DF/23/68
Corporate Infrastructure & Regulatory Services Scrutiny Committee
22 June 2023

TREASURY MANAGEMENT STEWARDSHIP ANNUAL REPORT 2022/23

Report of the Director of Finance and Public Value

Please note that the following recommendations are subject to consideration and determination by the Committee before taking effect.

1) Recommendation

that the Committee be asked to note the report and consider whether it wishes to make any further comments to Cabinet on the 2022/23 Treasury Management outturn position.

2) Introduction

2.1 The County Council has adopted the CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management in the Public Services. The policy requires the Council to agree an annual treasury strategy report, setting out the strategy and plans to be followed in the coming year, as part of the budget process. The Treasury Management and Investment Strategy for 2022/23 was agreed by Council in February 2022 and forms part of the published budget book for the year.

2.2 The purpose of this report is to show the outturn position, review performance and inform members of any key matters arising from the Council's Treasury and Debt Management activities during the 2022/23 financial year.

3) Minimum Revenue Positions

3.1 Each year the Council has a statutory obligation to charge to the revenue account an annual amount of Minimum Revenue Provision (MRP), which is a charge to make provision for the repayment of the authority's external debt and internal borrowing. The charge is based on the historic borrowing required to fund the Council's capital programme.

3.2 The current policy is to charge MRP based on the period of benefit of the capital investment, i.e. straight line, over the life of the asset. However, all supported borrowing up to 1st April 2008 is charged over the life of the assets, calculated using the annuity method. The final outturn for MRP for 2022/23 was £14.1m.

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4) Treasury Management Outturn Position 2022/23 – Borrowing

4.1 The overall aims of the borrowing strategy are to achieve:

- Borrowing at the lowest rates possible in the most appropriate periods;
- The minimum borrowing costs and expenses;
- A reduction in the average interest rate of the debt portfolio.

4.2 Since 2009 the Council has followed a policy of containing the capital programme, taking out no new external borrowing and repaying debt whenever this can be done without incurring a financial penalty. The Medium Term Financial Strategy (MTFS) and Capital Strategy set out in the budget book for 2022/23 continued to assume was that no new long-term borrowing would be required. However, it raised the possibility that reducing cash resources may mean that should the authority wish to undertake or invest in a major strategic project, then additional external borrowing could be needed.

4.3 In accordance with the Capital and Treasury Management Strategies, no long-term borrowing was undertaken during the 2022/23 financial year. Instead, all borrowing required to fund capital expenditure was met from internal cash balances. The reducing level of cash balances and the growing deficit on Special Education Needs and Disability (SEND) have increased the risk that additional external borrowing may be required in future.

4.4 Active treasury management and the maintenance of levels of liquidity have ensured that no short-term borrowing was required during the financial year. Cash positions are monitored daily and modelled over a monthly horizon to ensure that anticipated liquidity levels are forecast accurately.

4.5 The increases in interest rates since the start of 2022 have reduced the level of premium penalties on the early repayment of PWLB loans and for a short period during early October 2022 it would have been possible to repay a proportion of the Council's external debt without incurring premiums. However, with reducing levels of cash and the potential need for new external borrowing in 2024/25, it would not make sense for the Council to repay existing debt and then have to take out new external borrowing at higher rates than the loans that have been repaid.

4.6 At 31st March 2023 the level of long term debt stood unchanged at £507.85m as detailed in the table below.

Analysis of Long Term Debt

	Actual 31.03.22	Interest Rate	Actual 31.03.23	Interest Rate
	£'m	%	£'m	%
Fixed Rate Debt				
PWLB	436.35	4.99	436.35	4.99
Money Market	71.50	5.83	71.50	5.83
Variable Debt				
PWLB	0.00		0.00	
Money Market	0.00		0.00	
Total External Borrowing	**507.85**	**5.11**	**507.85**	**5.11**

4.7 The carrying amount for long term debt figure presented in the Statement of Accounts for 2022/23, comprising PWLB, LOBO and market debt, is £510.826million, £3 million higher than the figure stated above. This difference is due to an accounting standard adjustment which requires us to record the value of our long term debt at its Net Present Value in the Statement of Accounts. The LOBOs (Lender Option Borrower Option) have stepped interest rates and are revalued annually based on the effective interest rate for the duration of the loan. The revaluation has the effect of smoothing the stepping of the interest over the life of the loans.

