Agenda Item No:	9	Fenland CAMBRIDGESHIRE
Committee:	COUNCIL	
Date:	17 July 2023	
Report Title:	Treasury Management Annual Review 2022/23	

Cover sheet:

1 Purpose / Summary

The purpose of this report is to consider the overall financial and operational performance of the Council's treasury management activity for 2022/23.

2 Key issues

- Outstanding loans and finance lease liabilities of £7.823m and investments of £22.550m as of 31 March 2023.
- No new borrowing was undertaken, and the authorised limit was not breached during 2022/23.
- The investment activity during the year conformed to the approved strategy and the Council had no liquidity difficulties.
- Total investment income received from temporary investments and pooled property fund distributions was £593,700 (estimate £570,000) and £128,665 (estimate £125,0000) respectively.
- Overall interest rate achieved from temporary investments and pooled property funds was 1.86% and 3.33% respectively. The benchmark for temporary investments is the 7 day backward looking Sterling Overnight Index Averages (SONIA) uncompounded rate for 2022/23, 2.23%. The average rate of return, while increasing, has remained lower than SONIA due to the liquid nature of the cash holdings.
- Property funds are viewed as long term investments where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income. Property prices fell sharply in response to high inflation, rising interest rates and increased debt costs which accounts for the fall in value in the pooled property funds to £3.45m at 31.3.2023 (initial investment £4m). Income flows to property have remained strong and distributions from the fund are not affected by the movement in capital value.

3 Recommendations

- It is recommended that members note the report.

Wards Affected	All
Portfolio Holder(s)	Cllr Chris Boden, Leader & Portfolio Holder, Finance
Report Originator(s)	Peter Catchpole, Corporate Director and Chief Finance Officer Mark Saunders, Chief Accountant
Contact Officer(s)	Peter Catchpole, Corporate Director and Chief Finance Officer Mark Saunders, Chief Accountant
Background Paper(s)	Treasury Management and Annual Investment Strategy 2022/23

Report:

1 Introduction

1.1 The Council is required through 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 Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

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

- an annual Treasury Strategy in advance of the year (Council 24/02/2022);
- a mid-year treasury update report (Council 12/12/2022);
- an Annual Review following the end of the year, describing the activity compared to the strategy (this report).

1.3 The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. This report provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

1.4 In normal circumstances, the treasury management reports would be reviewed by Audit and Risk Management Committee before they are reported to Council. This Annual Review report is being presented directly to Council due to the Audit and Risk Management Committee not meeting until 24 July 2023. For all of the other above treasury management reports prior scrutiny by the Audit and Risk Management Committee has taken place as required by the Code.

2 The Council's Capital Expenditure and Financing

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

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

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

	2021/22 Actual £000	**2022/23 Revised Estimate £000**	**2022/23 Actual £000**
Capital expenditure	**11,583**	**11,136**	**9,487**
Financed In Year	9,938	8,885	8,485
Unfinanced capital expenditure	**1,645**	**2,251**	**1,002**

3 The Council's Overall Borrowing Need

3.1 The Council's underlying need to borrow to finance 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.

3.2 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service 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.

3.3 **Reducing the CFR** – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the 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).

3.4 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 24/02/2022.

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

3.6 **Gross borrowing and the CFR** - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2022/23) plus the estimates of any additional capital financing requirement for the current (2023/24) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure.

3.7 In February 2020 Council allocated £25m in the capital programme to enable the Council to take forward projects linked to its Commercial and Investment Strategy (CIS). At the 31.3.2023 £4.023m has been spent on two acquisitions approved by the Investment Board in accordance with the CIS. This impacts on the Capital Financing Requirement as explained in the table below. Currently both acquisitions have been funded from internal borrowing, i.e. no specific external borrowing to fund the investments has been undertaken, but the Council retains the flexibility to externalise the associated borrowing if it is deemed appropriate to do so.

3.8 The table below highlights the Council's gross borrowing position against the CFR (See Appendix A).

	31 March 2022 Actual £000	**31 March 2023 Revised Estimate £000**	**31 March 2023 Actual £000**
CFR opening balance	6,177	7,456	7,456
Capital expenditure – Capital Programme	1,320	1,551	1,002
Capital expenditure – Commercial and Investment Strategy	325	700	0
Less Minimum Revenue Provision	(366)	(377)	(406)
CFR Closing balance	**7,456**	**9,330**	**8,052**
of which: Capital Programme	3,442	4,626	4,048
Commercial and Investment Strategy	4,014	4,704	4,004
Gross Debt (see table at 4.1 below)	**7,906**	**8,523**	**7,823**

3.9 The CFR includes a finance lease. A finance lease is a commercial arrangement between the Council and a lessor (finance company), where in consideration for a series of payments the Council has the right to use an asset (e.g. refuse vehicle) for the lease duration (typically 7 years). The annual lease payment is made up of a capital and interest repayment.

