

Blaby District Council

Cabinet Executive

Date of Meeting	10 July 2023
Title of Report	Treasury Management Outturn 2022/23 This is not a Key Decision and is on the Forward Plan
Lead Member	Cllr. Maggie Wright - Finance, People & Performance (Deputy Leader)
Report Author	Finance Group Manager
Corporate Priority	Medium Term Financial Strategy (MTFS)

1. What is this report about?

- 1.1 The report reviews the Council's treasury management activities undertaken during the 2022/23 financial year and gives details of the prudential and treasury indicators for the same period.

2. Recommendation(s) to Cabinet Executive and Council

- 2.1 That the treasury management activities for 2022/23 are approved.
- 2.2 That the prudential and treasury indicators for 2022/23 are approved.

3. Reason for Decisions Recommended

- 3.1 The regulatory framework governing treasury management activities includes a requirement that the Council should produce an annual review of treasury activities undertaken in the preceding financial year. It must also report the performance against the approved prudential indicators for the year.
- 3.2 This report fulfils the requirement above and incorporates the needs of the Prudential Code to ensure adequate monitoring of capital expenditure plans and the Council's prudential indicators. The treasury strategy and prudential indicators for 2022/23 were contained in the report approved by Council on 24th February 2022.

4. Matters to consider

4.1 Background

The Council is required to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2022/23 by

regulations issued under the Local Government Act 2003. This report meets the requirements of both the Chartered Institute of Public Finance Accountants' (CIPFA) Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

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

- an annual treasury strategy in advance of the year (Cabinet Executive 21st February 2022, Council 24th February 2022)
- a mid-year treasury update report (Cabinet Executive 7th November 2022, Council 22nd November 2022)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

The regulations place responsibility on Members for the review and scrutiny of treasury management policy and activities. This report is 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.

The Council has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Cabinet Executive and/or Scrutiny Commission before they were reported to the full Council. Member training on treasury management issues is undertaken on an ad hoc basis as required. It is proposed to arrange for refresher training during 2023/24.

4.2 Capital Expenditure and Financing

The Council undertakes capital expenditure on long-term assets which may either be:

- Financed immediately through the application of capital or revenue resources (e.g., capital receipts, grants, revenue contributions), which has no resultant impact on the Council's borrowing need; or
- Financed through borrowing if insufficient resources are available, or a decision is taken not to apply resources.

The actual capital expenditure forms one of the main prudential indicators. The following table summarises the capital expenditure and financing for the year. A more detailed analysis is provided at Appendix A.

	2021/22 Actual £	2022/23 Budget £	2022/23 Actual £
Capital Expenditure	2,146,862	7,781,175	2,331,693
Financed in year	1,702,743	(3,115,415)	(1,421,427)
Unfinanced Capital Expenditure	444,119	4,665,760	910,266

4.3 The Council's Overall Borrowing Need

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 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.

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 to meet the capital plans and cash flow requirements. This may be sourced through borrowing from 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.

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 Minimum Revenue Provision (MRP) to reduce the CFR. This is effectively a repayment of the borrowing need. This 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
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

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 24th February 2022. However, on 20th September 2022, Council approved a change to the MRP Policy which means that the charge to revenue will, from 1st April 2023, be based on a weighted average annuity-based calculation rather than on a straight-line basis.

The Council undertook no new borrowing during 2022/23. Although there was a borrowing need to fund the capital programme, there are still sufficient reserves and balances available to enable the Council to effectively borrow internally. Since borrowing rates continued to be considerably higher than investment rates during 2022/23 this has led to net revenue savings.

The table below highlights the gross borrowing position against the CFR. The CFR represents a key prudential indicator. It includes finance leases that appear on the balance sheet, and which increase the Council's borrowing need. However, no borrowing is required to cover finance leases as there is a borrowing facility included in the contract.

