To:	**Cabinet**
Date:	**14 September 2022**
Report of:	**Head of Financial Services**
Title of Report:	**Treasury Management Annual Report 2021/22**

Summary and Recommendations	
Purpose of report:	The report sets out the Council's Treasury Management activity and performance for the financial year 2021/22
Key decision:	No
Cabinet Member:	Councillor Ed Turner, Deputy Leader (Statutory) – Finance and Asset Management
Corporate Priority:	All
Policy Framework:	Treasury Management Strategy
Recommendation: That Cabinet resolves to:	
1. **Note** the report.	

Appendices
None.

Executive Summary

1. This is a "backward looking" report covering Treasury Management activity over the 2021-22 financial year. The Council held investments of £112,053 million, including property and multi-asset funds and money market funds as at 31st March 2022. Net General Fund interest earned during the year, including from loans to companies and external borrowing costs, was £4.82 million against a target of £4.73 million, a favourable variance of £0.09million. This relates to two factors:

   - Higher returns of £0.22 million from investment interest than anticipated primarily due to higher investment levels arising from a reduction in internal borrowing associated with capital programme slippage;
   - Interest from companies was lower than anticipated due to lower than anticipated as lending by the council to the housing company was not as high as forecast however this was offset as the Councils borrowing requirement from PWLB was reduced due to the lower capital spend.

2. The average rate of return on the Council's investments in 2021/22 was 0.32% compared to 0.82% in 2020/21. The Bank of England base rate remained at

0.10% until 16th December 2021 when it increased by 0.15% to 0.25% it then increased again on 3rd February 2022 by 0.25% and then again on 17th March 2022 by 0.25% with the base rate finishing on 0.75% for the year ending 2021/22.

3. The Council held £198.5 million of fixed rate Public Works Loan Board (PWLB) debt as at 31st March 2022. The debt was borrowed in March 2012 to fund the self-financing of the Housing Revenue Account (HRA). All of the debt relates to housing and the maturity profile ranges from 5 to 50 years. Interest paid on the debt in 2021/22 and charged to the HRA was £6.40 million.

Background

4. The primary principle governing the Council's investment decisions is the security of the investment, with liquidity and yield being secondary considerations.

5. The Council has a statutory duty to set, monitor and report on its prudential indicators in accordance with the Prudential Code, which aims to ensure that the capital investment plans of local authorities are affordable, prudent and sustainable.

6. When considering whether to borrow, the Council's Debt Strategy requires a number of factors to be considered. These include:

- prevailing interest rates;
- the profile of the Council's debt portfolio;
- the type of asset being financed; and
- the availability of cash balances to finance capital expenditure.

7. The Council fully complied with its Treasury Management Strategy in relation to both debt and investment management in 2021/22.

8. The prudential indicators detailed in the body of this report compare the Council's outturn position against the target set for 2021/22.

Financing the Capital Programme 2021/22

9. Table 1 below shows actual capital expenditure and financing compared to the original budget.

Table 1 Capital Expenditure and Financing 2021-22			
Capital Expenditure	**2021/22 Original Budget £'000**	**2021/22 Actual £'000**	**Variation £'000**
Non-HRA Capital Expenditure	97,031	33,865	-63,166
HRA Capital Expenditure	79,728	44,154	-35,574
Total Capital Expenditure	**176,759**	**78,019**	**-98,740**
Resourced by:			
Developer Contributions	5,987	0	-5,987
Capital Receipts	6,463	11,619	5,157
Capital Grants and contributions	21,340	22,938	1,598
Major Repairs Reserve	9,136	8,201	-935
Prudential Borrowing	116,720	6,463	-110,257
Revenue	17,114	28,798	11,684
Total Capital Resources	**176,759**	**78,019**	**-98,740**

10. Much of the variation to the original budget relates to slippage in the programme, the resources for which will be moved into funding the expenditure in future financial years.

The Council's Overall Borrowing Need

11. The Council's underlying need to borrow, or Capital Financing Requirement (CFR), is the measurement and control of the Council's overall debt position. It represents all prior years' net capital expenditure which has not been financed by other means, i.e. revenue, capital receipts, grants etc.

