Audit Committee – 28 July 2023

Title of paper:	Treasury Management 2022/23 Annual Report	
Director(s)/ Corporate Director(s):	Ross Brown, Corporate Director of Finance and Resources and Section 151 Officer	**Wards affected:** All
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Does this report contain any information that is exempt from publication? No		
Recommendation(s):		
1.	To note the Treasury Management performance for 2022/23	

1. Reasons for recommendations

1.1 The Treasury Management function is governed by provisions set out under Part 1 of the Local Government Act 2003, whereby the City Council must have regard to the CIPFA Prudential Code and the CIPFA Code of Practice. Under the latter Code, an annual report is required to be submitted to and considered by councillors.

1.2 The Council's Treasury Management Strategy for 2022/23 was approved by full Council on 7 March 2022.

1.3 The Council borrows and invests substantial sums of money as part of its business as usual activity. In common with all local authorities, it is therefore exposed to financial risks including the loss of invested funds and the revenue account impact of changing interest rates. This report covers performance in relation to treasury management activity and the associated monitoring and control of risk.

2. Background (including outcomes of consultation)

2.1 The Council is required to operate a balanced budget, which broadly means cash raised during the financial year will meet its cash expenditure. Treasury management operations ensure that this cash flow is adequately planned, with surplus monies being invested by prioritising low risk counterparties and ensuring liquidity of funds before considering and optimising investment return.

2.2 The treasury management function also services the financing of the Council's capital expenditure plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer-term cash may involve arranging long or short term loans or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

2.3 Accordingly, Treasury Management is defined as: “The management of the local authority’s borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

2.4 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy’s (CIPFA) Code of Practice on Treasury Management (revised 2021).

2.5 The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council’s treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by the Full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead. Receipt by Executive Board of a Mid-year Review Report and an Annual Report, covering activities during the previous year.
- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Council of the role of scrutiny of Treasury Management Strategy and Policies to a specific named body. For this Council the delegated body is the Audit Committee.

2.6 This Annual report has been prepared in compliance with CIPFA’s Code of Practice on Treasury Management, and covers the following:

- An economic update for the 2022/23 financial year.
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy.
- The Council’s capital expenditure, and prudential indicators.
- A review of the Council’s investment portfolio for 2022/23.
- A review of the Council’s borrowing strategy for 2022/23.
- A review of any debt rescheduling undertaken during 2022/23.
- A review of compliance with Treasury and Prudential Limits for 2022/23.

3. Other options considered in making recommendations

3.1 Options for management of the Council’s debt and investment portfolio are continually reviewed. The overall aim is to minimise the net revenue costs of the Council’s debt whilst maintaining an even debt profile in future years and to maximise investment returns within stated security and liquidity guidelines.

4. Treasury Management Activity in 2022/23

4.1 The UK Economy, Growth, Monetary Policy and Inflation

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

4.1.2 Market commentators' misplaced optimism around inflation has been the root cause of the rout in the bond markets with, for example, UK, EZ and US 10-year yields all rising by over 2% in 2022. CPI inflation picked up to a peak reading of 11.1% in October, although hopes for significant falls from this level have been impacted by the resilience of core inflation. On balance, most commentators expect the CPI measure of inflation to drop back towards 4% by the end of 2023. As of March 2023, CPI was 10.1%.

4.1.3 **Appendix 2** shows the money market interest rates and the Public Works Loans Board (PWLB) borrowing rates for 2022-23

4.2 **Local Context**

4.2.1 Following a recent non-statutory review the Council has implemented a Voluntary Debt Reduction Policy (VDRP) with the aim to support the Council in returning to financial and operational stability. The borrowing and debt management strategies aim to reduce the Council's future requirement to borrow, known as the Capital Financing Requirement (CFR), and to reduce the level of debt held by the Council.

4.2.2 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 impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources based on robust financial modelling, the capital expenditure will give rise to a borrowing need, however this route is strictly limited by the Capital Strategy.

