Mid Devon
DISTRICT COUNCIL

Report for:	**Cabinet**
Date of Meeting:	6 June 2023
Subject:	**Annual Treasury Management Review 2022/23**
Cabinet Member:	Cllr James Buczkowski, Cabinet Member for Finance
Responsible Officer:	Andrew Jarrett, Deputy Chief Executive (S151)
Exempt:	N/A
Wards Affected:	All
Enclosures:	N/A

Section 1 – Summary and Recommendation(s)

To provide Members with a review of activities and the prudential treasury indicators on actuals for 2022/23.

Recommendation(s):

1. **That Cabinet note the treasury activities for the year.**
2. **That Cabinet approve the actual 2022/23 prudential and treasury indicators in this report.**

Section 2 – Report

1. Introduction

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:

- an annual treasury strategy in advance of the year (Council 23/02/2022)
- a mid-year (minimum) treasury update report (Council 14/12/2022)
- 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.

1.4 This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by Cabinet before they were reported to the full Council. Member training on treasury management issues was undertaken during 2019 in order to support members' scrutiny role, with further training being planned during 2023 following the recent district elections.

2. The Council's Capital Expenditure and Financing

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

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

2.2 The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

Capital Expenditure & Financing General Fund	2021/22 Actual £000	2022/23 Actual £000
Capital expenditure	7,479	10,273
Financed in year	1,545	4,815
Unfinanced capital expenditure	5,934	5,458
Funded by Leases	52	95
Funded by Internal & External Borrowing	5,882	5,363
HRA		
Capital expenditure	4,241	6,957
Financed in year	4,195	5,035
Unfinanced capital expenditure	46	1,922
Funded by Leases	44	63
Funded by Internal & External Borrowing	2	1,859

3. The Council's Overall Borrowing Need

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

3.2 **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 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 2022/23. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

Capital Financing Requirement	31 March 2022 Actual £000	31 March 2023 Actual £000
CFR General Fund	21,525	26,226
CFR HRA	39,603	40,552
Total CFR	61,127	66,778
Gross borrowing position	37,424	35,291
(Under) / over funding of CFR	-23,703	-31,487

3.3 **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. The table below demonstrates that during 2022/23 the Council has maintained gross borrowing within its authorised limit.

3.4 **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.

Borrowing Limits	**2022/23 £000**
Authorised limit	96,000
Maximum gross borrowing position during the year	37,424
Operational boundary	87,000
Average gross borrowing position	36,358

4. Treasury Position as at 31 March 2023

4.1 At the beginning and the end of 2022/23 the Council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

Debt Portfolio	**31 March 2022 £000**	**31 March 2023 £000**
Fixed rate funding:		
-PWLB	35,234	33,310
Total debt	35,234	33,310
CFR	58,938	64,797
(Under) / over borrowing	-23,704	-31,487
Total treasury investments*	32,000	21,000
Net debt	3,234	12,310

*See 4.3 for a breakdown of treasury investments

4.2 The maturity structure of the debt portfolio was as follows:

Debt Maturity Structure	**31 March 2022 Actual £000**	**31 March 2023 Actual £000**
Under 12 months	1,924	1,937
12 months and within 24 months	1,937	1,975
24 months and within 5 years	6,100	6,279
5 years and within 10 years	11,420	11,756
10 years and within 20 years	13,853	11,364
20 years and within 30 years	0	0

4.2.1. 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.

4.2.2. The policy of avoiding new borrowing by running down spare cash balances, has served the Council well over the last few years. However, this has been 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.

4.3 The Council's investment portfolio as at 31 March was as follows:

Investment Portfolio	**31 March 2022 Actual £000**	**31 March 2022 Actual %**	**31 March 2023 Actual £000**	**31 March 2023 Actual %**
Treasury investments				
Banks	12,000	38%	4,000	19%
Local authorities	15,000	47%	12,000	57%
Other Government Organisations	0	0%	0	0%
Total managed in house*	**27,000**	**84%**	**16,000**	**76%**
Property funds (CCLA)	5,000	16%	5,000	24%
Total managed externally	**5,000**	**16%**	**5,000**	**24%**
Total Treasury Investments	**32,000**	**100%**	**21,000**	**100%**

*See Appendix 1 for a breakdown of internally managed investments held as at 31 March.

4.4 The value shown in the above table for the Council's CCLA investment is the amount paid by the Council on share acquisition. This differs to the carrying amount in the year end accounts of £4,639k (£5,554k in 2021/22) as there is a requirement to carry the investment at fair value. The fair value of the fund will continue to change over the longer term, and so this decrease in value may only be temporary in which case it would not be realised as a loss to Council funds.

