CORPORATE GOVERNANCE COMMITTEE – 26 MAY 2023

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

ANNUAL TREASURY MANAGEMENT REPORT 2022/23

Purpose of Report

1. The purpose of this report is to advise the Committee of the action taken and the performance achieved in respect of the treasury management activities of the Council in 2022/23.

Policy Framework and Previous Decisions

2. Under the CIPFA Code of Practice it is necessary to report on treasury management activities undertaken in 2022/23 by the end of September 2023. This report will be referred to the Cabinet on 23 June 2023 and the Committee is asked to provide comments in advance of this meeting.

Background

3. The term treasury management is defined as: -

   "The management of the organisation's 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".

4. The Director of Corporate Resources is responsible for carrying out treasury management on behalf of the County Council, under guidelines agreed annually by the County Council.

Treasury Management 2021/22

5. The Treasury Management Policy Statement for 2022/23 was agreed by full Council on 23 February 2022, in relation to the sources and methods of borrowing and approved organisations for lending temporarily surplus funds.

6. The criteria for lending to Banks are derived from the list of approved counter parties provided by the County Council's Treasury Management advisors, Link Asset Services (Link). The list is amended to reduce the risk to the County Council by removing the lowest rated counterparties and reducing the maximum loan duration.

7. During the year all outstanding loans were repaid on time with the interest due.

8. For local authority lending the policy is unchanged with no loans permitted in excess of 12 months duration or £10 million in value to a single authority. In 2019, Moody's, one of the world's best-known credit rating agencies, re-affirmed its view that the UK local government sector has a high credit quality. The implication being that the sector continues to be a good risk for lenders.

9. There were no new loans made to local authorities during the year. However, there is an increased likelihood that the County Council will want to lend to another local authority going forwards. Attached as Appendix A to this report is a template which highlights the checks and considerations that will be taken into account before such a decision is made. Timelines are short to be able to agree a loan to another local authority. It's important to ensure sufficient due diligence is undertaken but this will mean that some potential opportunities could be missed. The checklist has not yet been put into action, but it is anticipated that the checks will be refined over time to balance time taken with focus on the most relevant areas.

10. In 2016 it was agreed that any counterparty that was downgraded whilst a loan was active, and where the unexpired period of the loan, or the amount on loan, would then breach the limit at which a new loan could be made to that counterparty, this would be included in the quarterly treasury management report to the Corporate Governance Committee. There was one such incident during 2022/23 which was reported to the Committee at its meeting on 13 May 2022.

11. On 29th April 2022 the credit default swap (CDS) price for Goldman Sachs increased beyond Link's acceptable range and the suggested lending duration was reduced from six months to 100 days. As per the Council's Annual Investment Strategy this meant that Goldman Sachs was no longer an acceptable counterparty. The Bank's credit rating remained unchanged during this period. The Council had £30m of loans with the bank at the time of the breach. The outstanding amount was repaid with full interest at the expiry of the loans in May 2022.

12. 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.

13. Starting in April 2022 at 0.75%, the 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 further increases in 2023/24.

14. 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. 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.

15. 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.

16. Nonetheless, while the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the Financial Crisis of 2008/9. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions. Nonetheless caution still needs to be exercised as evidenced by recent high profile failures (Silicon valley bank, Credit Suisse, etc.). The Council continues to monitor credit ratings and watches on a daily basis and confirm the counterparty list before any new loans are placed.

Debt Position as at 31 March 2023

17. On the debt portfolio, no new loans were taken. A total of £0.5m was repaid in the year which was in respect of three equal instalments of principal loans, thereby reducing the overall balance of the loan portfolio.

18. The Council's external debt position at the beginning and end of the year was as follows: -

	31 March 2022			**31 March 2023**		
	Principal	**Average Rate**	**Average Life**	**Principal**	**Average Rate**	**Average Life**
Fixed Rate Funding						
- PWLB	£159.1m	6.80%	29 yrs	£158.6m	6.81%	28 yrs
-Market	£ 0.0m	n/a	n/a	£ 0.0m	n/a	n/a
Variable Rate Funding:						
- Market (1)	£103.5m	4.37%	2 yr	£103.5m	4.37%	2 yr
Total Debt	£262.6m	5.84%	18 yrs	£262.1m	5.85%	17 yrs

(1) The majority of lenders have an option to increase the rates payable on these loans on certain pre-set dates, and if they exercise this option the Council can either repay or accept the higher rate. The average life is based on the next option date.

