Appendix 6

Annual Report on the Treasury Management Service and Actual Prudential Indicators for 2022/23

Purpose

The Council is required by regulations issued under the Local Government Act 2003 and the CIPFA Code of Practice on Treasury Management and the Prudential Code for Capital Finance to produce an annual treasury management review of activities and performance against the approved treasury indictors. This report meets these requirements.

The regulatory environment places responsibility on Members for the review and scrutiny of treasury management activities. This report is therefore important in that respect as it provides details of the outturn position for the treasury management function and highlights compliance with the Council's policies previously approved by Members in the Annual Treasury Strategy Report and Treasury Mid-Year Review.

Executive Summary

During 2022/23 the Council complied with it's legislative and regulatory requirements. The actual prudential indicators for the year, along with prior year comparators are as follows:

	2021/22	2022/23
	£m	£m
Capital Expenditure		
General Fund	79.523	65.681
HRA	58.277	55.043
Total Capital Expenditure	**137.800**	**120.724**
Capital Financing Requirement (CFR)		
General Fund	323.368	318.711
HRA	487.431	517.908
Total CFR - 31 March	**810.799**	**836.619**
Gross Debt		
General Fund - Treasury	138.720	143.007
General Fund - Other Long Term Liabilities	50.762	49.070
HRA - Treasury	336.868	327.801
HRA - Other Long Term Liabilities	17.763	14.715
Total Gross Debt - 31 March	**544.113**	**534.593**
Investments - 31 March	**51.101**	**30.704**
Net Debt - 31 March	**493.012**	**503.889**
Financing Costs as Proportion of Net Revenue Stream		
General Fund	4.9%	2.7%
HRA	16.6%	17.6%

The Actual Financing Costs as a Proportion of Net Revenue Streams indicator identifies the trend in the cost of servicing the capital debt costs of the council (Debt interest, MRP, other long term liability obligations [e.g. PFI], less investment income) against the Council's net revenue stream (General Fund: Council Tax, NDR and non ringfenced grants ; HRA : rent income and service charges).

Other Prudential and Treasury indicators are to found in the main body of this report. The Director of Finance can also confirm that borrowing was only taken for capital purposes and that the statutory borrowing limit (Authorised Limit) was not breached.

As at 31st March 2023, the Council's total external debt (including PFI and Finance Lease liabilities) was £534.593m (£544.113m as at 31st March 2022) and the investment balances totalled £30.704m compared to £51.101m the previous year.

The 2022/23 financial year reversed the historic low interest rate environment with increases commencing in May 2022 taking the opening Bank Rate position of 0.75% to 1.00% with regular increases thereafter taking Bank Rate to 4.25% by the end of the financial year. The rate of increase and the levels the rate were increased to were in excess of budgetary estimates and reflected the uncertainty in the UK economy.

Recommendations

The Council is recommended to:

- Approve the actual 2022/23 Prudential and Treasury Indicators within this report, and;
- To note this Annual Treasury Management Report for 2022/23.

1. The Council's Capital Expenditure and Financing for 2022/23

1.1. The Council undertakes capital expenditure on it's long term assets. These activities can either by finances immediately through the application of capital receipts, capital grants and contributions, or from revenue resources. This financing does not have an effect on the Council's underlying borrowing need.

1.2. If insufficient resources are available then the remaining expenditure can be serviced through Prudential Borrowing resulting in an increase in the Council's borrowing need (Capital Financing Requirement – CFR). For General Fund prudential borrowing this amount is charged to the Council's General Fund Revenue Account over a period of years linked to the life of the asset the borrowing funded (up to 40 years). This is known as the Minimum Revenue Provision (MRP). There is no legal requirement for an MRP to be charged to the Housing Revenue Account.

1.3. Actual capital expenditure is one of the Prudential Indicators and the table below provides a summary of information required and how this expenditure was financed:

	2021/22	2022/23	
	Actual	Estimate	Actual
	£m	£m	£m
Capital Expenditure			
General Fund	79.523	83.814	65.681
HRA	58.277	71.503	55.043
Total	**137.800**	**155.317**	**120.724**
Resources by:			
Capital Receipts	18.351	17.716	17.314
Grants and External Contributions	53.964	60.670	45.105
Revenue Contributions	9.779	12.860	6.010
Major Repairs Reserve (HRA)	15.944	16.875	16.834
Amounts to be financed by Prudential Borrowing	**39.762**	**47.196**	**35.461**
being:			
General Fund Prudential Borrowing	*9.381*	*6.549*	*3.628*
HRA Prudential Borrowing	*30.381*	*40.647*	*31.833*

2. The Council's Overall Borrowing Need

2.1. The Council's underlying need to borrow for capital expenditure is called the Capital Financing Requirement (CFR).

2.2. **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 it's gross external borrowing does not, except in the short term, exceed the total of the Capital Financing Requirement as at the end of the previous financial year plus estimates for any additional prudential funding requirements in the current and the next two financial years. This essentially means that the Council is not borrowing to support it's revenue activities. By including the following two financial years in this calculation does allow some flexibility to borrow in advance of need, although this Council has not utilised this option due to the economic uncertainty and the cost of debt which would create additional pressures on the Council's finances.