12. The CFR can be reduced by:

- The application of additional capital resources, such as unapplied capital receipts; or

- Charging a Minimum Revenue Provision (MRP), or a Voluntary Revenue Provision (VRP).

13. Table 2 below shows the Council's CFR as at the 31st March 2022, this is a key prudential indicator, and shows that actual borrowing is below the CFR:

Table 2 Capital Financing Requirement (CFR) 2020-21 and 2021-22			
CFR	**31st March 2022 Estimate £'000**	**31st March 2022 Actual £'000**	**Variation £'000**
Opening Balance	**403,525**	**289,497**	**-114,028**
Prudential Borrowing	116,720	6,463	**-110,257**
Minimum Revenue Provision	-165	-37	**128**
Capital Debtor Repayment	0	-616	**-616**
CFR Closing Balance	**520,080**	**295,307**	**-224,773**
External Borrowing	**198,528**	**198,528**	**0**
Internal Borrowing	**321,552**	**96,779**	**-224,773**

14. No new external debt was taken out during 2021/22 and as at 31st March 2022 the Council's total external debt was £198.5 million. This is below the CFR and indicates that the Council continues to internally borrow from its cash balances which is the cheapest form of borrowing.

Treasury Position at 31st March 2022

15. Whilst the Council's gauge of its underlying need to borrow is the CFR, the treasury function manages the Council's actual need to borrow by either:

- Borrowing to the CFR;
- Choosing to utilise temporary cash flow funds, instead of borrowing (known as "under borrowing"); or
- Borrowing for future increases in the CFR (borrowing in advance of need).

16. The Council's treasury position as at the 31st March 2022 for both debt and investments, compared with the previous year is set out in Table 3 below:

Table 3 : Borrowing and Investments 2020-2021 and 2021 and 2022				
	31st March 2021		31st March 2022	
Treasury Position	Principal £'000	Average Rate %	Principal £'000	Average Rate %
Borrowing				
Fixed Interest Rate Debt	198,528	3.15	198,528	3.15
Total Debt	**198,528**	**3.15**	**198,528**	**3.15**
Investments				
Fixed Interest Investments	48,000	0.48	65,500	0.19
Call Accounts	7,500	0.90	0	0.00
Variable Interest Investments	8,940	0.01	26,553	0.01
Investment Funds	15,000	3.54	20,000	3.58
Total Investments	**79,440**	**0.82**	**112,053**	**0.32**
Net Position	**119,088**		**86,475**	

17. Overall, the Council earned a weighted average return of 0.32% on its investment which is above the target of 0.2% above average base rate, which equated to 0.12% as at 31st March 2022.

Prudential Indicators and Compliance Issues

18. Some of the prudential indicators provide an overview, others a specific limit on treasury activity. These are detailed below:

19. ***Net Borrowing and the CFR*** – In order to ensure that borrowing levels are prudent, the Council's external borrowing (net of investments) over the medium-term must only be for a capital purpose, and not exceed the CFR except in the short-term. In the short term the Council can borrow for cash flow purposes. Table 4 below highlights the Council's net borrowing position against the CFR, and shows that it is significantly below the limit, due to the level of internal borrowing that has been undertaken.

Table 4 : Net Borrowing CFR 2020-21 and 2021-22		
Net Borrowing & CFR	**31st March 2021 Actual £'000**	**31st March 2022 Actual £'000**
Total Debt	198,528	198,528
Total Investment	79,440	112,053
Net Borrowing Position	**119,088**	**86,475**
CFR	**289,497**	**295,307**
Under Borrowing plus Investments	**170,409**	**208,832**

20. In the current climate, internal borrowing is preferable to borrowing externally as the interest rate payable on an external loan is much higher than that which can be earnt on investments. Therefore, forfeiting interest receivable on investments is more economical than paying additional interest charges for new external debt. If the net borrowing position, interest rate position and/or CFR changed significantly, the prospect of taking on additional debt would be reviewed.