3.10 Although legally the Council doesn't own the asset during the lease duration, International Accounting Standards require that the Council capitalise the asset and liability on its balance sheet, much like a loan. Whilst this increases the CFR, the nature of the finance lease agreement doesn't require the Council to separately borrow to fund the asset.

3.11 The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level.

3.12 The operational boundary – 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.

3.13 Neither the authorised limit nor operational boundary were breached during 2022/23.

4 Overall Treasury Position as at 31 March 2023

4.1 At the beginning and end of 2022/23, the Council's treasury position was as follows.

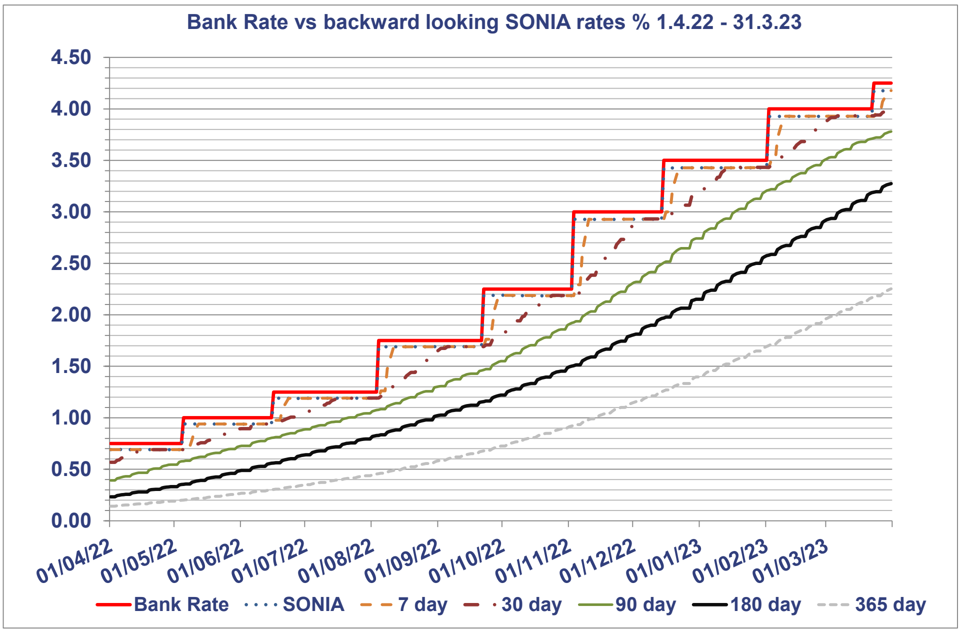
	31 March 2023 Principal £000	Rate / Return	Average Life years	**31 March 2022 Principal £000**	Rate / Return	Average Life years
Fixed rate funding						
• PWLB	**4,500**	7.29%	7.40 yrs	**4,500**	7.29%	8.40 yrs
• Market	**3,300**	4.70%	30.96 yrs	**3,300**	4.70%	31.96 yrs
• Finance Leases	**23**	3.21%	350 Days	**106**	3.59%	1.14 yrs
Total debt	**7,823**			**7,906**		
Investments						
• Banks/Building Societies	**(19,100)**	1.86%		**(31,850)**	0.13%	
• Property Funds	**(3,450)**	3.33%		**(4,066)**	N/A	
Total Investments	**(22,550)**			**(35,916)**		
Net debt /(Investments)	**(14,727)**			**(28,010)**		

4.2 In line with the Treasury Management Strategy and Annual Investment Strategy approved by Council on 23 February 2021, the Council invested £4M, split equally, into the Federated Hermes and Patrizia Hanover, Property Unit Trusts, in late March 2022. The distribution payable for the year was £128,664.61, which is a 3.33% return on the initial £4m investment.

4.3 All other investments held at 31 March 2023 are fixed term or callable deposits due for repayment within the next twelve months.

5 The Strategy for 2022/23

Investment Benchmarking Data – Sterling Overnight Index Averages (Backward-looking) 2022/23



Investment Strategy

5.1 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 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.