4.2.3 4.2.3 The CFR is a gauge of the Council's indebtedness and 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, and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

4.2.4 At 31 March 2023 the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £1,316.2m.

4.2.5 Table 1 below shows the original and the actual financing arrangements of the capital programme. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need will also be increased by maturing debt and other treasury requirements.

Table 1: Capital Outturn 2022/23			
	2022/23 Original Budget £m	2022/23 Actual £m	% Change original to actual
Capital Expenditure			
General Fund (exc. Midland Net Zero Hub)	153.891	69.581	(54.8%)
General Fund - Midland Net Zero Hub only	0.000	83.492	100.0%
Housing Revenue Account	71.003	51.689	(27.2%)
Total Expenditure	**224.894**	**204.762**	**(9.0%)**
Financed by:			
Capital Receipts	(27.161)	(33.045)	21.7%
Capital Grants & Contributions	(114.897)	(130.286)	13.4%
Internal Funds / Revenue (Inc. Major Repairs Reserve)	(48.023)	(32.957)	(31.4%)
Total Financing	**(190.081)**	**(196.288)**	**3.3%**
BORROWING REQUIREMENT	**(34.813)**	**(8.474)**	**(75.7%)**

4.3 **Borrowing**

4.3.1 To finance the CFR (the Capital Financing Requirement), the Council may borrow externally from the Public Works Loans Board (PWLB) or the market, or from its own internal balances on a temporary basis (internal borrowing), by using its cash balances that are not immediately needed for the delivery of services. The balance of external and internal borrowing is generally driven by market conditions.

4.3.2 During 2022-23, the Council continued its strategy to reduce the CFR and external debt balances by repaying maturing loans with its cash balances and by internal borrowing. This means that the overall capital borrowing need (known as the CFR), has not been fully funded by taking external loan debt.

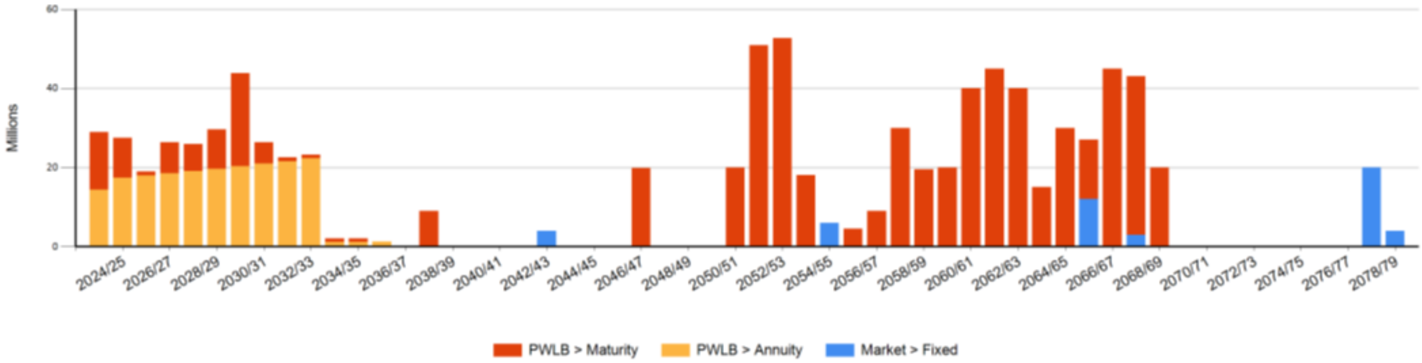
4.3.3 Total outstanding external loan debt in 2022-23 decreased by £22.9m (-2.5%) to £878.0m at 31 March 2023. The average rate of interest on total external loan debt decreased, from 3.431% at 31 March 2022 to 3.423% at 31 March 2023. Table 2 below analyses the debt portfolio:

Table 2: Debt Portfolio					
Debt	01-Apr-22		31-Mar-23		Movement
	£m	Average Interest %	£m	Average Interest %	£m
PWLB borrowing	849.7	3.385%	824.7	3.36%	-25.0
Market loans inc LOBO	49.0	4.348%	49.0	4.35%	0.0
Temporary borrowing	2.2	0.768%	4.3	2.29%	2.1

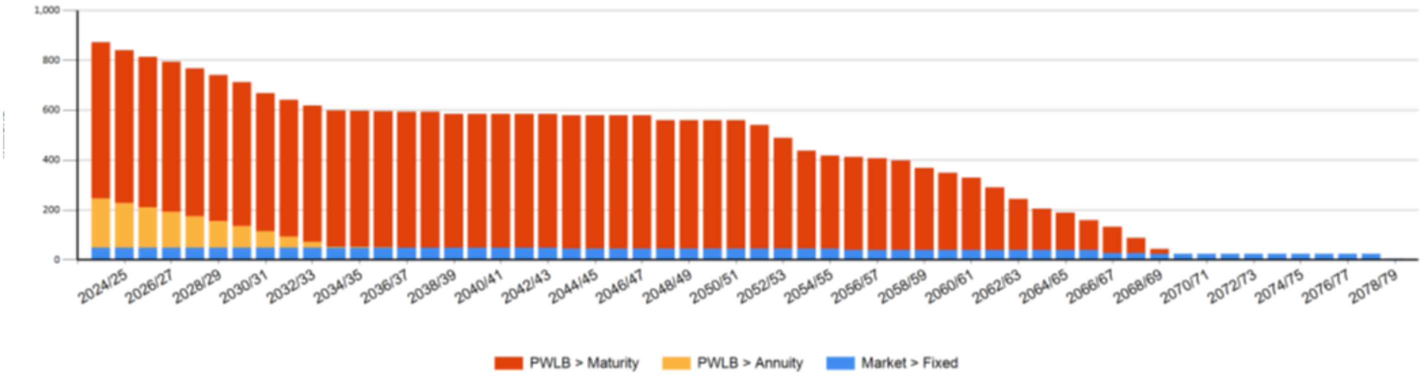
Table 2: Debt Portfolio					
Debt	01-Apr-22		31-Mar-23		Movement
	£m	Average Interest %	£m	Average Interest %	£m
& other					
TOTAL LOANS DEBT	**900.9**	**3.431%**	**878.0**	**3.423%**	**-22.9**
Other including PFI	170.2		158.3		-11.9
TOTAL DEBT	**1,071.1**		**1,036.3**		**-34.8**

4.3.4 The graphs below show the maturity profile of the debt portfolio and total debt each year. These graphs should be reviewed together with the Prudential Indicator for Debt Maturity shown in paragraph 4.11.4.

Graph 1 Debt Maturity profile



Graph 2 Total Debt each year



4.3.5 In 2022-23 the Council did not take any further long term borrowing from the Public Works Loans Board (PWLB) or from banks.

4.3.6 The Council's internal borrowing position at 31 March 2023 was £279.9m. This meant that c.24% of the overall capital borrowing need including prior year capital expenditure but excluding PFI liabilities (known as the Capital Financing Requirement), was not funded with loan debt as cash held by the Council for reserves, balances and cash flow was used as a temporary measure.

4.3.7 The strategy of using internal borrowing avoids the cost of interest payable on external borrowing in the short term until actual new borrowing is taken or the borrowing requirement reduces.

4.3.8 The Council expects to retain this internal borrowing position as a prudent and cost effective approach in view of the reducing CFR and the current forecast for balances available to support this position.

4.3.9 The continuation of this existing strategy will further support managing the Council's cost of financing in the coming years and supports the aims of the VDRP in reducing the Council's debt levels.

4.4 Compliance with the Voluntary Debt Reduction Policy

4.4.1 Table 3 below reflects the reductions in capital expenditure financed by borrowing and the capital receipt strategy in the forecast Capital Financing Requirement (CFR) and external loans debt in the medium term.