The table below highlights the Council's CFR and gross borrowing positions for 2022/23 and previous year and shows that the Council has complied with this Prudential Indicator:

	2021/22	2022/23	2022/23		
	Actual £m	Estimate £m	Actual General Fund £m	Actual HRA £m	Actual Total £m
Opening Capital Financing Requirement	**796.767**	**809.121**	**323.368**	**487.431**	**810.799**
plus Capital Expenditure financed by Prudential Borrowing	39.762	47.196	3.628	31.833	35.461
less Minimum/ Voluntary Revenue Provision (MRP/ VRP)	(22.345)	(6.593)	(6.593)	-	(6.593)
Movements in Other Long Term Liabilities	(3.385)	(3.361)	(1.692)	(1.356)	(3.048)
Appropriation of Assets	-	-	-	-	-
Closing Capital Financing Requirement	**810.799**	**846.363**	**318.711**	**517.908**	**836.619**
Treasury Debt Portfolio	475.588	471.016	143.007	327.801	470.808
Other Long Term Liabilities (PFI)	68.525	65.164	49.070	14.715	63.785
Gross Borrowing Position	**544.113**	**536.180**	**192.077**	**342.516**	**534.593**
(Under)/ Over Borrowing Position	**(266.686)**	**(310.183)**	**(126.634)**	**(175.392)**	**(302.026)**

2.3. The significant reduction in Minimum/ Voluntary Revenue Provision (MRP/ VRP) in 2022/23 compared to 2021/22 is due to the HRA no longer making a voluntary contribution as there is no regulatory requirement for the HRA to make such provision (£11m reduction), and a revision to the General Fund MRP Policy for 2022/23 reducing the amount charged by approximately £4m.

2.4. **The Authorised Limit** is the short term 'affordable borrowing limit' required by Section 3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level.

The Operational Boundary is the expected borrowing position of the Council during the year. Periods where the actual borrowing is either above or below this value does not constitute a breach but is an guide for managing debt levels with the approved strategy.

The following table provides all the relevant values and shows that although actual debt holdings during the year remained below the Operational Boundary, and therefore also below the statutory maximum level of the Authorised Limit.

	2022/23 £m
Indicators:	
Authorised Limit	861.852
Operational Boundary	553.503
Actuals:	
Maximum Gross Borrowing in year	562.735
Average Gross Borrowing in year	538.821

The lower debt levels were due to the Council not taking levels of new debt as originally expected due to the rapid increase in market rates. Therefore the overall under borrowed position increased.

3. Treasury Position at 31st March 2023

3.1. The Council's treasury management debt and investment position is managed by the internal treasury management service in order to ensure adequate liquidity for it's revenue and capital activities, ensure security for it's investments and to manage risks within all treasury activities. Procedures and controls to achieve these objectives are well established and relevant staff regular attend training services provided by Link (the Council's treasury advisory service) to ensure that staff are fully briefed and updated on any changes in the regulatory environment or best practice.

3.2. The figures in this report are based on the principal amounts borrowed and invested and so may differ from those in the Financial Statement of Accounts due to the accounting treatment of these items (e.g. accrued interest, fair value).

3.3. During 2022/23 the Treasury Team managed the debt and investment positions closing the financial year at £470.808m for borrowings and £30.704m for investments. The breakdown of these amounts compared to the end of the previous financial year are included in the table below *(Note: investment balances are held at full Council level and not split between General Fund and Housing Revenue Account):*

