Report to Audit and Governance Committee

Date:	28th July 2022
Title:	**Treasury Management Annual Report 2021/22**
Relevant councillors:	John Chilver, Cabinet Member for Accessible Housing and Resources and Cllr Timothy Butcher, Deputy Cabinet Member for Accessible Housing and Resources
Contact officer:	Julie Edwards, Pensions & Investments Manager
Ward(s) affected:	None specific
Recommendations:	**The Audit and Governance Committee is asked to note the Treasury Management Annual Report for 2021/22.**

1. Executive summary

1.1 The table overleaf is a summary of the Council's treasury position on 31st March 2021 and 31st March 2022.

31st March 2021 £m	%	Treasury Portfolio	31st March 2022 £m	%
Treasury Investments				
0.00	0%	Banks & Building Societies	15.00	8%
68.85	48%	Local Authorities (invested less than 364 days)	93.00	52%
29.17	20%	Money Market Funds	37.82	21%
15.35	11%	UK Government	0.00	0%
10.00	7%	Local Authorities (invested longer than 364 days)	10.00	6%
20.00	14%	Property Fund	22.92	13%
143.37	**100%**	**Total Treasury Investments**	**178.74**	**100%**
External Borrowing				
-286.46	91%	PWLB[1]	-279.64	90%
-30.00	9%	LOBOs[2]	-30.00	10%
-316.46	**100%**	**Total External Borrowing**	**-309.64**	**100%**
Net treasury investments / (Borrowing)				
-173.09		**Net Treasury Investments /(Borrowing)**	**-130.90**	

[1] PWLB Public Works Loans Board. The PWLB is a statutory body, part of HM Treasury; its purpose is to lend money to local authorities. The Council's main objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required.

[2]LOBOs Lender Option Borrower Option. LOBOs are long term borrowing instruments which include an option for the lender to periodically revise the interest rate. If the lender decides to revise the interest rate, the borrower then has the option to pay the revised interest rate or repay the loan.

1.1 In overall budget terms, the Council ended up £1.398m net better off during the year, despite an underachievement of £0.303m on treasury investment returns due in part to the low rates of interest available. Another factor was the continuation of the Council's strategy to use surplus cash instead of borrowing (known as internal borrowing), which led to an underspend against budget on borrowing costs of £1.701m. The overall favourable variance has been taken into account in the 2022/23 budget. The Council will continue the strategy of internal borrowing, which reduces risk and keeps external financing costs low, while it makes sense to continue to do so. Liquid cash was diversified over several counterparties and Money Market Funds to manage both credit and liquidity risks. Such an approach has also provided benefits in terms of reducing counterparty risk exposure, by having fewer investments placed in the financial markets. Recent increases in interest base rates should improve future investment returns, but PWLB borrowing has increased and so new borrowing will cost slightly more. The investment activity during the year conformed to the approved strategy and the Council had no liquidity difficulties.

1.2 Following a competitive tendering process, Link Treasury Services Limited (Link) were appointed as the Council's treasury advisor with effect from 1 August 2021. Link provided a training session for members of the Audit & Governance Committee in September and they advised the Council in developing the Treasury Management Strategy Statement (TMSS) for 2022/23, including investment counterparties and borrowing requirements.

CIPFA published a revised Treasury Management Code and Prudential Code on 20th December 2021 and has stated that formal adoption is not required until the 2023/24 financial year. This Council has to have regard to these codes of practice when it prepares the Treasury Management Strategy Statement and Annual Investment Strategy, and also related reports during the financial year. Members will be updated on how the changes impact our current approach and any changes required will be formally adopted within the 2023/24 TMSS report. The changes represent good practice and we don't envisage any issues implementing the changes.

2. Content of report

2.1 If In line with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice for Treasury Management and the Council's Financial Regulations, this Council is required to provide the Audit and Governance Committee with a report on the previous year's treasury management activity.

2.2 The Code of Practice defines Treasury Management as: The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

2.3 Treasury management is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code).

2.4 The Council's treasury management strategy was approved by Council on 24th February 2021. The general policy is the prudent investment of its treasury balances and cost-effective borrowing to finance long term investment in the Council's assets.

2.5 At 31st March 2022 the Council held £309.638m of loans, a decrease of £6.820m compared to 31st March 2021; £279.638m was from the Public Works Loans Board (PWLB1), £30.000m Lenders Option Borrowers Option (LOBOs[2]) from the money markets. The Council pursues a strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep external financing costs low. The Council will continue the strategy of internal borrowing while it makes sense to continue to do so. Liquid cash was diversified over several counterparties and Money Market Funds to manage both credit and liquidity risks. Such an approach has also provided benefits in terms of reducing counterparty risk exposure, by having fewer investments placed in the financial markets. Recent increases in interest base rates should improve future investment returns, but PWLB borrowing has increased and so new borrowing will cost slightly more.