Table 3: VDRP Forecast Refresh				
Debt Measurement	**VDRP Original Forecast £m**	**Outturn / Forecast £m**	**Movement (Under) / Over £m**	**Movement From forecast %**
CFR				
2020/21 *	1,443.50	1,411.60	**-31.90**	**-2.2%**
2021/22 *	1,434.20	1,374.21	**-59.99**	**-4.2%**
2022/23 *	1,390.60	1,316.15	**-74.45**	**-5.4%**
2023/24 **	1,337.30	1,251.18	**-86.12**	**-6.4%**
2024/25 **	1,272.50	1,168.82	**-103.68**	**-8.1%**
External Debt				
2020/21 *	981.60	932.80	**-48.80**	**-5.0%**
2021/22 *	991.00	900.94	**-90.06**	**-9.1%**
2022/23 *	986.20	878.00	**-108.20**	**-11.0%**
2023/24 **	954.80	844.58	**-110.22**	**-11.5%**
2024/25 **	927.40	817.14	**-110.26**	**-11.9%**

* Outturn; ** Forecast

4.5 Lender Option Borrower Option (LOBOs)

4.5.1 The Council holds £34.000m of LOBO loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. £14.000m of these LOBO loans had options during the year, none have been exercised by the lender.

4.6 Borrowing in advance of need

4.6.1 The Treasury Management Code of Practice states an organisation may only borrow in advance of the need in order to reduce financing and interest rate risks i.e. not purely in order to profit from the investment of the extra sums borrowed. The Council has complied with the Code in this respect.

4.7 **Debt Rescheduling**

4.7.1 The PWLB continued to operate a spread of approximately 1% between “premature repayment rate” and “new loan” rates so the premium charge for early repayment of PWLB debt has made rescheduling unviable for the existing loans in the Council’s portfolio. No rescheduling activity was undertaken as a consequence.

4.8 **Housing Revenue Account (HRA) Borrowing**

4.8.1 From 1 April 2002, the Council’s HRA was allocated a separate debt portfolio based on the appropriate proportion of the Council’s existing debt at that time. No new HRA borrowing was taken in 2022-23.

4.8.2 The HRA element of the CFR was £296.4m at 31 March 2023 and is fully financed at an average rate of 4.26%. This includes £53.161m of long term fixed rate loans from the General Fund (known as internal loans). The HRA interest charge for 2022-23 was £12.8m.

4.8.3 In October 2018 the Government announced the HRA debt cap was to be abolished, but the now notional cap has been retained as a useful indicator shown in **Appendix 1.** Any capital expenditure financed by borrowing needs to comply with the requirements of the CIPFA prudential code including ensuring the scheme was affordable, sustainable and in proportion to the resources available.

4.8.4 The HRA has 2 local indicators to manage its debt as shown below:

	2022/23 Estimate	**2022/23 Actual**
Ratio of Debt to Revenues		
HRA Debt £m	300.754	296.403
HRA Revenues £m	111.795	111.175
Ratio of Debt to Revenues	**2.7**	**2.7**
Debt per Dwelling		
HRA Debt £m	300.754	296.403
No. of Dwellings	24,756	25,082
Debt per Dwelling £	**12,149**	**11,817**

4.9 **Investments**

4.9.1 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 7 March 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.).

4.9.2 The investment activity during the year conformed to the approved strategy.

4.9.3 The Council has reduced cash and investment balances which averaged £377.0m for the year as Government grants received last year on behalf of other authorities have been distributed.

4.9.4 The Council held £308.0m of investments at 31 March 2023 (£368.2m at 31 March 2022) and the investment portfolio yield for the year was 1.947%, below the benchmark 7 day SONIA (sterling overnight index average rate of 2.225%. This under-performance was due to the rapid increase in short term interest rates during the year and the high proportion of fixed term deposits held in the portfolio.