5.2 The Council has mainly invested cash in liquid or in short term notice deposits over the year due to the liquid nature of the cash holdings.

5.3 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.

5.4 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 financial crisis of 2008/09. 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

5.5 At 1 April 2022 the Council's Debt position comprised other long-term liabilities relating to finance leases of £106k and external borrowing of £7.8m. These loans were taken out at prevailing market rates between 1994 and 2004. The term of these loans is between 25 and 50 years. Following the transfer of the Council's Housing Stock in 2007, which generated a significant capital receipt for the Council, the Council has retained investment balances which exceed the amounts borrowed. However, changes in prevailing interest rates since the loans were taken out mean that a high premium would be payable by the Council if it were to seek to repay any of the loans early. The premiums to be applied are considered to be prohibitively high for early redemption to be regarded as a reasonable treasury management decision. The Council continues to keep this situation under review with the support of its appointed treasury management advisors.

5.6 Therefore, as opposed to taking on additional loan debt to fund capital expenditure in 2022/23, the Council followed a strategy of using cash, supporting the Council's reserves, balances and cash flow as an interim measure. The strategy was prudent as investment returns were low and to reduce counterparty risk on placing investments.

5.7 The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was 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.

5.8 Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Chief Finance Officer 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.

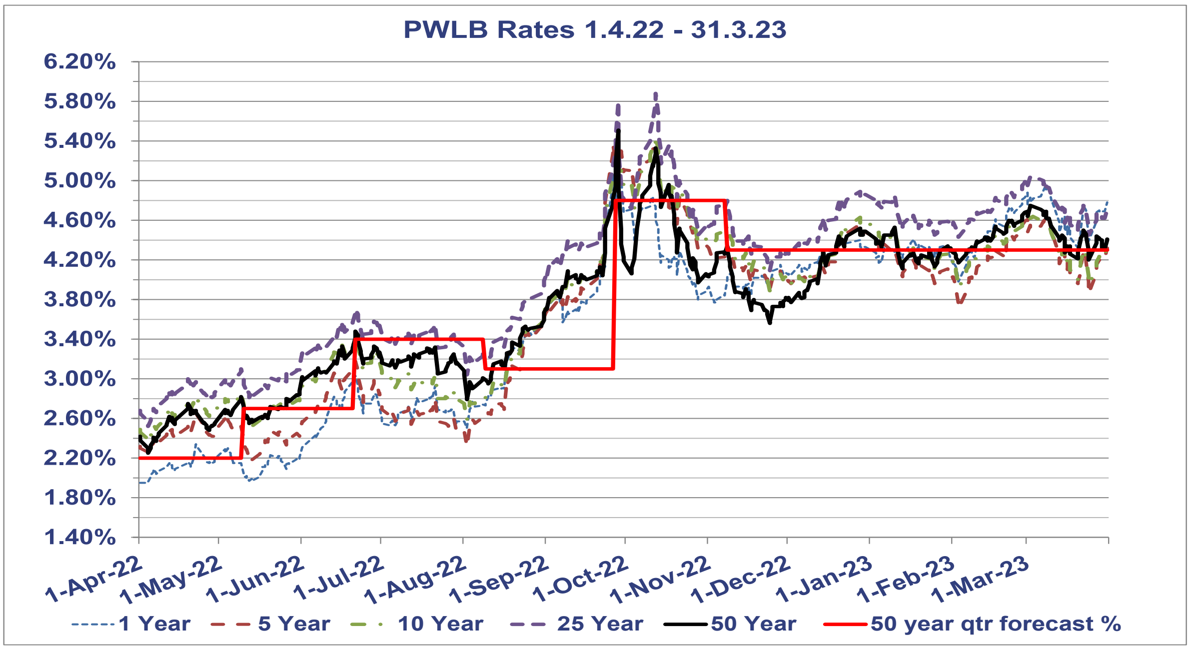
- if it had been felt that there was a significant risk of a much sharper RISE in long and short-term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden 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.

5.9 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 8.7% in the UK but is expected to fall further during 2023.

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

Link Group Interest Rate View 7.2.22	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	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
3 month av. earnings	0.80	1.00	1.00	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20
6 month av. earnings	1.00	1.10	1.20	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30
12 month av. earnings	1.40	1.50	1.60	1.70	1.70	1.60	1.60	1.50	1.40	1.40	1.40	1.40	1.40
5 yr PWLB	2.20	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30
10 yr PWLB	2.30	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40
25 yr PWLB	2.40	2.50	2.50	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60
50 yr PWLB	2.20	2.30	2.30	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40

PWLB Rates 2022/23



5.11 PWLB rates are based on gilt (UK Government bonds) yields through H.M.Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields.

