

Report To:	Audit and Governance Committee
Date:	3 July 2023
Report Title:	Treasury Management Annual Report 2022/23
Report of:	Director of Finance and Performance (Chief Finance Officer - S151 Officer)
Ward(s):	All
Purpose of report:	To report on the activities and performance of the Treasury Management service during 2022/23.
Officer Recommendations:	To recommend to Full Council (via Cabinet): 1. That Members consider and approve the Annual Treasury Management report 2022/23. 2. To approve the 2022/23 Prudential and Treasury Indicators included in the report (Section 9.1).
Reasons for recommendations:	Requirement of CIPFA Treasury Management in the Public Sector Code of Practice (the Code).
Contact Officer(s):	Name: Steven Houchin Post title: Interim Deputy Chief Finance Officer E-mail: steven.houchin@lewes-eastbourne.gov.uk Telephone number: 01323 415378

1 Introduction

- 1.1 This Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management 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 21 February 2022)
 - a mid-year (minimum) treasury briefing.
 - an annual report following the year describing the activity compared to the strategy (this report)
- 1.3 In addition, Treasury Management updates were included in the quarterly performance management reports, considered by both the Cabinet and Policy and Performance Advisory Committee.

- 1.4 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.
- 1.5 This Council also confirms that it has complied with the requirement under the Code to give prior scrutiny of all the above treasury management reports by the Audit & Governance Committee before they were reported to the full Council. Member training on treasury management issues was undertaken in autumn 2022, which is to support Members' scrutiny role. Further training will be undertaken in October 2023.
- 1.6 This report summarises:
- Capital activities during the year.
 - Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement).
 - The actual prudential and treasury indicators.
 - Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances.
 - Summary of interest rate movements in the year.
 - Debt activity and investment activity.

2 The Council's Capital Expenditure and Financing 2022/23

- 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 (Capital Financing Requirement).
- 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.

General Fund £'000	31/03/2022	2022/23	31/03/2023
	Actual	Budget	Actual
Capital expenditure	8,625	26,056	9,849
Financed in year	(5,864)	(15,077)	(7,469)
Unfinanced capital expenditure	(2,760)	(10,979)	(2,379)

HRA £'000	31/03/2022	2022/23	31/03/2023
	Actual	Budget	Actual
Capital expenditure	5,604	12,628	8,668
Financed in year	(1,294)	(12,628)	(8,668)
Unfinanced capital expenditure	(4,310)	-	-

3 The Councils Overall Borrowing Need

- 3.1 The Capital Financing Requirement (CFR) represents the Council's total underlying need to borrow to finance capital expenditure, i.e. capital expenditure that has not been resourced from capital receipts, capital grants and contributions or the use of reserves. Some of this borrowing is from the internal use of cash balances.
- 3.2 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 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 PWLB or the money markets), or utilising temporary cash resources within the Council.
- 3.3 Reducing the CFR – the Council's (non HRA) 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 non-Housing Revenue Account borrowing need (there is no statutory requirement to reduce the HRA CFR). 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. The total CFR can also be reduced by:
- the application of additional capital financing resources (such as unapplied capital receipts); or
 - charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).
- 3.4 The Council's 2022/23 MRP Policy (as required by Department for Levelling Up, Housing and Communities Guidance) was approved as part of the Treasury Management Strategy Report for 2022/23 on 21 February 2022. The Council's CFR for the year is shown below and represents a key prudential indicator.

CFR (£'000): General Fund	31/03/2022	2022/23	31/03/2023
	Actual	Budget	Actual
Opening balance	18,589	21,014	21,014
Add unfinanced capital expenditure	2,760	10,979	2,379
Less MRP	(334)	(367)	(359)

Less Loan repayments	(2)	-	(133)
Closing balance	21,014	31,626	22,902

CFR (£'000): HRA	31/03/2022	2022/23	31/03/2023
	Actual	Budget	Actual
Opening balance	70,679	74,989	74,989
Add unfinanced capital expenditure	4,310	-	-
Closing balance	74,989	74,989	74,989

- 3.5 The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the Authorised Limit.
- 3.6 Net borrowing and the CFR - to ensure that borrowing levels are prudent over the medium term, the Council's external borrowing net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure.
- 3.7 Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2021/22 plus the expected changes to the CFR over 2022/23 and 2023/24. This indicator allows the Council some flexibility to borrow in advance of its immediate capital need in 2022/23. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

£'000	31/03/2022	2022/23	31/03/2023
	Actual	Budget	Actual
Gross borrowing position	51,673	53,673	51,673
CFR	96,003	106,615	97,891
Over / (Under) Funding of CFR	(44,330)	(52,942)	(46,218)

- 3.8 The Authorised limit - the Authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. 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.

