Lincolnshire COUNTY COUNCIL Working for a better future

Open Report on behalf of Andrew Crookham, Executive Director - Resources

Report to:	**Overview and Scrutiny Management Board**
Date:	**29 September 2022**
Subject:	**Treasury Management Annual Report 2021/22**

Summary:

This report has been prepared in accordance with the reporting recommendations of the CIPFA Code of Practice for Treasury Management and details the results of the Council's treasury management activities for the financial year 2021/22. The report compares this activity to the Treasury Management Strategy for 2021/22, approved by the Executive Councillor for Resources, Communications, and Commissioning on 11 March 2021. It will also detail any issues arising in treasury management during this period.

Actions Required:

The Overview and Scrutiny Management Board is requested to review the contents of the report and pass any comments onto the Executive Councillor for Resources, Communications, and Commissioning.

1. Background

1. Introduction and Background

1.1. Treasury Management relates to the policies, strategies and processes associated with managing the cash and debt of the Council through appropriate borrowing and lending activity. It includes the effective control of the risks associated with the lending and borrowing activity and the pursuit of optimum performance consistent with the risks.

1.2. This Annual Treasury Report will cover the following matters for the year 2021/22:

- **Economic overview and interest rate review**.
- **Treasury Investments** - Treasury investment policy, risk appetite, treasury activity and return, comparing this with treasury strategy.
- **Long Term Borrowing** - Capital expenditure plans, borrowing requirement and activity, control of interest rate risk, debt rescheduling activity and internal borrowing position, comparing this with treasury strategy.
- **Other treasury issues** arising during 2021/22.

1.3. For reference, a **Key Points Summary** arising from this report has been included in the Conclusion in Section 6 of this report.

1.4. For further reference, a list of abbreviations used throughout this report is shown in **Appendix A**.

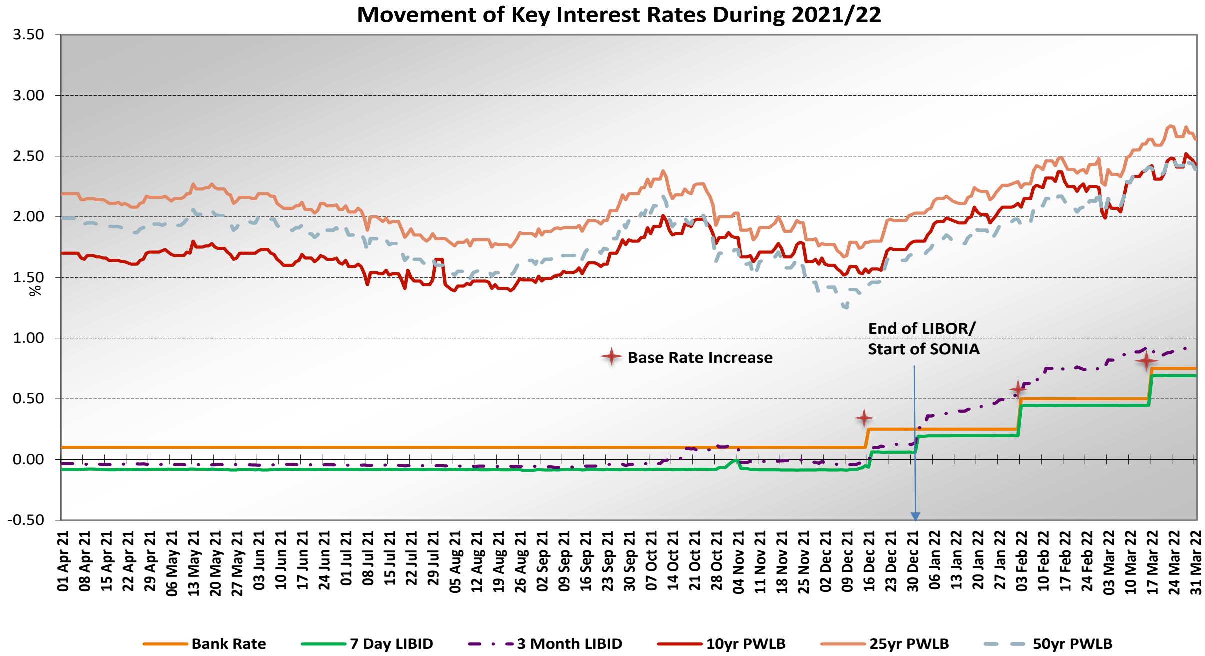
2. Economic Overview and Interest Rate Review 2021/22

2.1. At the time of setting the Strategy in March 2021, both short term bank rate and long-term rates were forecast to rise only moderately by **no more than 0.10% per year for the following 3 years.** This was based on a backdrop of the Covid-19 pandemic and its impact on the economy and the subsequent success of the UK vaccine program leading to an improved economic outlook.

