Harborough District Council

Report 4 to the Cabinet Meeting
16 January 2023

Title:	Annual Treasury Management Report 2021/22 and Prudential Indicators
Status:	Public
Key Decision:	No
Report Author:	Clive Mason Interim Deputy Chief Executive
Portfolio Holder:	Councillor James Hallam, Finance
Appendices:	**Appendix 1: Treasury position - 31 March 2022** **Appendix 2: Investment interest rates** **Appendix 3: Borrowing interest rates** **Appendix 4: Balance Sheet resources** **Appendix 5: Economic background**

Executive Summary

i. Treasury Management is an integral part of the Council's finances relating to cash flow management and financing of capital schemes and therefore underpins all of the Council's aims. The annual treasury report is a requirement of the Council's reporting procedures and covers the treasury management activity for 2021/22. The report also covers the actual Prudential Indicators for 2021/22 in accordance with the requirements of the Prudential Code.

Recommendations

a. To note the Annual Treasury Management Report for 2021/22

b. To note the Prudential Indicators for 2021/22

Reasons for Recommendations

ii. The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities.

Purpose of Report

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 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).

2. During 2021/22 the minimum reporting requirements were that the full Council should receive the following reports:
    a. an annual treasury strategy in advance of the year;
    b. a mid-year treasury update report;
    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.

Background

4. During 2021/22, the Council complied with its legislative and regulatory requirements. The financial year 2021/22 continued the challenging investment environment of previous years, namely low investment returns.
5. The report summarises the following:
    a. The actual prudential and treasury indicators (included throughout the report);
    b. Capital Activity during the year;
    c. Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
    d. Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on the investment balances;
    e. Summary of interest rate movements in the year;
    f. Detailed debt activity;
    g. Detailed investment activity;

Details

Capital Expenditure and Financing

6. The Council undertakes capital expenditure on long-term assets. These activities may either be:
    a. 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
    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. Table 1 below shows the actual capital expenditure and how this was financed. As at 31 March 2022 a mixture of external funding, capital receipts and direct revenue funding were used to reduce the need for unsupported borrowing.

Table 1: Capital Expenditure

	31-Mar-21 Actual £000	2021/22 Budget £000	31-Mar-22 Actual £000
Capital expenditure	2,132	3,421	2,336
Financed in year	1,292	2,698	2,336
Unfinanced capital expenditure	840	723	0

The Capital Financing Requirement

8. The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

9. **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 (2021/22) plus the estimates of any additional capital financing requirement for the current (2022/23) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2021/22. Table 2 below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator. The Council revised its CFR position during 2021/22 due to the restatement of the opening CFR at 01 April 2020 to include the amount invested in its subsidiary, Harborough District Commercial Services Limited.

Table 2: Capital Financing Requirement

	31-Mar-21 Actual £000	2021/22 Budget £000	31-Mar-22 Actual £000
Capital Financing Requirement	10,508	10,934	14,113
Gross borrowing position	1,490	3,673	1,490
Under /(over) funding of CFR	9,018	7,361	12,623

10. **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. Table 3 below demonstrates that during 2021/22 the Council has maintained gross borrowing within its authorised limit.

11. **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.

12. **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. This has reduced because of the change in MRP policy (Minimum Revenue Provision), explained as part of the mid-

year treasury report 2021/22 that was considered by Cabinet on 29 November 2021, reducing the necessary provision and thus the actual financing costs.

Table 3: Borrowing

	2021/22 £000
Authorised limit	23,000
Maximum gross borrowing position during the year	1,490
Operational boundary	12,500
Average gross borrowing position	1,490
Financing costs as a proportion of net revenue stream	2.98%

Treasury Position at 31 March 2022

13. The Council's treasury management debt and investment position is organised 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 Practices.

14. The Council's treasury position at the end of 2021/22 is shown in Appendix 1.

Investment Strategy and Control of Interest Rate Risk

15. Investment returns remained close to zero for much of 2021/22. Most local authority lending (including this authority) managed to avoid negative rates. The expectation for interest rates within the treasury management strategy for 2021/22 was that 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 - this is illustrated in Appendix 2.