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 is acceptable subject to the Authorised limit not being breached.

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.

£'000	2022/23
Authorised limit	139,277
Maximum gross borrowing position during the year	51,673
Operational boundary	126,615
Average gross borrowing position	51,673
GF Financing costs as a proportion of net revenue stream	-4.6%
HRA financing costs as a proportion of rental income	12.5%
Income from Commercial and Service Delivery Investments as a proportion of net revenue stream	12.2%

4 Treasury Position as at 31 March 2023

- 4.1 The Council's debt and investment position is organised by staff within Financial Services to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities.
- 4.2 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. At the beginning and the end of 2022/23, the Council 's treasury position was as follows:

DEBT PORTFOLIO	31/3/22 Principal	Rate/ Return %	31/3/23 Principal	Rate/ Return %
Fixed rate funding:				
-PWLB	46,673	3.1%	46,673	3.1%
-Market	5,000	4.5%	5,000	4.5%
Total debt	51,673		51,673	
CFR	96,003		97,891	
Over / (under) borrowing	(44,330)		(46,218)	
Total investments	33,267	0.14%	19,907	1.61%
Net debt	18,406		31,766	

- 4.3 The maturity structure of the debt portfolio was as follows:

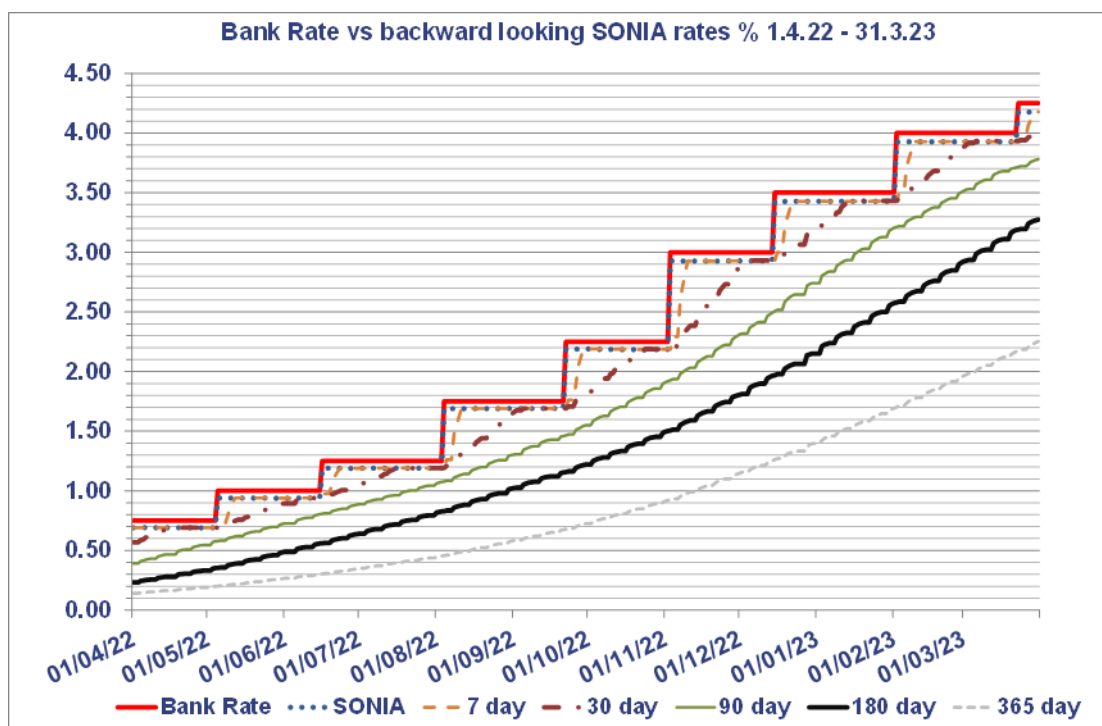
	31.3.22	2022/23	31.3.23
	Actual £'000	Original limits £'000	Actual £'000
Under 12 months	-	8,000	8,000
12 months and within 24 months	8,000	2,000	2,000
24 months and within 5 years	10,000	10,000	10,000
5 years and within 10 years	12,000	10,000	10,000
10 years and within 20 years	16,673	18,673	16,673
20 years and within 30 years	-	-	-
30 years and within 40 years	5,000	5,000	5,000
40 years and within 50 years	-	-	-