4.9.5 Table 4 below summarises investment activity in 2022-23.

TABLE 4: Investment Activity for 2022-23	Balance on 01.04.2022 £m	Balance on 31.03.2023 £m	Average Rate at 31.03.2023 %
Short term investments:			
- Banking Sector	90.0	95.0	3.83%
- UK Government	52.0	40.0	4.06%
- Local Authorities	142.0	41.0	2.82%
- Overseas Government	0.0	9.9	0.37%
- Money Market funds	49.3	112.2	4.12%
Long term investments			
- Local Authorities	15.0	0.0	n/a
- Overseas Government	19.9	9.9	1.08%
TOTAL INVESTMENTS	**368.2**	**308.0**	**3.63%**
Increase / (Decrease) in Investments		**-60.2**	

4.10 **External advisors**

4.10.1 External treasury management advisors are retained to provide additional input on treasury management matters. The service comprises economic and interest rate forecasting, advice on strategy, portfolio structure, debt restructuring, investment policy and credit ratings and technical assistance on other matters, as required.

4.10.2 The Council has retained Link Group as its treasury management advisors.

4.11 **Compliance with Prudential Indicators**

4.11.1 The Council confirms compliance with its Prudential Indicators for 2022-23 set on 7 March 2022 as part of the Council's Treasury Management Strategy Statement. The Prudential Indicators can be found in **Appendix 1**.

4.11.2 The Council measures and manages its exposures to treasury management risks using the following indicators.

4.11.3 **Interest Rate Exposures**: This indicator is set to control the Council's exposure to interest rate risk. The limits variable rate interest rate exposures are:

	2021-22 £m	2022-23 £m	2023-24 £m
Upper limit on variable interest rate exposure	300.0	200.0	200.0
Actual	41.3	38.3	

4.11.4 **Maturity Structure of Borrowing**: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Lower	Upper	Actual
Under 12 months	0%	25%	6%
12 months and within 24 months	0%	25%	3%
24 months and within 5 years	0%	25%	10%
5 years and within 10 years	0%	25%	14%
10 years and within 25 years	0%	50%	6%
25 years and within 40 years	0%	50%	40%
40 years and above	0%	50%	21%

4.11.5 **Principal Sums Invested for Periods Longer than 365 days**: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2021-22 £m	2022-23 £m	2023-24 £m
Limit on principal invested beyond year end	100	100	100
Actual	35	10	

4.11.6 **Operational Boundary and Authorised Limit for External Debt**: The operational boundary is based on the Council's estimate of most likely, i.e. prudent, but not worst case scenario for external debt. The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

	2022/23 Outturn £m	2022/23 Max Debt in year £m
Borrowing	878.0	900.9
Other Long-term Liabilities *	158.3	170.2
Total External Debt	**1,046.3**	**1,071.1**
Operational Boundary	1,365.1	
Authorised Limit	1,395.1	

* Includes PFI and Leases liabilities

4.12 **Treasury Management Reserve**

4.12.1 The Treasury Management Reserve is maintained to smooth the impact of any volatility in treasury management revenue charges in any one year including new technical accounting entries relating to IFRS 9 (which stipulates the treatment of expected loss model based impairments on Treasury related investments and capital investments such as loans to third parties and financial guarantees). There was no expected loss impairment made to treasury investments in 2022/23.

4.12.2 The reserve at 31 March 2023 was £15.9m, a net reduction over the year of £2.3m due in part to re-allocation to the Corporate Resilience Reserve following a review of the reserve. The appropriateness of the balance held will be reviewed as part of the annual reserves review, which forms part of the 2024/25 budget setting process.

4.13 **Risk Management**

4.13.1 Risk management plays a fundamental role in treasury activities, due to the value and nature of transactions involved. The management of specific treasury management risks is set out in the Manual of Treasury Management Practices and Procedures and a risk register is maintained for the treasury function.