16. 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. 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.

17. Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates as illustrated in the charts shown in Appendices 2 & 3. Such an approach has also provided benefits in terms of reducing the counterparty risk exposure, by having fewer investments placed in the financial markets.

Borrowing Strategy and Control of Interest Rate Risk

18. During 2021/22, 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 very low and minimising counterparty risk on placing investments also needed to be considered.

19. A cost of carry remained 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.

20. 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.

21. Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. Interest rates in financial markets were monitored and a pragmatic strategy adopted based upon the following principles to manage interest rate risks:

    a. 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.
    b. 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.

Interest rate forecasts are shown in **Appendix 3.**

Borrowing Outturn

22. No new borrowing was undertaken during the year.

Borrowing in advance of need

23. 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.

Rescheduling

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

Investment Outturn

25. **Investment Policy** – the Council's investment policy is governed by DLUHC investment guidance, which has been implemented in the annual investment strategy approved by the Council on 22 February 2021. 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.).

26. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties. The Council's resources are shown in **Appendix 4.**

Investments held by the Council

27. The Council:

    a. maintained an average balance of £34m of internally managed funds;

    b. earned an average rate of return of 0.10% on the internally managed funds;

    The comparable performance indicator was set as the average 7-day LIBID rate, which was -0.01% at its cessation at the end of 2021. The new indicator is the 7-day compounded SONIA (Sterling Overnight Index Average) which was 0.53% as at 31.03.22 (0.39% as at 28.02.22, 0.19% as at 31.01.22 and 0.10% before that, see graph in **Appendix 2**).

28. The Council's total investment income was £33k compared to a budget of £57k.

Investments held by fund managers

29. The Council maintained a balance of £1.5m with the Churches Charities and Local Authorities Investment Management Ltd (CCLA) Local Authorities' Property Fund throughout the year, which earned investment income of £51k against a budget of £75k, giving a rate of return of 3.41%.

30. The Council also invested in a Money Market Fund with the CCLA – The Public Sector Deposit Fund, holding an average balance of £4.5m during the year, which earned investment income of £5k, giving a rate of return of 0.11%. The budget for this is included in the investment income budget of £57k above.

IFRS 9 Fair Value of Investments

31. Following the consultation undertaken by the Ministry of Housing, Communities and Local Government [MHCLG], (now renamed the Department of Levelling Up, Housing and Communities [DLUHC]) on International Financial Reporting Standard ((IFRS 9, this standard determines how organisations account for financial instruments*)* the Government introduced a mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds. This was effective from 1 April 2018. The statutory override applies for five years from this date. Local authorities are required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve throughout the duration of the override in order for the Government to keep the override under review and to maintain a form of transparency. The override is due to end as of 31 March 2023 and a new consultation has been launched by DLUHC, the options are to allow the existing override to expire; extend for an additional period of time; or make it permanent.

Implications of Decisions

Corporate Priorities

The contents of this report are evidence of how the Council monitors issues that may affect the delivery of its Corporate Priorities.

Financial

These are covered in detail within the report. When it is time to report the 2022/23 Annual Treasury Management Report, this will be reported at the same time as the Quarter 4 Financial Outturn.

Legal

This report covers the requirement for capital financing and treasury management as set out in the Local Government Act 2003 and subsequent Regulations.

Policy

No policy issues arise directly from this report.

1.1 Environmental Implications including contributions to achieving a net zero carbon Council by 2030

No environmental issues arise directly from this report.

1.2 Risk Management

Management of the Council's financial resources is key to achieving targets set out in the budget. Security of the Council's money in the current banking market is paramount.

1.3 Equalities Impact

No equalities issues arise directly from this report.

1.4 Data Protection

No equalities issues arise directly from this report.

Summary of Consultation and Outcome

Consultation has been undertaken with the Portfolio Holder.

Alternative Options Considered

Not applicable.

Background papers

Various Treasury and Capital related reports approved by Council in February 2021 as part of the 2021/22 Budget and MTFS, as well as the Mid-Year Treasury Report reported during the year.