2.2. The graph below shows actual movement in rates during the year as follows:

- **Short Term Rates**: Due to measures to tackle the Covid-19 pandemic, the Bank of England took emergency action in March 2020 to cut Base Rate to 0.10% and left this unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16th December 2021, 0.50% at its meeting on 4th February 2022 and then to 0.75% in March 2022. The graph shows that short term rates mirrored this pattern during the year until the start of SONIA on 1st January 2022 at which point 3 Month rates started to exceed the Base Rate.
- **Long term rates**: Rates have been volatile over the period but generally flat until falling back at the end of 2021. Since this time, long term rates have risen in early 2022 to mirror the Base Rate increases, despite the war in Ukraine. These rises have been part of a global trend, as central banks have suggested they will continue to raise interest rates as a measure to contain inflation.

Movement of Key Interest Rates During 2021/22



2.3. **UK Economy:** The UK economy endured several false dawns through 2021/22, but with most of the economy opened up by March 2022, and nearly back to business-as-usual, the **GDP** numbers were robust (9% y/y Q1 2022) and sufficient for the MPC to focus on tackling the second-round effects of inflation**. CPI** reached 6.2% in February 2022 and was predicted to exceed 8.3% in April 2022. A further rise in US Treasury yields was predicted to drag UK gilt yields higher as there is a strong correlation between the two factors. However, the squeeze on real household disposable incomes arising from the 54% leap in April utilities prices as well as rises in council tax, water prices and many phone contract prices, were strong headwinds for any economy to deal with. In addition, from 1st April 2022, employees were also set to pay 1.25% more in National Insurance tax. Consequently, inflation was predicted to be a bigger drag on real incomes in 2022 than in any year since records began in 1955.

2.4. **Average Inflation targeting:** This was adopted by the Bank of England in 2020, in terms of implementing its inflation target of 2%. The key addition to the Bank's forward guidance in August 2020 was a new phrase in the policy statement, namely that "**it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and *achieving the 2% target sustainably***". That mantra now seems very dated. Inflation is the "genie" that has escaped the bottle, and a perfect storm of supply side shortages, labour shortages, commodity price inflation, the impact of Russia's invasion of Ukraine and subsequent Western sanctions all point to inflation being at elevated levels until well into 2023.

2.5. **USA:** Markets priced in a further 225bps of interest rate increases in 2022 on top of the initial move to an interest rate range of 0.25% - 0.5% and in addition the Fed was expected to start to run down its balance sheet as soon as May 2022. The upward pressure on inflation from higher oil prices and potential knock-on impacts on supply chains all argued for tighter policy (CPI is estimated at 7.8% across Q1), but the hit to real disposable incomes and the additional uncertainty pointed in the opposite direction. Quarter 1 (Q1) GDP growth was predicted to be only between 1.0% and 1.5% annualised (down from 7% in Q4 2021). But, on a positive note, the economy created more than 550,000 jobs per month in Q1, a number unchanged from the post-pandemic 2021 average. Unemployment was only 3.8%.

2.6. **Eurozone:** Inflation jumped to 7.5% in March leading to the tightening of monetary policy by the ECB and the end to net asset purchases. Markets were anticipating possibly three 25bp rate hikes later in 2022 followed by more in 2023. Policymakers also hinted strongly that they would re-start asset purchases if required. While inflation hit the headlines, the risk of recession was also rising. Among the bigger countries, Germany was most likely to experience a "technical" recession because its GDP contracted in Q4 2021, and its performance was subdued in Q1 2022. However, overall, Q1 2022 growth for the Eurozone was expected to be 0.3% q/q with the y/y figure posting a healthy 5.2% gain. Finishing on a bright note, unemployment fell to only 6.8% in February 2022.

2.7. **World Growth**: World growth was estimated to have expanded 8.9% in 2021/22 following a contraction of 6.6% in 2020/21.

2.8. **Deglobalisation:** Until recent years, world growth has been boosted by increasing globalisation i.e., countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last 30 years, which now accounts for 18% of total world GDP (the USA accounts for 24%), and Russia's recent invasion of Ukraine, has unbalanced the world economy. In addition, after the pandemic exposed how frail extended supply lines were around the world, both factors are now likely to lead to a **sharp retrenchment of economies into two blocs of western democracies v. autocracies**. It is, therefore, likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China (and to a much lesser extent Russia) to supply products and vice versa. This is likely to reduce world growth rates.

2.9. **Central banks' monetary policy**: During the pandemic, the governments of western countries have provided massive fiscal support to their economies which has resulted in a big increase in total government debt in each country. It is therefore very important that bond yields stay low while debt to GDP ratios slowly subside under the impact of economic growth. This provides governments with a good reason to amend the mandates given to central banks to allow higher average levels of inflation than we have generally seen over the last couple of decades. Both the Fed and Bank of England have already changed their policy towards implementing their existing mandates on inflation, (and full employment), to hitting an average level of inflation. Greater emphasis could also be placed on hitting subsidiary targets e.g. full employment before raising rates. Higher average rates of inflation would also help to erode the real value of government debt more quickly.

3. <u>Treasury Investments 2021/22</u>

<u>Treasury Investment Policy</u>

3.1. The Council's treasury investment policy, governed by the Ministry of Housing, Communities and Local Government (MHCLG) investment guidance, renamed the Department for Levelling Up, Housing and Communities (DLUHC), is implemented in the Council's Annual Investment Strategy for Treasury Investments 2021/22, that was approved by the Executive Councillor for Resources, Communications and Commissioning on 11 March 2021, after being scrutinised by the Overview and Scrutiny Management Board on 24 February 2021.