4.5 During 2021/22 the Council made two loans to Redlands Primary Care to help fund the construction of a new NHS hub in Crediton. The first loan of £1,200k was made on 18/06/2021 and the second of £975k on 25/10/2021, giving a total of £2,175k. These loans are being repaid in quarterly instalments over a period of 27 years, with a balance of £2,100k outstanding at 31 March 2023.

Investment Portfolio	**31 March Actual £000**	**31 March Actual %**	**31 March Actual £000**	**31 March Actual %**
Non-treasury investments				
Subsidiaries (3 Rivers Developments Ltd)	13,536	86%	20,075	91%
Crediton NHS Hub (Redlands Primary Care)	2,151	14%	2,100	9%
Total non-treasury investments	**15,711**	**100%**	**22,175**	**100%**

5. Borrowing Outturn

5.1 **Borrowing** – due to investment concerns, both counterparty risk and comparatively low investment returns, no borrowing was undertaken during the year.

5.2 **Borrowing in advance of need** – 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.

5.3 **Rescheduling** – no rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

6. Investment Outturn

6.1 **Investment Policy** – the Council's investment policy is governed by the Department of Levelling Up, Housing and Communities (DLUHC) investment guidance, which has been implemented in the annual investment strategy approved by the Council on 23/02/2022. 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 from our treasury advisers (Link Asset Services).

6.2 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

6.3 **Investments held by the Council** – the Council made a total return of £1,671k from investments in 2022/23 against a budget of £940k. This can be broken down as follows:

- The Council maintained an average balance of £28.6m of internally managed funds.
- The internally managed funds earned interest of £539k (£270k of which was transferred to HRA) giving an average rate of return of 1.84%.
- The comparable performance indicator is the 365 day backward looking SONIA rate, which was 0.9159%.
- The Council held £5m invested in Churches, Charities and Local Authorities (CCLA) property funds earning dividends of £201k (4.02%) in 2022/23.
- Interest received from 3 Rivers Ltd amounted to £856k in 2022/23.
- Interest received from Redlands Primary Care amounted to £75k in 2022/23.

7. Other Issues

7.1 IFRS 9 fair value of investments

7.1.1. Following the consultation undertaken by DLUHC on IFRS 9, 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 31 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.

7.1.2. Risk management will need to take account of the 2018/19 Accounting Code of Practice proposals for the valuation of investments. Whilst for many authorities, this may not be a significant issue, key considerations include:

- Expected credit loss model. Whilst this should not be material for vanilla treasury investments such as bank deposits, this is likely to be problematic for some investments such as property funds, loans to third parties or loans to subsidiaries.
- The valuation of investments previously valued under the available for sale category e.g. equity related to the “commercialism” agenda, property funds, equity funds and similar, have been changed to Fair Value through the Profit and Loss (FVPL).

7.2 **Non-treasury management investments**

7.2.1. As shown in the non-treasury investments table in section 4, the Authority holds a 100% interest in 3 Rivers Developments Limited (3 Rivers), a private limited company engaged in construction in the Mid Devon area. The Authority advances funds to the Company to facilitate operations with the intention that they are repaid from the proceeds of the sale of the developments.

7.2.2. During the year ended 31 March 2023, £6,540k was loaned to the Company. This brings the total loan value at 31 March 2023 to £20,075k. During the year £856k in interest was paid to the Authority in respect of these loans.

7.2.3. These loans are subject to overarching management review on a regular basis. This is reflected in the impairments of £4,527k provided for in the financial statements for 2022/23, which are additional to the impairments of £790k first provided for in 2019/20. These impairments do not necessarily mean that these amounts will never be recovered from 3 Rivers, rather they are a prudent provision based on possible outcomes given the company's current direction of travel.

8. Conclusion

8.1 Whilst 2022/23 has been far from that initially anticipated, it has provided the Council with significant additional income through its increased returns on investments, £731k above budget.

8.2 The Council continued its under borrowed position effectively utilising its balances to avoid additional debt financing costs. It also complied with all internal policies agreed by the previous Full Council and all requirements under the CIPFA Code of Practice.

Financial Implications

Good financial management and administration underpins the entire document. The Council's treasury position is constantly reviewed to ensure its continued financial health.

Legal Implications

Authorities are required by regulation to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003.

Risk Assessment

The S151 Officer is responsible for the administration of the financial affairs of the Council. Implementing this strategy and the CIPFA Code of Practice on Treasury Management manages the risk associated with the Council's treasury management activity.