21. ***The Authorised Limit*** – The Authorised Limit is the 'affordable borrowing limit' required by section 3 of the Local Government Act 2003. The Council does not have the power to borrow above this level unless it explicitly agrees to do so. Table 5 below demonstrates that during 2021/22 the Council's gross borrowing was within its Authorised Limit. The Authorised Limit allows for some headroom above the Council's projected CFR.

Table 5 : Authorised Lending Limits 2020-21 and 2021-22				
Authorised Limit compared to Actual Borrowing	**31st March 2021**		**31st March 2022**	
	Limit £'000	**Actual £'000**	**Limit £'000**	**Actual £'000**
Borrowing	532,111	198,528	662,122	198,528
Other Long Term Liabilities	0	0	0	0
Total Borrowed	**532,111**	**198,528**	**662,122**	**198,528**
Amount under Limit	**333,583**		**463,594**	

22. ***The Operational Boundary Limit*** – the Operational Boundary Limit is the expected borrowing position of the Council during the year. It is possible to exceed the Operational Boundary Limit, for a short period of time, providing that the Authorised Borrowing Limit is not breached. Table 6 below shows the limits for the last two financial years. Actual borrowing remained unchanged at £198.5m hence the limits were not breached during either period.

Table 6 : Operational Boundary Limits 2020-21 and 2021-22		
Operational Boundaries	**31st March 2021 £'000**	**31st March 2022 £'000**
Operational Borrowing Limit	353,523	423,525
Other Long Term Liabilities	0	0
Totals	**353,523**	**423,525**

23. ***Actual financing costs as a proportion of net revenue stream*** – this indicator identifies the trend in the net cost of capital against the net revenue stream and is an indicator of affordability. Table 7 below shows that for the General Fund, the ratio is negative as external loans have been repaid and investment income is positive. The HRA ratio has improved slightly after last year's reducing income stream, meaning that financing costs as a proportion have also fallen.

Table 7 : Financing Cost 2019-20 and 2020-21		
Actual Finance Costs	**2020/21 £'000**	**2021/22 £'000**
Revenue Stream		
General Fund	29,412	26,080
Housing Revenue Account	45,458	45,605
Comparison to Actual Revenue Position		
Financing Costs as a proportion of Net Revenue Stream - General Fund	-7.02%	-8.04%
Financing Costs as a proportion of Net Revenue Stream - HRA	16.35%	16.49%

Note that the General Fund Revenue Stream above has been adjusted to remove the additional £23.6 million section 31 grants paid in advance of in 2021/22 by the government.

Investment Income

24. The Council manages its investments in-house and invests with institutions listed in the Council's approved counterparty list. The Council invests for a range of periods from overnight to 364 days, dependant on cash flow requirements, its view on interest rates and duration limits set out in the Council's Investment Strategy.

25. During 2021/22, the Council maintained an average investment balance of £102 million and received an average return of 0.82%. The upper limit of non-specified investments allowed in the strategy is 30% of the average investment balance for the preceding calendar year or £30 million, whichever is the higher. The average balance for 2021-22 was £101 million giving a limit on non-specified investments of £30 million. Property funds and the Multi Asset Funds fell into the non-

specified investment category; their original investment value was £20 million which is within the non-specified limit.

26. The property funds and the Multi asset Fund are classified as Non-specified Investments within the approved Investment Strategy. The current rate of return on the investments is circa 4.4% per annum. The capital value of the Communities, Churches and Local Authorities (CCLA) Fund has increased by 46.5% between April 2013 and March 2022. The overall value of the Lothbury property fund investment has increased by 32.13% since inception in August 2014. Artemis Multi asset funds capital value increased by 6.81%. Fidelity multi asset fund decreased in value by 5.12%. It is important to understand that fluctuations in value are to be expected with property and multi asset fund investments over the short term and that they are a long term investment; as such, any gains and losses in fund value should be considered over the long term.

27. Actual investment income for 2021/22 was £1.01 million; £0.22 million higher than the budgeted estimate of £0.79 million. The difference is primarily due to investment balances and lower internal borrowing than anticipated.

28. Fluctuations in the Council's balances have been managed through a mix of instant access and notice accounts, money market funds and short term deposits (up to 364 days). This approach is in line with the Investment Strategy approved by the Council.