3.2. The policy sets out the Council's approach for choosing authorised investment counterparties with appropriate limits (amount and maturity) that meet the risk appetite set by the Council. This selection is based on credit ratings issued by the three main credit rating agencies, supplemented by additional market data such as rating outlooks, credit default swaps and bank share prices. The Council's treasury advisors, Link Asset Services (LAS), provide the Council this data in the form of a creditworthiness matrix of suggested counterparties and limits, which the Council follows. **Appendix B** shows the Council's Authorised Lending List on 31 March 2022, based on this creditworthiness approach, together with a key explaining the credit rating scores.

3.3. **Note**: **The treasury investment policy relates to treasury investments only. The policy relating to non-treasury investments, held for service or commercial reasons, is covered in the Council's Capital Strategy.**

Treasury Investment Risk Appetite

3.4. The Council prioritises the **security of capital** and the **liquidity of investments**, over and above the **return** achieved on its treasury investments and hence the risk appetite set for its treasury investments is **low.**

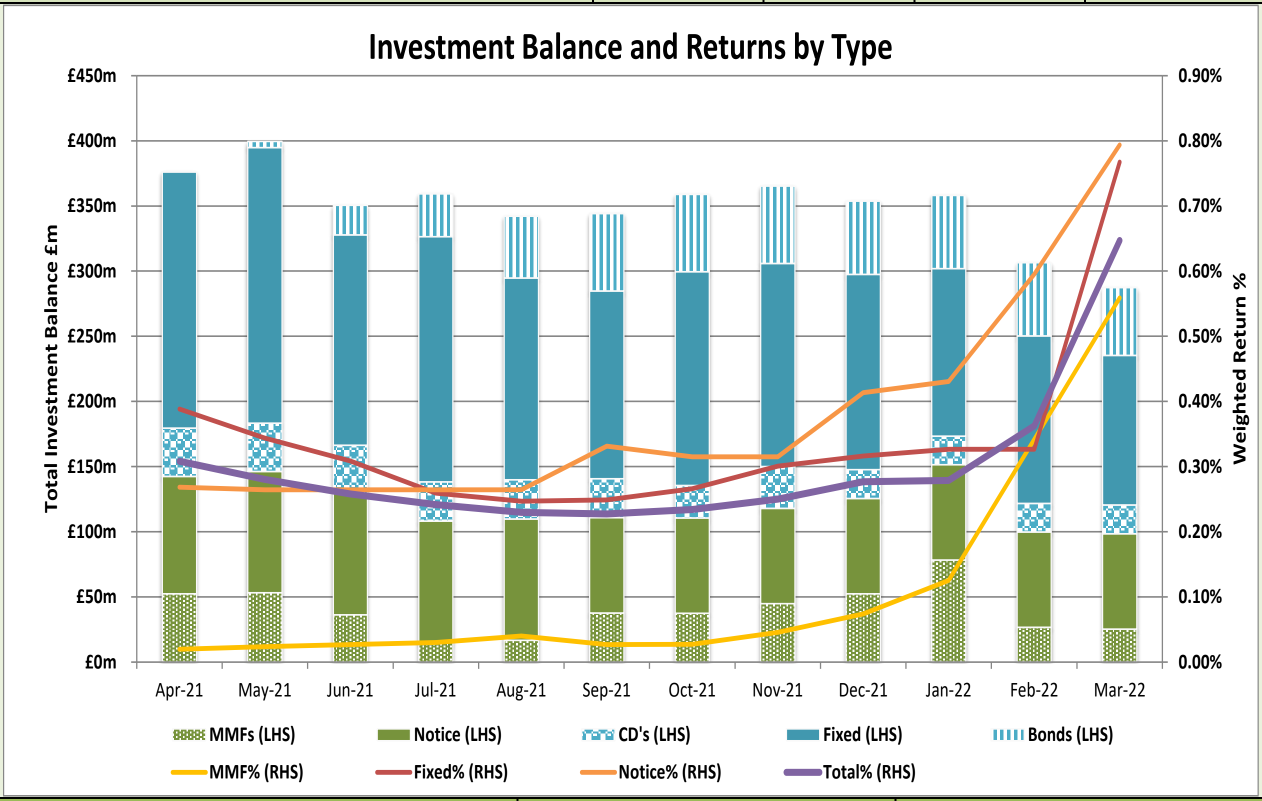
3.5. As such, in addition to LAS's credit methodology, the Council also maintains a minimum limit of **A+ Long Term Rating (two out of three agencies)** for all its Counterparties, excluding part-nationalised UK banks and a **minimum limit AA- Sovereign Rating (two out of three agencies)** for any Country in which a Counterparty is based to ensure investments are only placed with highly credit rated financial institutions and hence the return achieved is commensurate with this level of risk taken. For information, the UK Sovereign Rating is currently AA-.

3.6. The Covid-19 pandemic has not resulted in increased Credit Risk as Central Banks across the world have supported both their economies and banking sectors during the year. As such there have been no significant credit rating changes to Counterparties on the Authorise Lending List during the year.