Impact on Climate Change

The General Fund, Capital Programme and the Housing Revenue Account all contain significant investment in order to work towards the Council's Carbon Reduction Pledge.

Equalities Impact Assessment
No equality issues identified for this report.

Relationship to Corporate Plan
Maximising our return from all associated treasury activities enables the Council to support current levels of spending in accordance with our Corporate Plan.

Section 3 – Statutory Officer sign-off/mandatory checks

Statutory Officer: Andrew Jarrett
Agreed by or on behalf of the Section 151
Date: 24/05/2023

Statutory Officer: Maria De Leiburne
Agreed on behalf of the Monitoring Officer
Date: 24/05/2023

Chief Officer: Stephen Walford
Agreed by or on behalf of the Chief Executive/Corporate Director
Date: 24/05/2023

Performance and risk: Dr Stephen Carr
Agreed on behalf of the Corporate Performance & Improvement Manager
Date: 24/05/2023

Cabinet member notified: Yes.

Section 4 - Contact Details and Background Papers

Contact: Kieran Knowles, Principal Accountant & Procurement Manager
Email: kknowles@middevon.gov.uk
Telephone: 01884 24(4624)

Background papers: Treasury Management Strategy Statement 2022/23 (Council 23/02/2022) & Treasury Mid-Year Review 2022/23 (Council 14/12/2022)

Appendix 1: Investment Portfolio

Internally managed investments held as at 31 March:

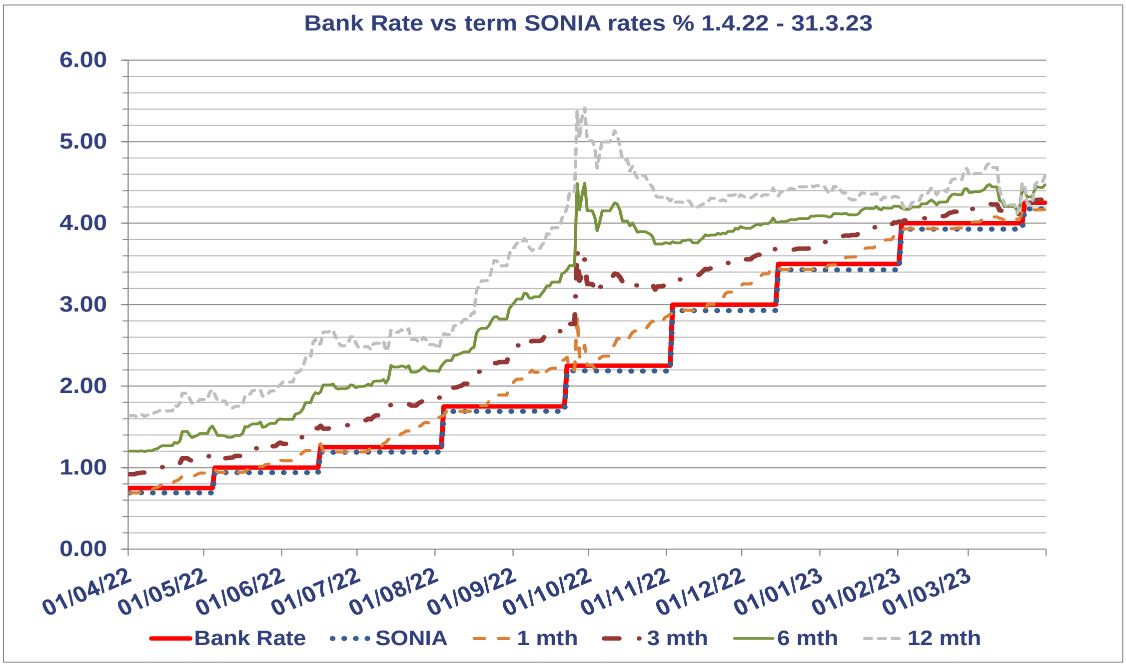
Bank/Building Society/Local Authority/PCC	Term		Fixed Interest Rate %	31/03/2022	31/03/2023
	From	To		£000	£000
Surrey Heath Borough Council	10/12/2021	10/06/2022	0.10%	2,000	
Thurrock Council	26/04/2021	25/04/2022	0.40%	2,000	
NBK International PLC	27/07/2021	27/07/2022	0.23%	1,500	
NBK International PLC	22/10/2021	21/10/2022	0.56%	1,500	
Lancashire County Council	25/10/2021	24/10/2022	0.15%	3,000	
Coventry BS	24/11/2021	24/05/2022	0.17%	4,000	
Surrey Heath Borough Council	16/12/2021	16/06/2022	0.10%	2,000	
Thurrock Council	16/12/2021	16/09/2022	0.18%	2,000	
Thurrock Council	14/01/2022	14/07/2022	0.20%	2,000	
Goldman Sachs International Bank	01/02/2022	01/08/2022	0.82%	3,000	
NBK International PLC	04/02/2022	03/02/2023	1.30%	2,000	
Slough Borough Council	15/02/2022	14/02/2023	1.10%	2,000	
Thurrock Council	25/10/2022	24/10/2023	3.55%		2,000
Thurrock Council	14/07/2022	14/04/2023	2.00%		2,000
London Borough of Croydon	24/10/2022	24/04/2023	4.00%		3,000
West Dunbartonshire Council	25/10/2022	25/07/2023	3.90%		2,000
NBK International PLC	15/11/2022	15/05/2023	3.92%		1,500
Santander	01/12/2022	01/06/2023	3.90%		2,500
Aberdeen City Council	26/01/2023	26/05/2023	3.60%		3,000
Total				**27,000**	**16,000**