The exposure to fixed and variable rates was as follows:

	31 March 2022 Actual £'000	31 March 2023 Actual £'000
Principal - Debt Fixed rate	51,673	51,673
Principal – Investments Variable rate	0	0

5 Investment Strategy and Control of Interest Rate Risk

- 5.1 The investment strategy during the financial year made reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Whilst greater returns are usually obtainable by investing for longer periods, there was the greater emphasis on ensuring cash balances were available to manage the ups and downs of the council's cash flow. Where cash sums were identified that could be invested for longer periods, the value to be obtained from longer term, investments were carefully assessed.
- 5.2 Investment returns picked up throughout the course of 2022/23 as central banks, including the Bank of England, realised that inflationary pressures were not transitory, and that tighter monetary policy was called for. Starting April at 0.75%, Bank Rate moved up in stepped increases of either 0.25% or 0.5%, reaching 4.25% by the end of the financial year, with the potential for a further one or two increases in 2023/24.
- 5.3 The tables below illustrate the change in Sterling Overnight Index Average (SONIA) compared to the Bank of England Base Rate throughout the year.



FINANCIAL YEAR TO QUARTER ENDED 31/03/2023							
	Bank Rate	SONIA	7 day	30 day	90 day	180 day	365 day
High	4.25	4.18	4.18	4.00	3.78	3.27	2.25
High Date	23/03/2023	31/03/2023	31/03/2023	31/03/2023	31/03/2023	31/03/2023	31/03/2023
Low	0.75	0.69	0.69	0.57	0.39	0.23	0.14
Low Date	01/04/2022	28/04/2022	29/04/2022	01/04/2022	01/04/2022	01/04/2022	01/04/2022
Average	2.30	2.24	2.20	2.09	1.81	1.42	0.90
Spread	3.50	3.49	3.49	3.43	3.39	3.04	2.11

- 5.4 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.
- 5.5 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) became more actively used.
- 5.6 Meantime, 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.
- 5.7 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 2008/9

6 Borrowing Strategy and Control of Interest Rate Risk

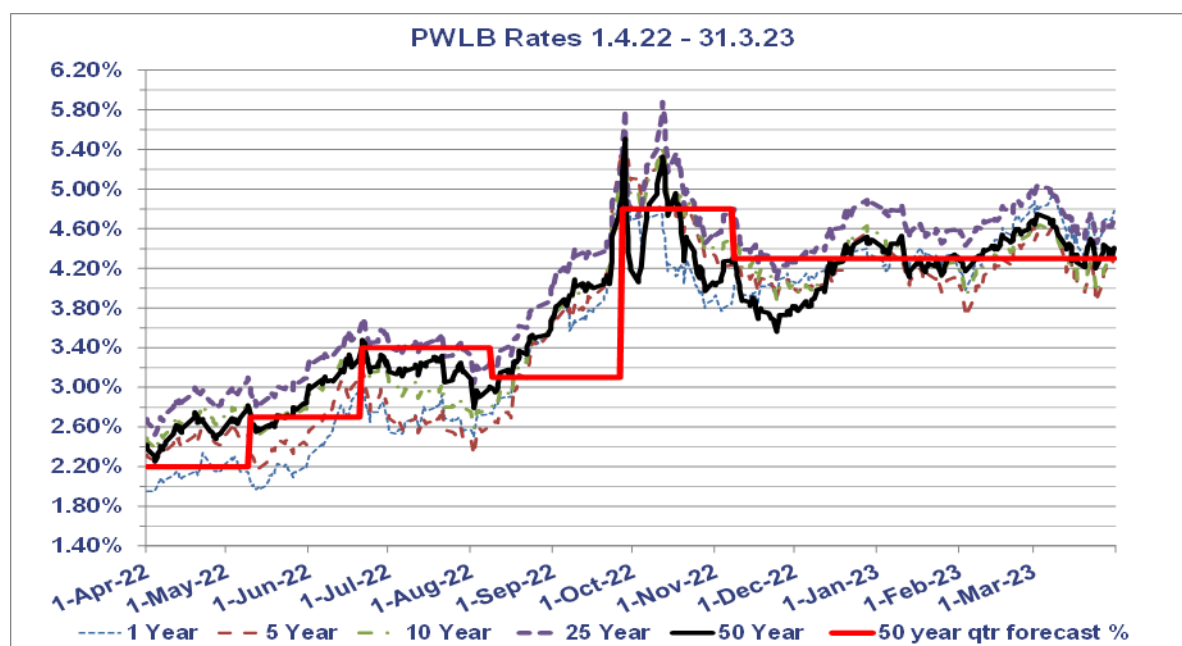
- 6.1 During 2022/23, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt as cash supporting the Council’s reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were very low and minimising counterparty risk on placing investments also needed to be considered.
- 6.2 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.
- 6.3 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. No new loans were drawn down from PWLB in 2022/23 to fund the net unfinanced capital expenditure and/or to replace maturing loans.