4.13.2 The treasury management risk register's overall risk rating at 31 March 2022 was 4.23, (Likelihood = unlikely, Impact = minor) and is a lower rating than as at 31 March 2021, but it remains over the targeted risk rating of 2.94 (Likelihood = remote, Impact = minor). The risk rating reflects reduced risks around the capital programme, impacts of Covid-19, working from home arrangements and the changes to the PWLB lending arrangements.

4.14 **Other Issues**

4.14.1 CIPFA published the revised Treasury Management Code and Prudential Code in December 2021. Both revised codes and guidance notes must be adopted within the 2023-24 Treasury Management Strategy, with the principles to be applied from the publication date of December 2021.

4.14.2 The Treasury Management Code key proposals – update to the Treasury management practices (TMP) TMP10 training requirements; TMP 12 Corporate Governance; Environmental, Social and Governance investment considerations to be included within the credit and counterparty risk management policies and amendments to Maturity Structure of Borrowing indicator.

4.14.3 The Prudential Code key proposals:

- revision to Borrowing in Advance of Need criteria, including in respect of primarily yield generating investments;
- inclusion of proportionality in key capital expenditure objectives;
- process and governance sections to incorporate further changes in respect of commercial activity;
- three new prudential indicators:
  - External Debt to Net Revenue Stream (NRS),
  - Income from Commercial and Service Investment to NRS;
  - Liability Benchmark;
- Proposal to abolish Gross Debt to Capital Financing Requirement indicator.
- Council investments are to be split and reported by code definitions for Service Investments, Treasury Management investments and Commercial Investments.

5. Finance colleague comments (including implications and value for money/VAT)

5.1 General Fund Revenue Implications

5.1.1 Revenue costs associated with borrowing and lending can be volatile, being affected by a number of factors including movements in interest rates, the timing of capital spending, the extent of reserves held and actual cash flows during the year.

5.1.2 The General Fund outturn in 2022-23 for treasury management costs was £81.8m comprising of interest charges, provisions for the repayment of debt, PFI related expenditure and investment income. The PFI expenditure accounted for £35.8m which includes the NET lines 1 & 2 (the Nottingham Tram Network). A proportion of the Council's debt relates to capital expenditure on HRA housing and an additional £12.8m of debt costs was charged to the HRA. The HRA also received their share of investment income on their cash balances which totalled £2.8m.

5.1.3 The General Fund budget and outturn for 2022-23 treasury management costs are summarised in the table below:

Treasury Management	**Budget 22-23 £m**	**Outturn 22-23 £m**	**Variance £m**
Interest Receivable	-0.1	-3.7	-3.6
Interest Payable			
Debt	19.9	17.9	-2.0
PFI	24.7	24.7	0.0
Debt Repayment (MRP)			
Non-PFI	32.8	31.8	-1.0
PFI	11.1	11.1	0.0
Total	**88.4**	**81.8**	**-6.6**

5.2 **Value for Money**

5.2.1 Management of borrowing and investments is undertaken in conjunction with our appointed external advisors, with the aim of minimising net revenue costs, maintaining an even debt maturity profile and ensuring the security and liquidity of investments.

6. List of background papers relied upon in writing this report (not including published documents or confidential or exempt information)

6.1 None.

7. Published documents referred to in this report

- Treasury Management Strategy 2023-24 and Capital Investment Strategy 2023-24
- Treasury Management Strategy 2021-22 and Capital Investment Strategy 2021-22
- Together for Nottingham Plan
- Money Market and PWLB loan rates
- Treasury Management in the Public Services Code of Practice 2017 & 2021– CIPFA
- Prudential Code 2017 & 2021 -CIPFA
- Treasury Management in the Public Services Guidance Notes 2018 & 2021– CIPFA
- Statutory guidance on local government investments 3rd Edition 2018
- Statutory guidance on Minimum Revenue Provision (MRP) 2018