Appendix 2: Market commentary provided by out Treasury Advisors (Link Group)

The strategy for 2022/23

Investment strategy and control of interest rate risk

The following chart shows how Bank Rate and SONIA (Sterling Overnight Index Average) rates have changed during the year.



Interest rate forecasts were initially suggesting only gradual rises in short, medium and longer-term fixed borrowing rates during 2022/23, but by August it had become clear that inflation was moving up towards 40-year highs. The Bank of England engaged in monetary policy tightening at every Monetary Policy Committee meeting during 2022, and into 2023, either by increasing Bank Rate by 0.25% or 0.5% each time. At the year end the CPI measure of inflation was still above 10% in the UK but is expected to fall back towards 4% by year end. Nonetheless, there remain significant risks to that central forecast.

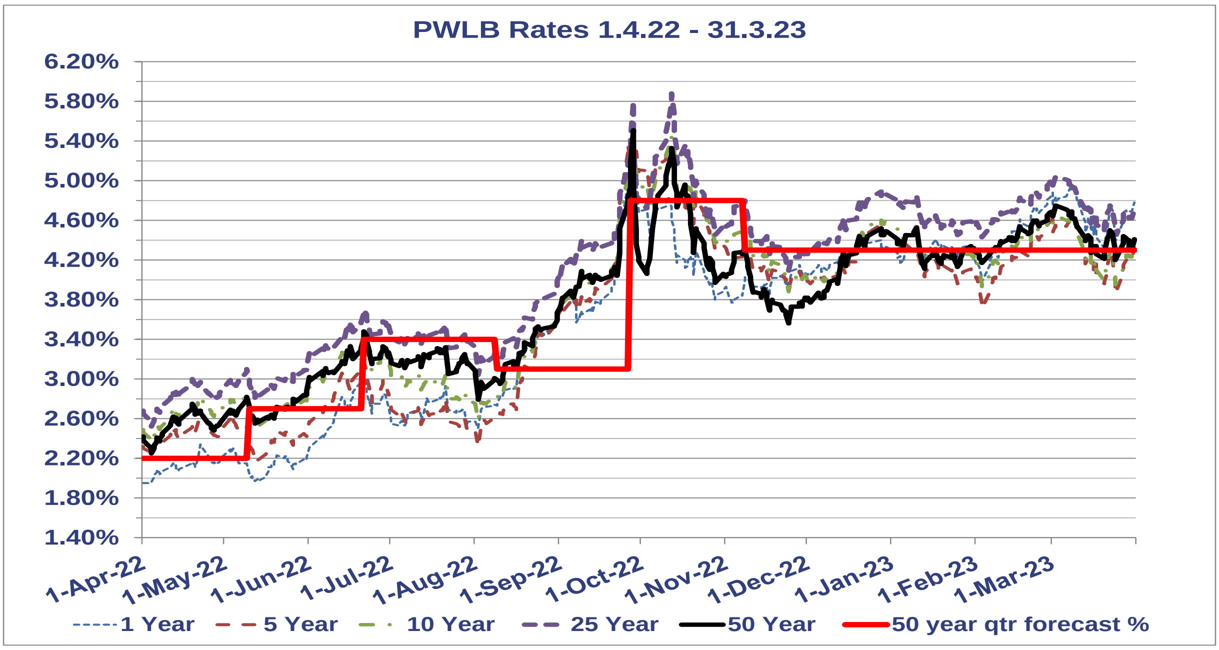
The sea-change in investment rates meant local authorities were faced with the challenge of pro-active investment of surplus cash for the first time in over a decade, and this emphasised the need for a detailed working knowledge of cash flow projections so that the appropriate balance between maintaining 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.