2.6 The Council is actively reviewing opportunities for borrowing at low rates if borrowing is required to finance items within the capital programme. The cost of external borrowing in 2021/22 was £9.220m, an underspend of £1.701m compared to the £10.921m budget. The Council continues to look for opportunities reschedule debt where this is expected to lead to an overall cost saving or a reduction in risk. The table below is a summary of the Council's borrowing.

Maturity structure of borrowing

31 March 2021 £m		**31 March 2022 £m**
6.820	Under 12 months	16.910
16.910	12 months and within 24 months	7.001
21.286	24 months and within 5 years	21.575
77.365	5 years and within 10 years	77.899
194.077	10 years and above	186.253
316.458	**Total Borrowing**	**309.638**

2.7 Following a competitive tendering process, Link Treasury Services Limited (Link) were appointed as the Council's treasury advisor with effect from 1 August 2021. Link provided a training session for members of the Audit & Governance Committee in September and they advised the Council in developing the Treasury Management Strategy Statement (TMSS) for 2022/23, including investment counterparties and borrowing requirements.

2.8 **Treasury Position:** The Council's investment strategy sets out the approach for choosing investment counterparties. They are based on a system of credit ratings provided by the three main credit rating agencies and supplemented by additional market data (such as rating outlooks, credit default swaps and bank share prices) provided by the Council's treasury advisors.

2.9 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the

Council's investment balances fluctuated due to timing differences between income and expenditure.

Treasury Cash Position

2.10 The treasury cash (investments) position is summarised below:

31 March 2021 £m	%	Treasury Investments	31 March 2022 £m	%
0.00	0%	Banks & Building Societies	15.00	8%
68.85	48%	Local Authorities (invested less than 364 days)	93.00	52%
29.17	20%	Money Market Funds	37.82	21%
15.35	11%	UK Government	0.00	0%
10.00	7%	Local Authorities (invested longer than 364 days)	10.00	6%
20.00	14%	Property Fund	22.92	13%
143.37	**100%**	**Total Treasury Investments**	**178.74**	**100%**

2.11 Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. The Council earned £0.933m interest on its investments, an underachievement of £0.303m compared to the budget of £1.236m. In light of the pandemic crisis and the likelihood of unexpected calls on cash flow, the Council kept more cash available at very short notice than is normal. Liquid cash was diversified over several counterparties and Money Market Funds to manage both credit and liquidity risks. The investment activity during the year conformed to the approved strategy and the Council had no liquidity difficulties. Several of the Council's treasury counterparties have Environmental, Social and Governance (ESG) strategies integrated into their investment processes. (ESG) treasury investments are being developed but do not represent a significant proportion of the investment vehicles / Money Market Funds available. Treasury management is about ensuring the Council's has available to meet its day to day cash requirements; investments are generally short term, some overnight, secure, providing access to cash when the Council needs it, they don't include investments in fossil fuels or companies with a large carbon footprint.

2.12 Investment returns remained close to zero for much of 2021/22. The expectation for interest rates within the treasury management strategy for 2021/22 was that the Bank of England Bank Rate would remain at 0.1% until it was clear to the Bank of England that the emergency level of rates introduced at the start of the Covid-19 pandemic were no longer necessitated. Investment earnings rates remained low until towards the turn of the year when it became necessary to increase interest rates to combat inflation concerns, CPI was 9.2% in May 2022. The Bank of England raised the Bank Rate to 0.25% in December 2021, 0.5% in February 2022, 0.75% in March, 1.0% in May and to 1.25% on the 16th June 2022.

2.13 **Externally Managed Pooled Funds** £22.923m of the Council's investments are held in an externally managed strategic pooled property fund where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. The dividend yield on the Local Authorities' Property Fund was 3.8% in the year to 31 March 2022.

2.14 The Council invests with other local authorities. A new sign off process has been introduced where a local authority has issued a section 114 notice or has been granted permissions to use capital to help with their revenue budgets the investment can only be placed with the prior approval of the Service Director – Corporate Finance and Section 151 Officer in consultation with the Cabinet Member for Accessible Housing and Resources.

2.15 **Prudential Indicators:** Each year, the Council agrees Prudential Indicators under the Local Government Act 2003 which are affordable, prudent and sustainable. The indicators were agreed by Council on 24th February 2021.

2.16 **Borrowing Indicators:** The Capital Financing Requirement measures the Council's underlying need to borrow for capital purposes. This is essentially the Council's outstanding debt, necessary to finance the Council's capital expenditure. The actual debt is dependent on the type and maturity of the borrowing undertaken as well as seeking the optimal cashflow situation.