Treasury Investment Activity 2021/22

3.7. The Council's treasury investment position and movement in activity during 2021/22 is shown as follows:

INVESTMENT PORTFOLIO	31.3.2021 £m	Annual Return %	31.3.2022 £m	Annual Return %
Treasury Investments:				
Money Market Liquidity Funds	38.225	0.10%	25.325	0.09%
Notice Accounts	80.000	0.35%	73.100	0.35%
Fixed Deposits, CD's & Bonds	241.450	0.68%	189.011	0.32%
Total Treasury Investments	**359.675**	**0.52%**	**287.436**	**0.28%**



Maturity Structure	31.3.2021		31.3.2022	
Weighted Average Maturity (WAM)	**114 Days**		**119 Days**	
Liquidity	£118.225m	32.87%	£98.425m	34.24%
< 1 Month	£20.000m	5.56%	£5.000m	1.74%
1-3 Months	£82.950m	23.06%	£62.458m	21.73%
3-6 Months	£91.500m	25.44%	£78.053m	27.15%
6-9 Months	£20.000m	5.56%	£37.000m	12.87%
9-12 Months	£22.000m	6.12%	£0.000m	0..00%
1-2 Years	£5.000m	1.39%	£6.500m	2.26%
Total	**£359.675m**	**100.00%**	**£287.436m**	**100.00%**

3.8. The investment balances shown above are made up of general and earmarked reserves, Pension Fund cash (£67.7m - 31st March 2022/ £74.1m - 31st March 2021), income received but not yet used/spent and general movement of working capital. The data shows that the investment balance on 31st March 2022 was some £72.2m lower than the previous year. This is predominantly due to internal cash balances being used to fund capital expenditure in 2021/22, as no external borrowing was undertaken, and due to the Pension Fund Balance held within the total balance dropping over the year by £6.4m.

3.9. The average value of investments during 2021/22 was £356m, some £8m higher than the previous year. The graph at 3.7 above shows that the balance of investments (bars on graph) remained fairly constant but then fell in the last two months of the year as capital expenditure peaked at this time.

3.10. The graph at 3.7 also shows how these funds were invested by type of investment, split between investments held for liquidity (Money Market Funds and Notice accounts) (green bars) as opposed to fixed term investments (blue bars) held for return. It shows that Notice Account returns were the highest during the year (orange line) so Notice Account balances were kept high (solid green bars). The graph also shows that all returns increased from January 2022, as Base Rate increased, including Money Market Fund returns that got close to zero during the early part of the year (yellow line).

3.11. All investments made during the year were in line with the strategy, including making some 1- and 2-year investments where possible to lock into higher rates above benchmark levels at the time taken and lengthen the Weighted Average Maturity (WAM) of the fund which ended the year at 119 days, close to the previous year. The table above shows the maturity profile of the investments made in light of this strategy which is very similar to the previous year.

3.12. Temporary borrowing of £34.5m was taken when required during the year to cover liquidity shortfalls at an average cost of 0.04%, below money market fund yield levels. This was in line with strategy and as an alternative to drawing on higher yielding Notice Accounts. No temporary borrowing remained outstanding on 31 March 2022.

3.13. A full list of the investments held on 31 March 2022, compared to Link's creditworthiness list, and changes to credit rating of counterparties during March 2022 are shown in **Appendix C**.

Treasury Investment Return and Benchmarking Results

3.14. The table below shows the Council's annualised investment return for 2021/22 based on the above activity against the benchmark return for internal investments (weighted market rate to reflect low risk appetite taken), compared to the previous year, and the actual versus budgeted investment income earned as a result.

	2020/21	2021/22
Annualised Investment Return	0.52%	0.28%
Annualised Benchmark Rate	0.07%	0.13%
Outperformance	**0.45%**	**0.15%**
Total Investment Return Income	£1.78m	£0.65m
Budgeted Investment Return Income	£1.30m	£0.50m
Surplus Investment Return Income	**£0.48m**	**£0.15m**

3.15. The table highlights how the investment return and income fell sharply in 2021/22 as the impact of Covid-19 on the economy and interest rates continued to be felt. Despite this the investment benchmark was exceeded by 0.15% and the budgeted investment return was exceeded by £150k. The significant underspend in both the Capital and Revenue budgets in 2021/22 was a contributory factor to the surplus investment income achieved over that budgeted.

3.16. The Annualised Benchmark Rate used moved from 7 Day/3 Month LIBID rates to Overnight/3 Month SONIA rates in the last quarter of the year, as LIBID ceased on 31st December 2021. SONIA is the risk-free rate for sterling markets administered by the Bank of England. It represents the average overnight rate that banks and financial institutions will lend overnight to each other during Sterling Clearing Operations. This is a relative benchmark which moves with the markets, however the rate is not representative of what general Money Market participants, such as the Council, can achieve, due to size and available counterparties. It is also just an average rate with no Bid/Offer spread. (The LIBOR/LIBID spread was around 0.12%). To make the SONIA rate into a relevant benchmark to use therefore will require some adjustment. The initial benchmark rate that is being used therefore is **SONIA less 0.10%,** but this is still a higher rate to benchmark against than LIBID, as reflected by the lower outperformance in 2021/22 of 0.15%. The SONIA benchmark will be reviewed for appropriateness during 2022/23, as more data becomes available with help from Link Asset Services (LAS).