	31st March 2022 Actual £	31st March 2023 Budget £	31st March 2023 Actual £
Opening Balance	14,666,611	13,965,132	13,965,132
Add Unfinanced Capital Expenditure	444,119	4,758,467	910,266
Less MRP	(1,145,597)	(389,373)	(389,373)
Closing Balance	13,965,132	18,334,226	14,486,025

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

It is important to ensure that borrowing is prudent over the medium term and that it is only undertaken for capital purposes. Therefore, the Council needs to make sure that, except in the short term, its gross external borrowing does not exceed the total of the CFR in the preceding year (2022/23) plus the estimates of any additional CFR for the current year (2022/23) and next two financial years. Effectively this means that the Council is not borrowing to support revenue expenditure. This indicator also allows the Council some flexibility to borrow in advance of its immediate need where it is appropriate to do so. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31st March 2022 Actual £	31st March 2023 Budget £	31st March 2023 Actual £
CFR	13,965,132	18,334,226	14,486,025
Gross Borrowing	8,597,179	7,685,096	6,385,096
(Under)/Over Funding of CFR	(5,367,953)	(10,649,130)	(8,100,929)

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

The Operational Boundary – this is the expected borrowing position for the year. Periods where the actual position is either above or below the boundary are acceptable subject to the authorised limit not being breached.

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

	2022/23
Authorised limit	£23,000,000
Maximum gross borrowing position during the year	£8,597,179
Operational boundary	£20,700,000
Average gross borrowing position	£8,106,193
Financing costs as a proportion of net revenue stream	6.78%

4.4 The Treasury Position at 31st March 2023

The Council's treasury management debt and investment position is organised by the treasury management service 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 Practices. At the end of 2022/23 the Council's treasury position was as follows:

	Principal at 31st March 2022	Rate/ Return	Average Life	Principal at 31st March 2023	Rate/ Return	Average Life
PWLB Debt	£6,141,780	2.24%	17.1 years	£5,929,939	2.24%	16.1 years
Market Debt	£2,000,000	1.75%	0.8 years	0	n/a	n/a
Total debt	£8,141,780	2.12%	14.8 years	£5,929,939	2.24%	16.1 years
Capital Financing Requirement	£13,965,132			£14,486,025		
Over/(under) borrowing	(£5,823,352)			(£8,556,086)		
Short Term investments	(£35,560,000)	0.36%		(£25,456,000)	3.98%	
Long Term Investments	(£1,093,910)	3.46%		(£844,874)	4.84%	
Net debt	(£28,512,130)			(£34,856,960)		

Other long-term liabilities, such as finance leases, are excluded from the table above.

The interest rates in the table above are based on the loans and investments outstanding at the year end and are not necessarily the same as the average rate payable during the financial year.

The maturity structure of the debt portfolio was as follows:

	31st March 2022 £	31st March 2023 £
Less than one year	2,211,841	216,500
Between one and two years	216,500	855,837
Between two and five years	1,713,439	857,602
Between five and ten years	0	0
Over ten years	4,000,000	4,000,000
	8,141,780	5,929,939

Investment Portfolio	31st March 2022 £	31st March 2022 %	31st March 2023 £	31st March 2023 %
Banks	23,560,000	0.29%	17,373,000	3.95%
Local Authorities	0	0.00%	2,000,000	2.90%
Money Market Funds	12,000,000	0.49%	8,083,000	4.03%
Property Fund	1,093,910	3.46%	844,874	4.84%

The return on the Lothbury Property Fund comprises both rental income and interest income gross of fees.

4.5 The Strategy for 2022/23

Investments

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.

Starting in April 2022 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.

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.

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

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.

Nonetheless, whilst 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

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.

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.

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 the Council may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Strategic Director (Section 151) therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks:

- if it had been felt that there was a significant risk of a sharp **fall** in long and short-term rates, (e.g., due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.
- if it had been felt that there was a significant risk of a much sharper **rise** in long- and short-term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst

interest rates were lower than they were projected to be in the next few years.

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.

4.6 Borrowing Outturn

Due to investment concerns, both counterparty risk and comparatively low investment returns, no borrowing was undertaken during the year. As a result, gross borrowing has fallen from £8,141,780 to £5,929,939 on 31st March 2023. The movement is summarised in the following table:

	£
Balance at 1st April 2022	8,141,780
New borrowing in year	0
Loans repaid in year	(2,211,841)
Balance at 31st March 2023	5,929,939

The total interest payable in 2022/23, excluding finance leases, was £167,745 (£175,318 in 2021/22), and the average interest rate payable was 2.14% (2.12% in 2021/22). The slight increase in the interest rate payable is reflective of a non-PWLB loan with a rate of 1.76% being repaid in January 2023.