Through the autumn, and then in March 2023, the Bank of England maintained various monetary policy easing measures as required to ensure specific markets, the banking system and the economy had appropriate levels of liquidity at times of stress.

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 Great Financial Crisis of 2008/09. 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

PWLB rates during 2022/23 are illustrated by the following chart:



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.95%	2.18%	2.36%	2.52%	2.25%
Date	01/04/20	13/05/20	04/04/20	04/04/20	04/04/20
High	5.11%	5.44%	5.45%	5.88%	5.51%
Date	28/09/20	28/09/20	12/10/20	12/10/20	28/09/20
Avera	3.57%	3.62%	3.76%	4.07%	3.74%
Sprea	3.16%	3.26%	3.09%	3.36%	3.26%

The following table shows forecast interest rates over the next three years:

Link Group Interest Rate View	27.03.23											
	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26
BANK RATE	4.50	4.50	4.25	4.00	3.50	3.25	3.00	2.75	2.75	2.50	2.50	2.50
3 month ave earnings	4.50	4.50	4.30	4.00	3.50	3.30	3.00	2.80	2.80	2.50	2.50	2.50
6 month ave earnings	4.50	4.40	4.20	3.90	3.40	3.20	2.90	2.80	2.80	2.60	2.60	2.60
12 month ave earnings	4.50	4.40	4.20	3.80	3.30	3.10	2.70	2.70	2.70	2.70	2.70	2.70
5 yr PWLB	4.10	4.10	3.90	3.80	3.70	3.60	3.50	3.40	3.30	3.20	3.20	3.10
10 yr PWLB	4.20	4.20	4.00	3.90	3.80	3.70	3.50	3.50	3.40	3.30	3.30	3.20
25 yr PWLB	4.60	4.50	4.40	4.20	4.10	4.00	3.80	3.70	3.60	3.50	3.50	3.40
50 yr PWLB	4.30	4.20	4.10	3.90	3.80	3.70	3.50	3.50	3.30	3.20	3.20	3.10

PWLB rates are based on gilt (UK Government bonds) yields through HM Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields. In recent years many bond yields up to 10 years in the Eurozone turned negative on expectations that the EU would struggle to get growth rates and inflation up from low levels. In addition, there has, at times, been an inversion of bond yields in the US whereby 10-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession.

However, since early 2022, yields have risen dramatically in all the major developed economies, first as economies reopened post-Covid-19; then because of the inflationary impact of the war in Ukraine in respect of the supply side of many goods. In particular, rising cost pressures emanating from shortages of energy and some food categories have been central to inflation rising rapidly. Furthermore, at present the Fed, ECB and Bank of England are all being challenged by persistent inflation that is exacerbated by very tight labour markets and high wage increases relative to what central banks believe to be sustainable.

Gilt yields have been on a continual rise since the start of 2022, peaking in the autumn of 2022. Currently, yields are broadly range bound between 3% and 4.25%. At the close of the day on 31 March 2023, all gilt yields from 1 to 50 years were between 3.64% and 4.18%, with the 1 year being the highest and 6-7.5 years being the lowest yield.

Regarding PWLB borrowing rates, the various margins attributed to their pricing are as follows:

PWLB Standard Rate is gilt plus 100 basis points (G+100bps)
PWLB Certainty Rate is gilt plus 80 basis points (G+80bps)
Local Infrastructure Rate is gilt plus 60bps (G+60bps)

There is likely to be a fall in gilt yields and PWLB rates across the whole curve over the next one to two years as Bank Rate first rises to dampen inflationary pressures and a tight labour market, and is then cut as the economy slows, unemployment rises, and inflation (on the Consumer Price Index measure) moves closer to the Bank of England's 2% target. As a general rule, short-dated gilt yields will reflect expected movements in Bank Rate, whilst medium to long-dated yields are driven primarily by the inflation outlook.

The Bank of England is also embarking on a process of Quantitative Tightening, but the scale and pace of this has already been affected by the Truss/Kwarteng "fiscal experiment" in the autumn of 2022 and more recently by the financial market unease with some US (e.g., Silicon Valley Bank) and European banks (e.g., Credit Suisse). The gradual reduction of the Bank's original £895bn stock of gilt and corporate bonds will be sold back into the market over several years. The impact this policy will have on the market pricing of gilts, while issuance is markedly increasing, is an unknown at the time of writing.