6.4 In taking this decision, the Council carefully considered achieving best value, the risk of having to borrow at higher rates at a later date, the carrying cost of the difference between interest paid on such debt and interest received from investing funds which would be surplus until used, and that the Council could ensure the security of such funds placed on temporary investment.

7 Interest Rates

7.1 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, and 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. Currently the CPI measure of inflation is 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.

7.2 The tables below illustrate the change in Public Work Loans board (PWLB) rates throughout the year.



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.95%	2.18%	2.36%	2.52%	2.25%
Date	01/04/2022	13/05/2022	04/04/2022	04/04/2022	04/04/2022
High	5.11%	5.44%	5.45%	5.88%	5.51%
Date	28/09/2022	28/09/2022	12/10/2022	12/10/2022	28/09/2022
Average	3.57%	3.62%	3.76%	4.07%	3.74%
Spread	3.16%	3.26%	3.09%	3.36%	3.26%

7.3 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.

- 7.4 Inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation and the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc.
- 7.5 This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. Indeed, 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.
- 7.4 However, since early 2022, yields have risen dramatically in all the major developed economies, first as economies opened post-Covid; then because of the inflationary impact of the war in Ukraine in respect of the supply side of many goods.
- 7.5 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 FOMC, 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.
- 7.6 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.
- 7.7 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.
- 7.8 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.

8 Investment Outturn for 2022/23

- 8.1 The Council's investment policy is governed by DLUHC guidance, which was implemented in the annual investment strategy approved by the Council on 9

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.).

- 8.2 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.
- 8.3 Resources – the Council’s longer-term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations. The Council’s core cash resources comprised as follows, and met the expectations of the budget:

Balance Sheet Resources - General Fund (£'000)	31/03/2022	31/03/2023
GF Balances	3,723	3,723
Earmarked reserves	10,219	8,476
Capital Grants & Contributions	9,139	9,326
Provisions	-	-
Usable capital receipts	956	10,096
Total	24,037	31,621

Balance Sheet Resources - HRA (£'000)	31/03/2022	31/03/2023
HRA Balances	4,495	3,342
Earmarked reserves	86	86
Major Repairs Reserve	10,041	10,051
Usable capital receipts	9,815	8,779
Total	24,437	22,258

8.4 Investments held by the Council

- 8.5 Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority’s objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.
- 8.6 At 31 March 2023 the Council held investments totalling £25.255m in a mixture of Treasury and Non-Treasury investments illustrated in the tables below. Interest received on Treasury Investments was £0.55m in 2022/23 compared to £0.02m in the previous year because of base rate increases during the financial year. Interest received on Non-Treasury Investments was £0.69m in 2022/23 compared to £0.3m in the previous year. Additional interest was on loans to a council owned subsidiary company (Aspiration Homes Limited)