5) Treasury Management Outturn Position 2022/23 – Investments

5.1 The overall aim of the Council's investment strategy is to:

- Limit the risk to the loss of capital;
- Ensure that funds are always available to meet cash flow requirements;
- Maximise investment returns, consistent with the first two aims;
- Review new investment instruments as they come to the Local Authority market, and to assess whether they could be a useful part of our investment process.

5.2 The following table shows the County Council's fixed and variable rate investments as at the start and close of the financial year, and at the end of October.

Schedule of Investments

		Actual 31.03.22	Interest Rate	Actual 31.03.23	Interest Rate
		£'m	%	£'m	%
Bank, Building Society & MMF Deposits					
Fixed Rates					
Term Deposits	Over 365 days	127.50	0.48	96.00	2.95
	365 days & Under	31.00	0.86	20.00	2.43
Variable Rate					
Call Accounts		49.01	0.58	0.00	4.05
Notice Accounts		40.00	0.32	10.00	4.43
Money Market Funds (MMF's)		16.86	0.55	46.48	4.07
Property Fund		10.00	3.72	10.00	3.66
All Investments		**274.36**	**0.64**	**182.48**	**3.30**

5.3 When the Council set a target interest rate of 0.35% for 2022/23, inflation was at that time was seen to be a temporary blip and Russia's invasion of Ukraine had yet to happen. Increases in the cost of consumer goods, underpinned by strong demand and supply chain bottlenecks were exacerbated by rising fuel and food prices caused by the invasion of Ukraine by Russia. The Consumer Prices Index (CPI) rose from 7% in March 2022 to 10.1% in March 2023 and spent most of 2022/23 in double digit territory.

5.4 In response to rising inflation, the Bank of England raised interest rates eight times over the year which is unheard of since the late 1980's. By the end of the year the base rate had reached 4.25%. This enabled the Council to achieve significantly higher rates on its investments as the year progressed, tempered by the longer terms loans made at lower rates before interest rates started to increase.

5.5 The average interest rate earned on investments, excluding the CCLA property fund, for the year was 1.73%, against the full year budget target return of 0.35%. The CCLA property fund has yielded an average rate of 3.66% for the same period against a full year budget target of 4.0%. The combined total return from all investments was 1.93%.

5.6 Revenue lending during 2022/23, including the use of term deposits, call accounts and property funds, earned interest of £4.338 million against a full year budget of £900,000. The surplus achieved over budget can be attributed both to the higher rates of interest earned compared to the target rate and to a higher average level of cash balances over the year than anticipated. The interest figure quoted is the return from the Council's Treasury Management activity and is different from the figure presented in the Outturn Report and the Statement of Accounts which also includes interest generated from a number of other sources.

5.7 All lending has been carried out in accordance with the Council's Treasury Management Strategy and with institutions on the list of approved counterparties.

6) Prudential Indicators

6.1 Linked to its Treasury Management Strategy, the County Council is required to monitor its overall level of debt in line with the CIPFA Code of Practice. Part of the code requires consideration of a set of Prudential Indicators in order to allow the Council to form a judgement about the affordable, prudent and sustainable level of debt.

6.2 The purpose of the indicators is to demonstrate that:

- Capital expenditure plans are affordable;
- All external borrowing and other long term liabilities are within prudent and sustainable levels;
- Treasury management decisions are taken in accordance with professional good practice.