19. The Authority has not raised any new external loans since August 2010 and external debt is around £100m lower than it was at its peak in November 2006. The most recent MTFS capital programme, for 2023-27, includes a funding requirement of £124m to be funded from borrowing. However, due to the strength of the County Council's balance sheet, it is expected to be possible to use internal balances to fund this on a temporary basis instead of raising new loans.

Investment Position as at 31st March 2023

20. The position in respect of investments varies throughout the year due to the large inflows and outflows of cash that occur. Over the course of the year the loan portfolio (which includes cash managed on behalf of schools with devolved banking arrangements) varied between £406m and £468m and averaged £429m. Investments as at 31 March 2023 were £468m.

Debt Transactions

21. The Council began the financial year £49m over-borrowed compared with the amount required to fund the historic capital programme - this is denoted as the Capital Financing Requirement.

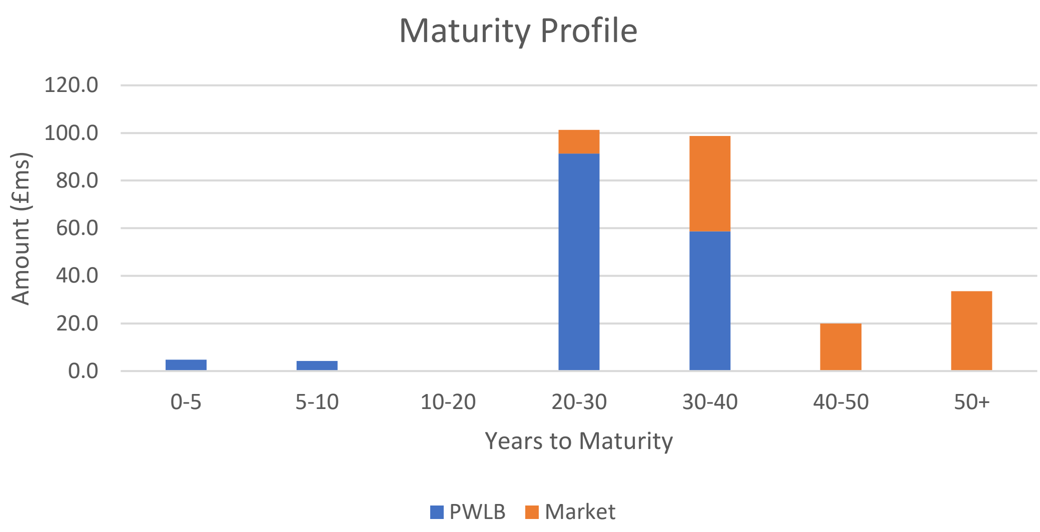
22. Although the term ‘over borrowed’ suggests an unusual situation it is simply caused by the Council setting aside money each year so that when loans become due they can be repaid. Historically this situation did not arise because new borrowing was undertaken each year. For the last ten years and more, there has been no requirement to borrow to fund the capital programme (which leads to debt financing costs that fall on the revenue budget), and also the Government’s change of approach, a number of years ago, to award grants to fund the capital programme rather than the previous approach of supported borrowing. Ideally the situation would be remedied by repaying loans early. However, given the large penalties that would be incurred, early repayment won’t be an option unless long-term interest rates rise significantly.

23. Furthermore, it is expected that the overborrowed position will reverse during the MTFS period due to the requirement to fund the new capital programme for 2023-27. As mentioned earlier in the report there is a funding requirement of £124m for the new capital programme. Due to the level of cash balances held, it is expected that the additional funding requirement will be funded internally without raising any new external debt.

24. At the end of the financial year, after the repayment of debt and setting aside funding for the Minimum Revenue Provision (MRP) of £6.2m, to ensure that loans raised to finance capital expenditure are paid off over the longer term, the Council was £54m over-borrowed.