3.17. The level of return achieved directly correlates with the level of risk taken with investments. To demonstrate this, Appendix D shows the performance of a variety of major asset classes over several years ranked by riskier assets first (risk to capital loss). The Council has set its risk appetite at the bottom of this spectrum, including Money Market Funds held for liquidity and 3 – 12-month money market deposits.

3.18. The Council's investment return was also benchmarked against analysis as at 31st March 2022, provided by LAS, which comprised a mixture of 13 other Councils in the East Midlands area and 14 English Counties. The results of this benchmarking are detailed below.

Link Benchmarking – Position at 31/3/2022			
	LCC	Benchmark Group(14)	English Counties (13)
31st March Return %	0.65%	0.51%	0.50%
Risk Banding	0.40% -0.60%	0.36% - 0.56%	0.39% -0.58%
Performance	Above	Inline	Inline
Risk Weighted Score (Duration/Credit Quality)	3.73	2.88	2.73
WAM (days)	119	98	109

3.19. The benchmarking results show that the Council is above par with the investment returns achieved by its LAS comparators in 2021/22, mainly because of having a slightly longer WAM (duration of investments). This is a good result given the low-risk nature of the Counterparties allowed on the Council's Lending List (restricted to a Long-Term minimum rating of A+), which does not apply to other comparators. LAS calculate a risk banding return that should be achievable for the level of risk being taken on investments and the Council has performed above this banding.

4. Long-Term Borrowing 2021/22

Capital Expenditure Plans and Borrowing Requirement 2021/22

4.1. The Council's capital expenditure plans are the key driver of treasury management activity, as they set the long-term borrowing requirement plans for the Council.

4.2. The Council is required by regulation to comply with the CIPFA Prudential Code for Capital Finance in Local Authorities (referred to as the 'Prudential Code') when assessing the **affordability**, **prudence** and **sustainability** of its capital investment plans. It does this by setting a series of **Prudential Indicators** that ensure and demonstrate the Council's capital expenditure plans remain affordable, prudent, and sustainable.

4.3. **Appendix E** shows a summary of the actual Prudential Indicators for 2021/22, compared to those estimated and approved by the County Council at its meeting on 19 February 2021, along with the Council Budget 2021/22. It can be confirmed that no Prudential Indicators were breached during 2021/22.

4.4. Extracted from these Prudential Indicators, shown in the table below, is the Council's **net capital expenditure** for 2021/22 (PI 1) and the resulting **borrowing requirement** for 2021/22 (the element of this expenditure which is not to be financed straight away from cash resource or grants, hence, to be financed at a future date by borrowing). Plans were revised during 2021/22 from that agreed by the County Council and both actual spending and borrowing requirement were under budget for the year.

	Original Budget at 1/4/2021 £m	Final Budget at 31/3/2022 £m	Actual at 31/3/2022 £m	Underspend £m
Net Capital Expenditure Programme 2021/22	111.283	150.449	**100.400**	50.049
Borrowing Requirement 2021/22	111.213	121.594	**60.339**	61.225

Capital Financing Requirement, Borrowing Strategy and Control of Interest Rate Risk 2021/22

4.5. **The Capital Financing Requirement** (CFR) is another Prudential Indicator shown in Appendix E (PI 2). It is a measure of the amount of capital expenditure that the Council has already spent that has yet to be funded from cash resources or the Council's total indebtedness or **need to borrow for capital financing purposes**. Credit arrangements (finance leases and PFI) are also included in the CFR as they have the same practical impact as borrowing. The CFR is increased each year by the **new borrowing / credit arrangement** requirement, as highlighted in the table above, and reduced each year by the **Minimum Revenue Provision (MRP)**, a provision the Council must set aside to repay its debt each year.

4.6. In fulfilling the underlying need to borrow to finance its capital expenditure plans, the Council has flexibility when it takes external borrowing to ensure borrowing is taken at a time when interest rates are at their lowest (thereby controlling interest rate risk) and to minimise cost of carry (where borrowing costs exceed investment return, until utilised by capital expenditure). The Council can also utilise its own internal cash resource to finance borrowing requirement not taken externally and this is known as **Internal Borrowing**.

4.7. A benefit of internal borrowing is the reduction of Counterparty risk as a reduced cash balance leads to reduced investments made and in times when investment returns are low this is a prudent strategy. Cash resource is depleted by internal borrowing and therefore there is an ultimate limit as to how much internal borrowing can be done before cash resource is put at risk. The **level of internal borrowing on 31st March 2022 was £161.3m or 25% of CFR.** This was increased from the previous year by £34m to lower the excess cash balance held in the year as explained in 3.8 and 3.9 above.

4.8. Another Prudential Limit, (PI 3), states that external borrowing should not exceed the CFR two years hence in order to ensure that borrowing remains prudent and affordable and not undertaken for revenue purposes. Appendix E shows that the Council has maintained this limit.

