance to the council's ambition to be Net Zero by 2030. There is no perceived impact regarding either an increase or decrease in carbon emissions in the district, or supporting the resilience of the natural environment.

Conclusions

The overall return on the Council's investment was above budget in 2022/23 by more than £330,000 achieving an average interest rate of 2.63%.

Appendices

Appendix A – Investment Portfolio at the beginning and end of the year

Appendix B – Investment Maturity and repayment dates

Appendix C – Investment performance in 2022/23

Appendix D - Economic Background and interest rates

Background Papers

[Treasury Management Strategy for 2022/23 - Council 22 February 2022]

Adrian Rowbotham

Deputy Chief Executive and Chief Officer – Finance & Trading