5.12 Gilt yields have been on a continual rise since the start of 2021, peaking in the autumn of 2022.

5.13 At the close of the day on 31 March 2023, all gilt yields from 1 to 50 years were between 3.64% and 4.18%, with the 1 year being the highest and 6-7.5 years being the lowest yield.

5.14 There is likely to be a fall in gilt yields and PWLB rates across the whole curve over the next one to two years as Bank Rate first rises to dampen inflationary pressures and a tight labour market, and is then cut as the economy slows, unemployment rises, and inflation (on the Consumer Price Index measure) moves closer to the Bank of England's 2% target.

6 Borrowing Outturn

6.1 No long term or temporary borrowing was taken during 2022/23. The approach during the year was to use cash balances to finance new capital expenditure, so as to run down cash balances that were earning comparatively low investment returns and to minimise counterparty risk incurred on investments. Additionally, it is important to note that Council had abnormally high cash balances due to the receipt of significant funds from government in respect of schemes to both support eligible residents through the energy crisis and funding received in advance to enable the Council to deliver grant-funded schemes included in its capital programme.

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

6.3 No rescheduling was completed during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates and the penalty position which can arise from early repayment of debt, made rescheduling unviable.

7 Investment Outturn

7.1 The Council's investment policy is governed by the Department for Levelling Up, Housing and Communities investment guidance, which has been implemented in the annual investment strategy approved by Council on 24 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 and bank share prices etc).

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

7.3 The Council maintained an average balance of £27.517m of internally managed funds. The internally managed funds earned an average rate of return of 1.86% (£593,700). The comparable performance indicator is the average 7-day backward looking SONIA rate, which was 2.23%.The Council has mainly invested cash in liquid or in short term notice deposits over the year and so as the Bank of England has increased interest rates from 0.75 to 4.25 during 2022/23 the Councils average rate of return, while increasing, has remained lower than SONIA due to the liquid nature of the cash holdings.

7.4 £4m of the Council's investments are held in externally managed pooled property funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income (from quarterly cash distribution payments) and long-term price stability. The Council views these as a long-term investment that it has entered into for a minimum of five years as this manages the risk of fluctuations in the value of the investment which was £3.450m at 31 March 2023. The second half of 2022 was a difficult time for the commercial property market in general as property prices fell sharply in response to, high inflation, rising interest rates and increased debt costs which accounts for the fall in value. Income flows to property have remained strong and distributions from the fund are not affected by the movement in capital value. The distributions payable for the year was £128,665 which is a 3.33% distribution return on the initial £4m investment.

8 Prudential and Treasury Indicators

8.1 During 2022/23 the Council complied with its legislative and regulatory requirements. The Prudential Indicator - Actual Ratio of Financing Costs to Net Revenue Stream (5.90%) marginally exceeded the revised estimate (5.65%) due to higher MRP charges.

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Appendix A - Prudential Indicators

	Prudential Indicators	2021/22 Actual £000	2022/23 Revised Estimate £000	**2022/23 Actual £000**
1	**Capital Expenditure (including Commercial and Investment Strategy)**	11,583	11,136	**9,487**
2	**Ratio of Financing Costs to Net Revenue Stream**	8.13%	5.65%	**5.90%**
3	**Gross Borrowing and the Capital Financing Requirement**			
	Gross Debt	7,906	8,523	**7,823**
	CFR	7,456	9,330	**8,052**

	Treasury Management Indicators	2021/22 Actual £000	2022/23 Revised Estimate £000	**2022/23 Actual £000**
4	**Authorised Limit for External Debt**			
	Borrowing	17,000	19,500	**19,500**
	Other Long-Term Liabilities	1,000	1,000	**1,000**
	Commercial Activities	21,302	20,977	**20,977**
	Total	39,302	41,477	**41,477**
5	**Operational Boundary for External debt**			
	Borrowing	12,000	15,500	**15,500**
	Other Long-Term Liabilities	1,000	1,000	**1,000**
	Commercial Activities	21,302	20,977	**20,977**
	Total	34,302	37,477	**37,477**
6	**Actual External debt (as at 31 March)**			
	Borrowing	7,800	8,500	**7,800**
	Other Long-Term Liabilities	106	23	**23**
	Total	7,906	8,523	**7,823**