25. The lack of opportunity to reduce the debt portfolio, because of historic stagnant interest rates, makes the punitive redemption costs prohibitive. The debt portfolio stands at £262.1m and the average pool rate 5.85%.

26. The maturity profile of the Council’s debt portfolio is shown in the chart below. This illustrates the long-term nature of the historic debt.



27. Debt repayments of £0.5m were made during the year meaning that the average pool rate was stagnant.

Investments

28. The loan portfolio produced an average return of 2.29% in 2022/23, compared to an average base rate of 2.30% and a Sterling Overnight Index Average (SONIA) of 2.26%. SONIA, published daily by the Bank of England. The SONIA rate is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors. It is therefore a good proxy for the risk-free rate of investing surplus cash.

29. The loan portfolio has outperformed both the average base rate and the average SONIA in four of the last five years. The average rate of interest earned on the portfolio in the last five years is 0.95% which compares favourably to average base rate and the SONIA which have reported returns of 0.79% and 0.75% respectively.

30. The variability of balances makes it difficult to calculate the excess interest that the over performance has achieved over the whole of the five year period, but it is estimated to be at least £2.5m.

31. An appendix would usually be added to the Annual Treasury Management report to provide the Committee with Link's benchmarking analysis of the Council's investment performance against comparator local authorities. However, this will not be available until the end of May and will therefore not be available in time for this meeting. Once this is received a copy will be circulated to all members of the Committee for information. A copy will also be included with the report to be considered by the Cabinet in June 2023.

32. Despite the supplementary analysis being unavailable at the current time, a comparison is able to be made against the latest available report as at end of September 2022. This shows the weighted average rate of return for Leicestershire County Council (2.16%) against other councils in its benchmarking group (1.76%) and an average for other County Councils (1.79%) and indicates that the Council is currently performing slightly better than its peers. This represents an improvement in

comparative performance compared to last year - Leicestershire County Council (0.25%) against other councils in its benchmarking group (0.17%) and other County Councils (0.26%).

33. The above paragraphs exclude investments relating to private debt and bank risk sharing funds. The capital value of these investments as at 31st March 2023 was £42m. Since inception (January 2018) the Council has received interest payments totalling £3.1m from these investments and the current performance as measured by the internal rate of return is 6.05% - which is in line with expectations.

Summary

34. Treasury Management is an integral part of the Council's overall finances, and the performance of this area is very important. Whilst individual years obviously matter, performance is best viewed on a medium to long term basis. The action taken in respect of the debt portfolio in recent years has been extremely beneficial and has resulted in significant savings. Short term gains might, on occasions, be sacrificed for longer term certainty and stability.

35. The loan portfolio has produced a strong level of over performance in the period in which performance figures have been calculated. Adding significant value in a period of extremely low interest rates is very difficult. Ironically a period in which there begins to be differentiation in expectations for both the pace and extent of future base rate rises will make the cash sums that can be gained larger, whilst also giving a higher level of risk that the decisions taken might retrospectively prove to be sub-optimal.

Recommendations

36. That the contents of the annual report for 2022/23 be noted.

37. That the Committee further notes that the annual report will be submitted to the Cabinet for consideration at its meeting in June 2023.

Equality and Human Rights Implications

38. None.

Background Papers

Report to County Council on 17 February 2021 – 'Medium Term Financial Strategy 2022/23 - 2025/26. Appendix N, 'TMS 2022-26:
https://politics.leics.gov.uk/mgAi.aspx?ID=70346#mgDocuments

Report to the Corporate Governance Committee on 13 May 2022 – Quarterly Treasury Management Report
https://politics.leics.gov.uk/documents/s168986/Quarterly%20TM%20Report%20Q4%2021-22%20Final.pdf

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None.

Officers to Contact

Mr C Tambini, Director of Corporate Resources,
Corporate Resources Department,
☎0116 305 6199 E-mail Chris.Tambini@leics.gov.uk

Mr D Keegan, Assistant Director (Strategic Finance and Property),
Corporate Resources Department,
☎0116 305 7668 E-mail Declan.Keegan@leics.gov.uk

Appendix

Appendix A – Local authority lending checklist.

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