4.9. The table below shows the final CFR position for 2021/22 and how this is split between External and Internal Borrowing.

CFR 2021/22		£m	£m	%
Opening CFR Balance at 1.4.2021			624.298	
Net Capital Expenditure 2021/22		100.400		
Financed by Cash Resource:	Grants	(14.937)		
	Capital Receipts	(11.206)		
	Reserves	(4.299)		
	Revenue	(9.519)		
Add: Borrowing Requirement 2021/22			60.339	
Less: Minimum Revenue Provision 2021/22			(12.540)	
Less: Voluntary Revenue Provision 2021/22			(26.177)	
Closing CFR Balance at 31.3.2022			**645.920**	**100.0%**
Represented By:				
External Borrowing (Including Credit Arrangements)			**484.525**	**75.0%**
Internal Borrowing			**161.395**	**25.0%**

External Borrowing Activity 2021/22

4.10. The Strategy for 2021/22 stated that new external borrowing would be undertaken in all periods with the aim of achieving an even spread of maturity profile and keeping an increase in the average cost of the Council's debt to a minimum. Borrowing would be undertaken at a time appropriate to coincide with an identified dip in borrowing rates available.

4.11. The Council’s actual borrowing position on 31st March 2022 and activity during 2021/22, is detailed in the table below:

Borrowing Activity 2021/22	Market Debt (LOBO) £m	PWLB Debt £m	Total £m	% Cost
Opening Balance at 1.4.2021	20.000	467.186	487.186	3.743%
New Borrowing in 2021/22	0.000	0.000	0.000	
Borrowing Matured/Repaid in 2021/22	0.000	(11.064)	(11.064)	
Debt Rescheduling: - Borrowing Repaid in 2021/22 Borrowing Replaced in 2021/22	 (0.000) 0.000	 0.000 0.000	 (0.000) 0.000	
Closing Balance at 31.3.2022	**20.000**	**456.122**	**476.122**	**3.733%**
Authorised Limit For External Debt 2021/22			**691.748**	

4.12. The table above shows that no new external borrowing was taken during the year with the Borrowing Requirement for 2021/22 met in full, from internal borrowing, to reduce surplus cash balances held in the year and to save on borrowing costs, (see 4.17).

4.13. **Appendix F** shows the external borrowing maturity profile on 31st March 2022, including the variability effect of the £20m LOBO debt held. The graph shows that no debt maturing in any one year exceeds 10.7% of the total debt portfolio.

4.14. The table also shows that no debt rescheduling was undertaken in 2021/22 and the balance of LOBO debt remains at £20m, all held with BAE Systems Pension Fund. This is well within the LOBO limit set in the Strategy of 10% of total external debt (equating to £47.6m). A limit is set on this type of borrowing to limit the amount of variability within the debt portfolio for debt repayment.

4.15. Total long-term debt outstanding at 31st March 2022 fell to £476.122m and is well within the Council's Authorised Limit for External Debt of £691.748m. This is the Council's statutory 'Affordable Borrowing Limit' as per the Local Government Act 2003, which should not be breached and is also another Prudential Indicator, (PI 4).

External Borrowing Cost and Benchmarking Position

4.16. The table below shows the interest cost of the Council's total external debt. New borrowing is benchmarked against the average cost of debt that was available from the PWLB in the year. No new borrowing was undertaken in 2021/22 and the reduction in the % Cost of the total borrowing portfolio was due to the debt repayment in the year.

	2020/21		2021/22	
	% Cost	£m	% Cost	£m
Long-Term Borrowing Outstanding at 31st March.	-	487.186	-	476.122
Actual Interest Cost of External Debt	3.743%	18.484	3.733%	17.886
Budgeted Cost of External Debt	-	22.093	-	17.746
(Underspend)/Overspend		**(£3.609m)**		**£0.140m**
New Borrowing Taken and Average Cost	-	0.000	-	0.000
Benchmark Cost of Borrowing Available in Year (50 Year PWLB)	2.140%	-	1.850%	-
Outperformance/(Underperformance)	**0.000%**	**£0.000m**	**0.0%**	**£0.000m**

Internal Borrowing Activity 2021/22

4.17. The borrowing requirement (CFR) not taken externally is known as 'internal borrowing' and this utilises the internal balances of the Council to finance the capital spend. The level of internal borrowing is adjusted for amounts carried forward along with any capital programme underspends each year and for adjustment to borrowing taken for any voluntary repayment of debt or excess borrowing taken for maturing debt more than the MRP level. The balance of internal borrowing on 31st March 2022 stood at £161.345m and the table below shows how this balance has been derived.