6.3 Three Prudential Indicators control the overall level of borrowing. They are:

- **The authorised limit** - this represents the limit beyond which any additional borrowing is prohibited until the limit is revised by the County Council. Revision may occur during the year if there are substantial and unforeseen changes in circumstances, for example, a significant delay in achieving forecast capital receipts. In normal circumstances this limit will not require revision until the estimate for the following year is revised as part of the budget setting process.
- **The operational boundary** – this indicator is based on the probable external debt and other long term liabilities during the year. Variations in cash flow may lead to occasional, short term breaches of the Operational Boundary that are acceptable.
- **The upper limit for net debt** - the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the Capital Financing Requirement.

6.4 During the Budget process, the following Borrowing Limits were set for 2022/23:

- Maximum borrowing during the period (Authorised Limit) £761.193 million.
- Expected maximum borrowing during the year (Operational Limit) £736.193 million.
- Maximum amount of fixed interest exposure (as a percentage of total) 100%.
- Maximum amount of variable interest exposure (as a percentage of total) 30%.

6.5 Members are asked to note that during 2022/23 the Council remained within its set Borrowing Limits and complied with the interest rate exposure limits.

7) 2023/24 Update

7.1 As outlined above, inflation has remained elevated, standing at 10.1% in March 2023 having spent most of 2022/23 in double digit territory. Core inflation (excluding food and energy) remains elevated, and the Bank of England raised rates again in May to 4.5%, with economists predicting that rates could rise to 5.5% in the autumn 2023.

7.2 While inflation is proving to be stickier than the Bank of England expected, they still believe that we have now passed the peak and that it will quickly fall to around 5% by the end of 2023 and back to their 2% target by late 2024. Link, the Council's treasury management advisors, and other economists are therefore expecting rates to start reducing again during 2024.

7.3 From an investment point of view, the increase in interest rates provides the opportunity to earn higher returns on the Council's cash balances, and as a result the interest income earned in 2023/24 is likely to be higher than budgeted. However, given the current level of inflation, the value of the Council's reserves will decline in real terms. Should the Council be required to take out external borrowing then the rate of interest payable will also be higher than the rates available in recent years.

7.4 The Medium Term Financial Strategy (MTFS) and Treasury Management Strategy set by the Council in February increased the level of internal borrowing by £7.1 million to £72.7 million. With the current financial pressures on the Council, it is projected that the balances available for internal borrowing will be significantly reduced as a result of:

- Budgeted use of earmarked reserves during 2022/23 and 2023/24.
- Continued unbudgeted expenditure on Special Educational Needs and Disability (SEND), charged to an unusable reserve.
- Spending of accumulated capital grants, for example Section 106 provision of infrastructure and major projects such as the North Devon Link Road.
- Spending of approved carry-forwards.

As a result the ability to use internal borrowing, as opposed to external borrowing, to fund the capital programme will become more limited.

7.5 In April 2022, the Cabinet agreed to support proposals for the creation of the Plymouth and South Devon Freeport. The Business Case includes the requirement for the Council to externally borrow up to £15 million for the capital works needed. The borrowing will not be required until 2024/25, but at that point the Council's total external debt will increase. The additional external borrowing will be ringfenced to the Freeport, and all the associated capital financing costs will be funded by the excess business rate income derived from the scheme.

7.6 The Council continues to await the outcome of the Safety Valve Intervention programme with the Department for Education in relation to the deficit position on Special Educational Needs.

8) Conclusion

8.1 No long term or short-term borrowing was undertaken during 2022/23.

8.2 Concern over the future level of cash balances has precluded the possibility of repaying any of the outstanding debt during 2022/23.

8.3 Investment income of £4.338 million was achieved in 2022/23 against a full year budget of £900,000. This represented a return of 1.93% including the Property Fund investment. Successful prudent management of the Council's short-term cash reserves has delivered a surplus of £3.348 million for the 2022/23 financial year.

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Electoral Divisions: All

Local Government Act 1972: List of background papers

Nil

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