Interest Rates since 31st March 2022

29. The Council takes advice from Link Asset Services on the appropriate durations to place investments with counterparties. These durations and also the availability of individual counterparties are subject to change dependant on market conditions and the credit ratings of the individual institutions. This means that the investment portfolio has to be actively managed to ensure both the availability of enough suitable counterparties and that the Council achieves the best interest rates possible within the agreed security and liquidity parameters.

30. Over the last two years, the coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16th December 2021, 0.50% at its meeting of 4th February 2022, 0.75% in March 2022, 1.00% in May 2022, 1.25% in June 2022 and then 1.75% in August 2022. Although the Interest rates are more favourable for investments it takes time for existing investments to mature in order to take advantage of the enhanced rates.

Environmental Social and Governance

31. The Council adopted an ethical investment policy in 2015/16. No changes were made to the policy in setting the 2020/21 Treasury Management Strategy which is set out below:

The Council will not knowingly invest directly in businesses whose activities and practices pose a risk of serious harm to individuals or groups, or whose activities are inconsistent with the Council's mission and values. This would include, inter alia, avoiding direct investment in institutions with material links to:

a. Human rights abuse (e.g. child labour, political oppression)
b. Environmentally harmful activities (e.g. pollutants, destruction of habitat, fossil fuels)
c. Socially harmful activities (e.g. tobacco, gambling).

32. There is a more detailed Environmental Social and Governance policy within the 2022/23 Treasury Strategy and this will continue to be developed over time. Environmental, social, and governance (ESG) criteria are a set of standards for a company's operations that socially conscious investors use to inform potential investments. Environmental criteria consider how a company performs as a steward of nature. Social criteria examine how it manages relationships with employees, suppliers, customers, and the communities where it operates. Governance deals with a company's leadership, executive pay, audits, internal controls, and shareholder rights. Support for how this could be implemented when considering the placing treasury investments alongside the normal Security Liquidity Yield principles is being looked at by the Councils Treasury advisors Link.

Minimum Revenue Provision (MRP)

33. Following a consultation by the Department for Levelling Up, Housing and Communities on proposed changes to regulations, aimed at strengthening compliance with the duty to make Minimum Revenue Provision (MRP) which ran for 10 weeks from 30 November 2021 until 8 February 2022, the government were made aware of concerns raised by a number of authorities that the changes may have unintended consequences where authorities have made capital loans. The Council were foremost on lobbying the Local Government Association (LGA) and also the Department for Levelling Up Housing and Communities on these issues.

The Government's stated intent for the changes was to make sure that prudent MRP is made each year, as well as prevent practices that result in under-provision of MRP, the government has also been clear that it does not want to stymie sensible investment or cause undue financial pressures. A post consultation proposal has been launched by the Government with responses required between 27th June 2022 and 8th July 2022. The intent of this survey is to test these proposals with the sector and stakeholders to make sure that they address the specific concerns raised but do not create additional risk to either the government's objectives or to the sector. This is particularly important given the technical nature of the changes. The evidence gathered in this exercise will inform the government's final response.

The Council's response in the post consultation is that as the proposals currently stand, they allow the payment of a loan or lease to substitute for MRP and also only require an MRP if there is an impairment or expected impairment of the asset. This is as per our current treatment in accordance with the council's current MRP policy. This avoids the double counting of MRP and capital receipt. The exception to this is commercial loans which is in line with the government agenda and it was expected that these would still be subject to an annual MRP because of that.

Financial implications

34. These are set out within the body of the report.

Legal Issues

35. The Council is required by regulations issued under the Local Government Act 2003 including The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 SI 2003 No 3146 and subsequent amendments' to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2021/22. 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).

Level of risk

36. The key risk going forward is around uncertainty caused by the aftermath of the Covid19 pandemic and the national and global markets, both geo-political and economic. Risk assessment and management is a key part of Treasury Management activity, especially in the selection of counterparties when investment is being considered. The Council uses external advisors and counterparty credit ratings issued by the rating agencies to assist in this process.

Equalities impact

37. The Council follows an ethical investment policy, and investment interest helps provide council services, which has a beneficial equalities impact.

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Background Papers: None