Internal Borrowing 2021/22	£m	£m
Internal Borrowing Balance BF		128.002
Original Borrowing Requirement 2021/22	121.594	
Less Underspend Carried Forward	(61.255)	
Adjustment for Voluntary /Maturing Debt/VRP	(26.712)	
Final Borrowing Requirement 2021/22		33.627
Actual External Borrowing Undertaken (Salix)		(0.234)
Internal Borrowing Balance CF		**161.395**

4.18. The £61.225m carry forward of internal borrowing for 2021/22 will be carried forward to 2022/23, along with the Capital Programme and Borrowing Requirement underspends. The Council will take external borrowing in 2022/23, after adjusting for debt repayments and underspends, to ensure the level of debt remains within the new **Debt Liability Benchmark**. This is a new Prudential Indicator introduced in the revised CIPFA Code of Practice for Treasury Management issued in December 2021 and focuses on taking external debt to maintain a level of cash balance needed for liquidity rather than focusing on level of internal borrowing. This strategy will be developed during 2022/23 and will be applicable for the following year.

5. Other Treasury Management Issues Arising During the Year

5.1. Revised CIPFA Codes of Practices for Treasury Management and the Prudential Code Published in December 2021

CIPFA published revised Treasury Management and Prudential Codes on 20th December 2021 and has stated that formal adoption is not required until the 2023/24 financial year. The revised Codes will have the following implications:

- Investments and investment income to be classified as having one of the following three purposes: **Treasury Management**, **Service Delivery** and **Commercial Return.**

- Requirement to set a **proportionate approach to commercial and service capital investment** by setting approriate Prudential Indicators;
- Creation of new **Investment Practices** to manage risks associated with non-treasury investment (similar to the current Treasury Management Practices);
- Implementation of a policy to review **commercial property**, with a view to divest where appropriate;
- Requirement to clarify **reporting requirements for service and commercial investment**, (especially where supported by borrowing/leverage).
- Requirement for the Council to adopt a new **debt liability benchmark treasury indicator** to support the financing risk management of the capital financing requirement;
- Ensuring that any **long term treasury investment** is supported by a business model;
- Requirement to **effectively manage liquidity and longer term cash flow requirements**;
- Address **Environmental, Social and Governance (ESG) issues** within the Capital Strategy;
- An amendment to TMP1 to address **ESG policy** within the treasury management risk framework;
- An amendment to the **knowledge and skills register** for individuals involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each council;

These new implications are being developed throughout 2022/23 and will be reported on fully within the 2023/24 Treasury Management and Capital Strategies.

5.2. Review of Minimum Revenue Provision (MRP) -Link Asset Services

The Council is required to determine a level of MRP it considers to be prudent, whilst having regard to the MRP Guidance issued by the Ministry of Housing, Communities and Local Government (MHCLG), renamed the Department for Levelling Up, Housing and Communities (DLUHC).

As reported in the Treasury Management Strategy 2021/22, Link Asset Services was asked to undertake a review of the Council’s Minimum Revenue Provision policy in 2021/22, with the aim to identify any savings that could be made in the calculation of the MRP level whilst maintaining a prudent level.

Following this review undertaken in November 2021, Link Asset Services identified significant potential reductions in MRP in the following areas:

- **Correction to Historic CFR** – Link identified an overstatement of the calculation of MRP going back to 2009/10, resulting from the use of an incorrect CFR balance. This historic overstatement was corrected in the MRP charge for 2020/21 which was reduced by £7.659m. Future MRP will also reduce by £0.367m per annum from this correction.

- **Change to Annuity Method -** The Council's existing MRP policy uses the Asset Life method calculation when calculating MRP for different asset life classes within the capital programme for its unsupported borrowing. MRP for supported borrowing is calculated on a straight-line basis consistent with previous regulations of 4% of CFR. Within the Asset Life calculations at present, only the MRP for Infrastructure Assets is currently charged on an Annuity basis. This means that the MRP charge is higher in the later life of the asset, which is consistent to when the benefit of longer life assets is received for future residents. Link has suggested that the Annuity Method is used for all asset life calculations and for the Supported Borrowing charge. This would have the benefit of reducing the total MRP charge in earlier years and increasing the MRP charge to later years. Link has estimated that the potential total MRP saving in Net Present Value terms of this move could be £26m. Work is underway to cost this proposal in 2022/23 and if adopted this will require a change to MRP Policy for the 2023/24 MRP charge.

- **Voluntary Revenue Provision (VRP) –** The reduction of MRP charge in 2021/22 of £7.659m has allowed the Council to make a VRP charge in 2021/22. VRP charged can be redeemed to reduce future years MRP requirement and therefore gives the Council more flexibility over its MRP charge for future years. For this reason, a VRP charge of £26.177m was made in 2021/22 also making use of a reduction in the Capital Financing Charges Reserve.

5.3. <u>Review of Enhanced Money Market Funds</u>

It was reported in the Treasury Management Strategy 2021/22 that a review of Enhanced Money Market Funds (VNAV) would be undertaken during 2021/22. These funds are Non-Specified Investments within our Annual Investment Strategy and offer slightly higher yields than existing funds but have different risk parameters and access restrictions.

This review did not take place as it was superseded by the proposed requirements of the new CIPFA Treasury Management Code to be implemented in 2023/24.

6. Conclusion

<u>Key Points Summary</u>:

- This report relates to Treasury Investments only. Non-Treasury Investments made for service reasons are covered in the Council's Capital Strategy.