Borrowing in advance of need:

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

Rescheduling:

No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

4.7 Investment Outturn

The Council's investment policy is governed by guidance issued by the Department for Levelling Up, Housing and Communities (DLUHC), which has been implemented in the annual investment strategy approved by the Council on 24th 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.).

The investment activity during the year conformed to the approved strategy with one exception, that being that the £8m counterparty limit in respect of deposits in HSBC Call Account was exceeded on one occasion during January 2023. The Council experienced no liquidity difficulties during the financial year.

Interest on in house investments amounted to just £778,213 (£56,018 in 2021/22), significantly above even the revised budget, due to continuing rate rises and cash flow balances remaining high. The average rate of return for 2022/23 was 3.98% well in excess of the average of 0.36% achieved in 2021/22.

In addition to this the Council achieved a return of £40,892 interest and rental income on its property fund investment during 2022/23, equivalent to 4.84% for the year (3.46% in 2021/22). The statutory override in place until 31st March 2023, which prevents fluctuations in the fund value from having to be charged to the General Fund, has been extended for a further two years. The Council has set up an earmarked reserve as a mitigation against changes in fund value that may occur after the statutory override is removed.

After a strong recovery post-pandemic, the fund value has again been hit by the fall in property values experienced in the second half of 2022/23. By 31st March 2023, the fund value had consequently fallen to £0.845m, a reduction of £0.249m from the previous year, and considerably lower than the original £1m invested in the fund.

In recent weeks, the Council has been notified by Lothbury that it is suspending the fund, following receipt of a large number of redemption requests. The exact reason for this is unknown but other funds are experiencing a similar situation. One possibility is that pension funds are looking to get out of the property market and into more liquid funds. The waiting list for redemptions has now reached approximately 70% of the value of the fund, and the Council has been advised to submit a redemption request of its own. This is to ensure that the Council is in an equivalent position to other organisations seeking a redemption, and not left in an even worse position if all of those organisations do pull out their money. Lothbury is expected to propose a new funding strategy and it remains to be seen whether this will be enough to encourage investors to remain in the fund.

5. What will it cost and are there opportunities for savings?

5.1 Not applicable.

6. What are the risks and how can they be reduced?

6.1

Current Risk	Actions to reduce the risks
That external borrowing might not be undertaken at the most advantageous rate	Treasury officers maintain regular contact with the Council's advisors, Link Treasury Services, who monitor movements in interest rates on our behalf. The aim is always to drawdown loans when interest rates are at their lowest point.
Credit risk – the risk that other parties might fail to pay amounts due, e.g., deposits with banks etc	The Annual Investment Strategy sets the criteria through which the Council decides with whom it may invest. The lending list is updated regularly to reflect changes in credit ratings.
Liquidity risk – the Council might not have sufficient funds to meet its commitments	Daily monitoring of cash flow balances. Access to the money markets to cover any short-term cash shortfall.
Refinancing and maturity risk – the risk that the Council might need to renew a loan or investment at disadvantageous interest rates	Monitoring of the maturity profile of debt to make sure that loans do not all mature in the same period. Monitoring the maturity profile of investments to ensure there is sufficient liquidity to meet day to day cashflow needs.
That the Lothbury Property Fund might collapse	The Council has submitted a redemption request with the intention of protecting its current position as far as possible. At this point in time, it is not certain what the future holds for the fund, but Lothbury are looking at alternative funding strategies. An earmarked reserve is in place to mitigate any potential fluctuations in the fund value, although it does not cover the full value of the initial investment.

7. Other options considered

7.1 None. It is a legislative requirement that the Council receives an annual report covering its treasury activities for the financial year.

8. Environmental impact

8.1 No environmental impact directly arising from this report.

9. Other significant issues

- 9.1 In preparing this report, the author has considered issues related to Human Rights, Legal Matters, Human Resources, Equalities, Public Health Inequalities, and Climate Local and there are no areas of concern.

10. Appendix

- 10.1 Appendix A – Prudential and Treasury Indicators

11. Background paper(s)

- 11.1 None.

12. Report author's contact details

Nick Brown	Finance Group Manager
Nick.Brown@blaby.gov.uk	0116 272 7625