Investment Portfolio	31/03/2022	31/03/2022	31/03/2023	31/03/2023
	Actual	Actual	Actual	Actual
	£'000	%	£'000	%
Treasury investments				
Banks	15,966	48.0%	18,907	95.0%
Building Societies - rated	-	0.0%	-	0.0%
Building Societies – unrated	-	0.0%	-	0.0%
Local authorities	-	0.0%	-	0.0%
DMADF (H M Treasury)	17,300	52.0%	1,000	5.0%
Money Market Funds	1	0.0%	-	0.0%
Total managed in house	33,267	100.0%	19,907	100.0%
Bond funds	-	0.0%	-	0.0%
Property funds	-	0.0%	-	0.0%
Cash fund managers	-	0.0%	-	0.0%
Total managed externally	-	0.0%	-	0.0%
Total Treasury Investments	33,267	100%	19,907	100%
Non-Treasury investments				
Third party loans	612	22.3%	517	19.5%
Subsidiaries	2,132	77.7%	2,132	80.5%
Companies	-	0.0%	-	0.0%
Property	-	0.0%	-	0.0%
Total Non-Treasury Investments	2,743	100.0%	2,648	100.0%
Total Investments	36,010	100%	22,555	100%

9 Executive Summary and Conclusion

- 9.1 During 2022/23, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:-

Prudential and treasury indicators	31.3.22	2022/23	31.3.23
	Actual	Original	Actual
	£'000	£'000	£'000
Capital expenditure			
Non-HRA	8,625	26,056	9,849
HRA	5,604	12,628	8,668
Total	14,229	38,684	18,517

Capital Financing Requirement:			
Non-HRA	21,014	31,626	22,902
HRA	74,989	74,989	74,989
Total	96,003	106,615	97,891
Gross borrowing	75,774	67,931	79,374
External debt	51,673		51,673
Treasury Investments			
Longer than 1 year	33,267		19,907
Under 1 year	0		0
Total	33,267		19,907
Net borrowing	18,406		31,766

9.2 Other prudential and treasury indicators are to be found in the main body of this report. The Chief Finance Officer also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the Authorised limit), was not breached. The financial year 2022/23 continued the challenging environment of previous years; low investment returns, and continuing counterparty risk continued.

10 The Economy and Interest Rates Forecast

10.1 The Council's treasury advisor, Link, provides the Economy and Interest Rates Forecast, which is attached as Appendix A.

11 Other

11.1 **IFRS 9 fair value of investments:** Following the consultation undertaken by the Department of Levelling Up, Housing and Communities [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 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.

11.2 **IFRS 16:** The implementation of the new IFRS 16 Leases accounting standard to currently off-balance sheet leased assets onto the balance sheet was due to come into force for local authorities from 1st April 2022. Following a consultation of CIFPA/LASAAC it was agreed that implementation of the standard would be deferred until 1 April 2024, impacting financial statements for the period 2024/25 onwards.

12 Investment Consultants

12.1 The Council has a contract with Link Treasury Services Limited who act as the Council's Treasury Adviser. The Link Treasury Services has been

appointed to support both the Lewes District Council and Eastbourne Borough Council, given that a shared finance team (with treasury management responsibility) has been established. The Link contract was extended on 30 May 2023 for a further two years.

13 Corporate plan and council policies

- 13.1 The priority themes were considered as part of the overall Capital Programme which forms part of the Treasury Management Strategy.

14 Financial appraisals

- 14.1 Financial appraisals were considered as part of the overall Capital Programme which forms part of the Treasury Management Strategy.

15 Legal implications

- 15.1 Comment from the Legal Services Team is not necessary for this routine monitoring report.

16 Risk management implications

- 16.1 Risks relating to the timing of borrowing and terms of borrowing are considered and advice is provided by Link. Risk management is considered for each of the schemes within the Capital Programme.

17 Equality analysis

- 17.1 Equality issues are considered.

18 Appendices

- 18.1 Appendix A – The Economy and Interest Rates
18.2 Appendix B – Glossary - Local Authority Treasury Management Terms

19 Background papers

The Background Papers used in compiling this report were as follows:

CIPFA Treasury Management in the Public Services code of Practice (the Code)

Cross-sectorial Guidance Notes

CIPFA Prudential Code

Treasury Management Strategy and Treasury Management Practices.

Link Asset Services Citywatch and interest rate forecast