	31 March 2022				31 March 2023			
	General Fund £m	HRA £m	Total £m	Interest Rate	General Fund £m	HRA £m	Total £m	Interest Rate
Borrowing:								
Fixed Rate:								
PWLB	49.921	255.139	305.060	5.1%	49.410	246.072	295.482	5.1%
Market Loans	10.271	81.729	92.000	4.1%	10.271	81.729	92.000	4.1%
Local Authorities	28.283	-	28.283	1.7%	41.498	-	41.498	3.0%
Interest Free	2.503	-	2.503	0.0%	1.895	-	1.895	0.0%
Total Fixed Rate	**90.978**	**336.868**	**427.846**	**4.6%**	**103.074**	**327.801**	**430.875**	**4.7%**
Variable Rate:								
Other Temporary Loans (repayable on demand)	47.742	-	47.742	0.2%	39.933	-	39.933	1.9%
Total Debt	**138.720**	**336.868**	**475.588**	**4.2%**	**143.007**	**327.801**	**470.808**	**4.4%**
Investments:								
Money Market Funds	[redacted]	[redacted]	50.200	0.6%	[redacted]	[redacted]	19.834	4.2%
Bank (Cash Reserve Account)	[redacted]	[redacted]	0.651	0.0%	[redacted]	[redacted]	0.620	1.0%
Variable	[redacted]	[redacted]	-	0.0%	[redacted]	[redacted]	-	0.0%
Fixed Interest (Short [365 days or less])	[redacted]	[redacted]	-	0.0%	[redacted]	[redacted]	10.000	4.3%
Fixed Interest (Long [>365 days])	[redacted]	[redacted]	0.250	1.5%	[redacted]	[redacted]	0.250	0.0%
	[redacted]	[redacted]			[redacted]	[redacted]		
Total Investments	[redacted]	[redacted]	**51.101**	**0.6%**	[redacted]	[redacted]	**30.704**	**4.1%**
Net Debt (Treasury Management)			**424.487**				**440.104**	

3.4. The actual maturity structure of the fixed rate debt portfolio indicator is to reflect the potential re-financing risk associated with debt maturing in any particular year. The actual portfolio as at 31st March compared to the approved indicator is shown in the following table:

Fixed Rate Debt Maturity Profile	as at Indicator	31 March 2023 Actual	Actual £m
Within 12 months	10%	11.7%	50.391
12 months - 2 years	10%	4.0%	17.254
2 to 5 years	20%	6.0%	25.958
5 to 10 years	20%	9.9%	42.500
10 to 20 years	20%	8.9%	38.203
20 to 30 years	30%	19.2%	82.646
30 to 40 years	40%	31.1%	133.923
40 to 50 years	50%	4.6%	20.000
Over 50 years	90%	4.6%	20.000
		100.0%	**430.875**

3.5. Levels of fixed rate debt maturing within 12 months are marginally above the approved indicator. This was due to a borrowing need late in the financial year and with borrowing rates at very high levels it was considered prudent to take short term debt (3 – 6 months) and seek to refinance for a longer period when borrowing rates return to more affordable levels. This approach avoided high debt interest costs being incurred for longer than necessary and was a strategy adopted by many Council's where a borrowing need was identified. At the time the original indicator was set and approved borrowing rates were not forecast to be at the levels they currently are.

4. The Investment Strategy for 2022/23

4.1. The priorities for the Council's investments are Security, Liquidity and Yield.

- Security – ensuring only suitable investment counterparties are used for investments
- Liquidity – Investment are placed for periods following cash flow considerations to ensure sufficient cash resources are available to meet expenditure commitments
- Yield – Only after the above two criteria have been addressed is the actual return on the investment considered to obtain optimum return.

4.2. For 2022/23 the strategy was to maintain investments short term to cover cash flow requirements, although consideration was to be given to place investments for periods up to 12 months with high credit rated institutions, in line with the approved counterparty selection criteria.

4.3. Bank Rate was predicted to remain low throughout the financial year, slowly increasing to 0.75% by March 2023. However, the turbulent economic position the UK faced during the year resulted in Bank Rate actually increasing to 4.25%. This inflated position did generate additional investment returns compared to the approved budget.

4.4. During the financial year a £10m deposit was placed for a period of 6 months with Lloyds Bank plc, in line with the strategy, which did create additional returns compared to purely holding balances within Money Market Funds.

4.5. Investments held by the Council are proactively managed in-house on a daily basis, ensuring that the most effective use of cash resources is maintained. The table below details the average balances and returns by class of investment for the financial year with prior year information allowing comparison.