2.17 Comparing gross debt with the capital financing requirement is an indicator of the Council's prudence in managing its capital expenditure and is designed to ensure that, over the medium term, external borrowing is only for capital purposes. The Council should ensure that gross debt does not exceed the total of the 'capital financing requirement'. The values are measured at the end of the financial year.

2.18 The authorised limit for external debt is required to separately identify external borrowing (gross of investments) and other long-term liabilities such as covenant repayments and finance lease obligations. The limit provides a maximum figure that the Council could borrow at any given point during each financial year.

2.19 The Operational Boundary for External Debt is a key management tool for in-year monitoring and is lower than the Authorised Limit as it is based on an estimate of the most likely level of external borrowing at any point in the year. In comparison, the authorised limit is the maximum allowable level of borrowing.

Comparison of gross debt with the capital financing requirement

Indicator	Approved £m	Actual £m
Gross Debt	394.56	309.64
Capital Financing Requirement	483.58	579.76

Authorised Limit (for total external debt)

Indicator	Approved £m	Actual £m
Authorised limit (for borrowing) *	495.00	309.64
Authorised limit (for other long-term liabilities) *	10.00	0.00
Total Authorised limit (for external debt) *	**505.00**	**309.64**

* These limits can only be breached with the approval of the full Council to raise them

Operational boundary (for borrowing)

Indicator	Approved £m	Actual £m
Operational boundary (for borrowing)	395.00	309.64
Operational boundary (for other long-term liabilities)	7.50	0.00
Total Authorised limit (for external debt)	**402.50**	**309.64**

2.20 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 is acceptable subject to the authorised limit not being breached. The operational boundary allowed for circa £100m borrowing approval delegated to Cabinet should viable and robust businesses come forward, this was not utilised in 2021/22.

2.21 **Treasury Management Indicators:** The Council measures and manages its exposures to treasury management risks using the following indicators.

2.22 **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk. The portfolio average credit rating of AA- exceeded the target of A.

Credit Risk Indicator

	Indicator as at 31 March 2022	Target
Portfolio average credit rating	AA-	A

2.23 **Liquidity:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling one-month period, without additional borrowing. In light of the pandemic crisis and the likelihood of unexpected calls on cash flow, the Council kept more cash available at very short notice than is normal. Liquid cash was diversified over several counterparties and Money Market Funds to manage both credit and liquidity risks.

Liquidity Risk Indicator

	Actual	Target
Total cash available within one month	£57.815m	£10m

2.24 **Maturity structure of borrowing:** This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator

	31 March 2022	Upper Limit	Lower Limit
Under 12 months	5%	30%	0%
12 months and within 24 months	2%	25%	0%
24 months and within 5 years	7%	30%	0%
5 years and within 10 years	24%	40%	0%
10 years and above	62%	80%	20%

2.25 Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

2.26 **Principal sums invested for periods longer than a year:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Principal Sums Invested for Periods Longer than a Year

	2021/22	2022/23	2023/24
Investments as at 31st March 2022 invested for longer than 365 days	£10m	£10m	£0m
Limit on principal invested beyond year end	£50m	£25m	£25m

2.27 The £10m invested with a maturity date in the financial year 2023/24 complied with the limit of £25m, on 31st March 2023 the investment will have less than 1 year to maturity.

2.28 CIPFA published revised Treasury Management Code and Prudential Code on 20th December 2021 and has stated that formal adoption is not required until the 2023/24 financial year. This Council has to have regard to these codes of practice when it prepares the Treasury Management Strategy Statement and Annual Investment Strategy, and also related reports during the financial year.

2.29 Members will be updated on how the changes impact our current approach and any changes required will be formally adopted within the 2023/24 TMSS report. The changes represent good practice and we don't envisage any issues implementing the changes.

2.30 The revised codes will have the following implications:

a requirement for the Council to adopt a new debt liability benchmark treasury indicator to support the financing risk management of the capital financing requirement;

- Clarify what CIPFA expects a local authority to borrow for and what they do not view as appropriate. This will include the requirement to set a proportionate approach to commercial and service capital investment;

- Create new Investment Practices to manage risks associated with non-treasury investment (similar to the current Treasury Management Practices(TMPs));
- Ensure that any long term treasury investment is supported by a business model;
- A requirement to effectively manage liquidity and longer term cash flow requirements;
- amendment to Treasury Management Practice 1 to address Environmental, Social and Governance policy within the treasury management risk framework;
- Amendment to the knowledge and skills register for individuals involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each council;
- A new requirement to clarify reporting requirements for service and commercial investment, (especially where supported by borrowing/leverage).

3. Legal and financial implications

3.1 The publication of an annual strategy, a mid-year treasury report and an annual treasury management report conforms to best practice as required by the Code of Practice CIPFA Treasury Management in the Public Services.

4. Corporate implications

4.1 There are none.