- Bank Base rate was increased three times in the last quarter of the year to reach 0.75% at the year end, as the Economy looked set to recover from the impact of Covid-19 and the MPC started to focus on tackling the increase in inflation. Long term rates fell back at the end of 2021, but as part of the general global trend to tackle inflation, started to increase in the last quarter of the year.

- The economy was starting to open up after enduring the impacts of the pandemic in the previous year, with GDP improving and labour markets returning to normal. However, the last quarter of the year saw the emergence of inflationary pressures from increasing commodity and food price increases, supply side shortages and the impact of the Ukrainian invasion by Russia. At the end of March 2022, CPI was expected to reach 8%, however this was a global problem affecting countries all around the world.

- The Council's cashflow returned to normal patterns during 2021/22, after the Covid-19 disruption of the previous year, with balances remaining relatively constant throughout the year, then dropping by around £70m to £287m at the year end as internal balances were used to fund capital expenditure. (Internal borrowing).

- The Council's risk appetite for its treasury investments remains low, as it prioritises security of capital and liquidity over return. Although investment return fell in the year because of the record low interest rate environment, the Council outperformed the benchmark set for this low risk level, by 0.15%, which equated to £150k in monetary terms. It also outperformed benchmarking comparators whilst having a lower risk profile, primarily by having a slightly longer weighted average maturity of investments.

- The Council's benchmark investment rate has moved to SONIA less 10%, as LIBID ceased at the end of December 2021. This is an average overnight rate from banks sterling clearing operations and is not really a comparable rate to benchmark against, hence further work is being done in 2022/23 with Link to look at how this benchmark can be revised to be more suitable.

- Short-term borrowing at less than investment rate levels was taken during the year to support predicted liquidity shortfalls, in line with the Strategy.

- The Council adheres to the CIPFA Prudential Code for Capital Finance by setting Prudential Indicators to ensure its capital plans are affordable, prudent and sustainable. All prudential limits have been adhered to with no breaches in 2021/22.

- Both capital expenditure and hence its borrowing requirement for 2021/22 were significantly underspent in the region of £50m. This will be carried forward into 2022/23.

- The Council's CFR on 31 March 2022 (or underlying need to finance its capital expenditure plans by borrowing) has been met by a combination of both external and internal borrowing as follows:

External Borrowing	£484.5m	75.0%
Internal Borrowing	£161.4m	25.0%
CFR	£645.9m	

- No new external borrowing was taken in 2021/22, £11.1m of debt was repaid which has reduced the total cost of the Council's external debt to 3.733%, equating to £17.9m borrowing interest paid in 2021/22.

- No debt rescheduling was undertaken in 2021/22.

- Internal borrowing was increased in 2021/22 by £33.4m leaving the balance of internal borrowing at £161.4m which is considered in line with the Council's general level of cash balance available.

- The Council will focus on the Debt Liability Benchmark in 2022/33 in determining the level of external borrowing to take. This is a new Prudential Indicator introduced in the revised CIPFA Code of Practice and Prudential Code in December 2021.

- A revised CIPFA Code of Practice for Treasury Management and Prudential Code were published in December 2021 and will be applicable for 2023/24. They include new requirements for commercial investments, the introduction of a 'knowledge and skills framework' and a Debt Liability Benchmark, restrictions to longer term treasury investments and amendments to TMP1 (Risk) to include an ESG policy.

- Significant savings to MRP were identified by a review in November 2021, undertaken by Link Asset Services. MRP in 2021/22 was reduced by £7.659m because of a historic correction to CFR in 2009/10 that was identified. This will also result in a reduction of £367k per year going forward for future years. A change to the Annuity Method to calculate MRP going forward would result in potential savings in Net Present Value terms of £26m. Any changes to this method of calculation will require a change to the existing MRP Policy approved along with the Annual Budget.

7. Consultation

a) Risks and Impact Analysis

Risk and Impact Analysis for Treasury Management forms TMP1 of the Treasury Management Practices, as required by the CIPFA Code of Practice 2017. A Risk Register which details the main risks for Treasury Management has been completed and is reviewed annually. Both the TMPs and the Risk Register are held in the Treasury Files held on IMP at County Offices.

8. Appendices

These are listed below and attached at the back of the report	
Appendix A	Glossary of Abbreviations Used in this Report
Appendix B	Authorised Lending List on 31st March 2022 and Credit Rating Key
Appendix C	Investment Analysis Review on 31st March 2022 - Link Asset Services Ltd
Appendix D	Risk and Reward per Asset Class 2021/22 and Comparative Years
Appendix E	Prudential Indicators - Actuals Compared to Estimate 2021/22
Appendix F	LCC Long-Term Borrowing Maturity Profile as at 31st March 2021

9. Background Papers

The following background papers as defined in the Local Government Act 1972 were relied upon in the writing of this report.

Document title	Where the document can be viewed
Treasury Management Strategy Statement and Annual Investment Strategy 2021/22 - 11/3/2021	Decision - Treasury Management Strategy Statement & Annual Investment Strategy 2021/22 (moderngov.co.uk)
Council Budget 2021/22 - 19/2/2021	Agenda for Council on Friday, 19th February, 2021, 10.00 am (moderngov.co.uk)

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