	2021/22		2022/23		
	Average Balance £m	Average Return	Average Balance £m	Average Return	Balance at 31 March 2023 £m
Liquid Investments (variable rate)					
Money Market Funds	87.280	0.06%	88.215	2.14%	19.834
Bank (Cash Reserve Account)	0.883	0.01%	1.011	0.55%	0.620
Other Variable Rate Deposits	-	0.00%	-	0.00%	-
Total Liquid Cash	**88.163**	**0.06%**	**89.226**	**2.12%**	**20.454**
Non Liquid Investments (fixed rates)					
Fixed Interest (Short [365 days or less])	-	0.00%	4.630	4.34%	10.000
Fixed Interest (Long [>365 days])	0.250	1.49%	0.250	0.93%	0.250
Total Non-Liquid Cash	**0.250**	**1.49%**	**4.880**	**4.17%**	**10.250**
Total Investments	**88.413**	**0.06%**	**94.106**	**2.23%**	**30.704**

4.6. As can be seen from the data above, average returns for the year increased from 0.06% to 2.23% reflecting the increasing investment returns available due to an increasing interest rate environment. The 2.23% returns achieved are equal to the comparable benchmark (7 day SONIA uncompounded) reflecting an improved performance compared to the previous year with returns of 0.06% compared to the benchmark of 0.14%.

5. The Borrowing Strategy for 2022/23

5.1. The strategy was to maintain an under-borrowed position (internal borrowing) while cash resources allowed, but to monitor the debt markets to seek opportunities to externalise the internal borrowing position should there be a risk of a sharp rise in borrowing rates.

5.2. The expectations were for gradual increases in fixed borrowing rates during 2022/23 but by August it had become clear that inflation was rapidly increasing and the Monetary Policy Committee were committed to tackling this by aggressive tightening at every meeting either increasing rates by 0.25% or 0.5%. This resulted in a spike in fixed borrowing rates and therefore the opportunity to take longer term fixed rate borrowing had gone.

5.3. During the year £29.6m of fixed rate debt naturally matured with £35m of new debt being taken.

- April 22 - £20m maturity [0.1%] £20m new 1 year debt taken [1.11%]
- Sept 22 - £4.6m maturity [8.63%] Not replaced

- March 23 - £5m loan maturity [2.63%] £15m new loans 2-3 months [4.53%]

5.4. Towards the end of the financial year a borrowing need was identified to maintain sufficient cash flow resources. However due to the inflated long term borrowing rates it was not prudent to 'lock in' at those levels and create a long term cost burden on either the General Fund or the Housing Revenue Account. Therefore the £15m new borrowing taken was all very short term to allow time for the markets to settle and possibly refinance for longer periods later in the year. All new debt taken during the year was with other Local Authorities.

5.5. **Debt Rescheduling :** No rescheduling of debt was undertaken during 2022/23.

6. The UK Economy During 2022/23

6.1. Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022/23.

6.2. Market commentators' misplaced optimism around inflation has been the root cause of the rout in the bond markets with, for example, UK, Eurozone and US 10-year yields all rising by over 200bps in 2022.

6.3. Q2 of 2022 saw UK GDP deliver growth of +0.1% quarter on quarter, but this was quickly reversed in the third quarter, albeit some of the fall in GDP can be placed at the foot of the extra Bank Holiday in the wake of the Queen's passing. Q4 GDP was positive at 0.1%. Most recently, January saw a 0.3% m/m increase in GDP as the number of strikes reduced compared to December. In addition, the resilience in activity at the end of 2022 was, in part, due to a 1.3% quarter on quarter rise in real household disposable incomes. A big part of that reflected the £5.7bn payments received by households from the government under the Energy Bills Support Scheme.

6.4. Nevertheless, CPI inflation picked up to what should be a peak reading of 11.1% in October, although hopes for significant falls from this level will very much rest on the movements in the gas and electricity markets, as well as the supply-side factors impacting food prices. On balance, most commentators expect the CPI measure of inflation to drop back towards 4% by the end of 2023. As of February 2023, CPI was 10.4%.

6.5. The UK unemployment rate fell through 2022 to a 48-year low of 3.6%, and this despite a net migration increase of c500k. The fact remains, however, that with many economic participants registered as long-term sick, the UK labour force shrunk by c500k in the year to June. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity, and with average wage increases running at over 6% the MPC will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food (up 18.3% year on year in February 2023) and energy that have endured since Russia's invasion of Ukraine on 22 February 2022.

6.6. Bank Rate increased steadily throughout 2022/23, starting at 0.75% and finishing at 4.25%.

6.7. In the interim, following a Conservative Party leadership contest, Liz Truss became Prime Minister for seven weeks that ran through September and October. The markets did not react well to the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng, and their reign lasted barely seven weeks before being replaced by Prime Minister Rishi Sunak and Chancellor Jeremy Hunt. Their Autumn Statement of the 17th of November gave rise to a net £55bn fiscal tightening, although much of the "heavy lifting" has been left for the next Parliament to deliver. However, the markets liked what they heard, and UK gilt yields have reversed the increases seen under the previous tenants of No10/11 Downing Street, although they remain elevated in line with developed economies generally.