Harborough District Council

Report to Cabinet on the 23 October 2023

Title:	Annual Treasury Management Report 2022/23 and Prudential Indicators
Status:	Public
Key Decision:	No
Report Author:	Clive Mason, Interim Deputy Chief Executive
Portfolio Holder:	Councillor Mark Graves, Finance
Appendices:	**Appendix 1: Treasury position - 31 March 2023** **Appendix 2: Investment interest rates** **Appendix 3: Borrowing interest rates** **Appendix 4: Balance Sheet resources** **Appendix 5: Economic background**

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 2022/23. The report also covers the actual Prudential Indicators for 2022/23 in accordance with the requirements of the Prudential Code.

Recommendations

a. To note the Annual Treasury Management Report for 2022/23

b. To approve the actual 2022/23 Prudential and Treasury Indicators included in this report

Reasons for Recommendations

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

1. Purpose of Report

1.1 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 2022/23. 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).

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

1.2.1 an annual treasury strategy in advance of the year (Council 21/02/2022)

1.2.2 a mid-year treasury update report (Cabinet 16/01/2023, Council 27/02/2023)

1.2.3 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 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.

2. Background

2.1 During 2022/23, the Council complied with its legislative and regulatory requirements.

2.2 The report summarises the following:

2.2.1 The actual prudential and treasury indicators (included throughout the report)

2.2.2 Capital activity during the year

2.2.3 Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement)

2.2.4 Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on the investment balances

2.2.5 Summary of interest rate movements in the year

2.2.6 Detailed debt activity

2.2.7 Detailed investment activity.

3. Details

Capital Expenditure and Financing

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

3.1.1 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

3.1.2 If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

3.2 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 2023 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-22 Actual £000	2022/23 Budget £000	31-Mar-23 Actual £000
Capital expenditure	2,336	6,763	4,740
Financed in year	2,336	6,188	4,740
Unfinanced capital expenditure	0	575	0

The Council's Overall Borrowing Need

3.3 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.

3.4 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.

3.5 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.

3.6 The total CFR can also be reduced by:

3.6.1 the application of additional capital financing resources, (such as unapplied capital receipts); or

3.6.2 charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

3.7 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 21/02/2022.

3.8 The Council's CFR for the year is shown in **Table 2** and represents a key prudential indicator.

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

3.10 **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. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2022/23. **Table 2** below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

Table 2: Capital Financing Requirement

	31-Mar-22 Actual £000	2022/23 Budget £000	31-Mar-23 Actual £000
Capital Financing Requirement	14,113	11,110	13,750
Gross borrowing position	1,490	2,975	1,490
Under /(over) funding of CFR	12,623	8,135	12,260

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. **Table 3** below demonstrates that during 2022/23 the Council has maintained gross borrowing within its authorised limit.

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 **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.

Table 3: Borrowing

	2022/23 £000
Authorised limit	18,000
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	-4.68%

Treasury Position at 31 March 2023

3.14 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.

3.15 The Council's treasury position at the end of 2022/23 is shown in **Appendix 1.**

Investment Strategy and Control of Interest Rate Risk

3.16 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.

3.17 With bond markets selling off, equity valuations struggling to make progress and, latterly, property funds enduring a wretched Q4 2022, the more traditional investment options, such as specified investments (simple to understand, and less than a year in duration) generally became more actively used.

3.18 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 2008/9. 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 Strategy and Control of Interest Rate Risk

3.19 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.

3.20 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. 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 borrowing.

3.21 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.

3.22 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:

3.22.1 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.

3.22.2 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

3.23 No new borrowing was undertaken during the year.

Borrowing in advance of need

3.24 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

3.25 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

3.26 **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 21 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.).

3.27 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

3.28 The Council:

3.28.1 maintained an average balance of £46m of internally managed funds

3.28.2 earned an average rate of return of 1.96% on the internally managed funds

3.28.3 The comparable performance indicator was set as the average 7-day compounded SONIA (Sterling overnight index average) rate, which averaged at 2.20% for the year (see graph in **Appendix 2**).

3.29 The Council's total investment income was £909k compared to a budget of £107k (due to the increasing interest rates throughout the year).

Investments held by fund managers

3.30 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 £56k against a budget of £75k, giving a rate of return of 3.73%.

3.31 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 £97k, giving a rate of return of 2.17%. The budget for this is included in the investment income budget of £107k above.

IFRS 9 Fair Value of Investments

3.32 Following the consultation undertaken by the Department of Levelling Up, Housing and Communities (DLUHC) on IFRS 9 (International Financial Reporting Standard 9, this standard determines how organisations account for financial instruments), the Government has extended the mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds to 31st March 2025. 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.

4. Implications of Decisions

Corporate Priorities

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

Financial

4.2 These are covered in detail within the report.

Legal

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

Policy

4.4 No policy issues arise directly from this report.

Environmental Implications

4.5 No environmental issues arise directly from this report.

Risk Management

4.6 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.

Equalities Impact

4.7 No equalities issues arise directly from this report.

Data Protection

4.8 No equalities issues arise directly from this report.

5. Alternative Options Considered

5.1 Not applicable.

6. Background papers

6.1 Various Treasury and Capital related reports approved by Council in February 2022 as part of the 2022/23 Budget and MTFS, as well as the Mid-Year Treasury Report reported during the year.