Report to the Audit & Governance Committee

Epping Forest District Council

Date of meeting: 27th July 2023

Portfolio:	**Finance, Qualis Client & Economic Development**	
Subject:	**Treasury Management Outturn 2022/23**	
Responsible Officer:	**Andrew Small**	**(01992 564278)**
Democratic Services:	**Laura Kirman**	**(01992 564243)**

Recommendations/Decisions Required:

(1) To note the Treasury Management Outturn 2022/23 ***(Appendix A)*** and pass comment for full Council.

Executive Summary:

The Council's Treasury Management Strategy (including Investment Strategy) for 2022/23 was considered at a meeting of the Audit and Governance Committee on 17th January 2022 and was subsequently agreed by full Council on 24th February 2022.

In accordance with CIPFA's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) and generally accepted good practice, the Treasury Management Outturn for 2022/23 (presented in ***Appendix A***) sets out the Council's actual Treasury Management activity for 2022/23, including the year-end position contained in the Council's (draft) Statement of Accounts for 2022/23.

Appendix A begins by setting the external context for 2022/23 by exploring the Economic Background, Financial Markets and Credit Ratings; this includes the well-documented inflation spike and spiralling interest rates.

The Borrowing and Investment position for Epping Forest District Council as at 31st March 2023 shows the following:

- *Borrowing* – external borrowing marginally increased by £12.6 million (from £269.0 million to £281.6 million) during the period April 2022 to March 2023; and
- *Investments* – there was a decrease in investments of £4.6 million (from £18.7 million to £14.1 million) during the same period.

The CIPFA Code also covers all the financial assets of the Council, as well as other non-financial assets which the Council holds, primarily for financial return. This report therefore also considers the Council's Commercial Property Portfolio, which delivered Net Income of £8.447 million in 2022/23 and continues to be a key part of the Council's strategy to minimise Council Tax increases.

Appendix A concludes by considering compliance with the Council's adopted Treasury

Management indicators. Compliance was achieved in all areas.

Reasons for Proposed Decision:

To enable the robust scrutiny the Council's Treasury Management performance in 2022/23 in compliance with CIPFA's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) and generally accepted good practice.

Legal and Governance Implications:

The Local Government Act 2003 created a framework for the financing of capital investments in local authorities which came into operation from April 2004. Alongside this, the Prudential Code was developed by CIPFA as a professional Code of Practice to support local authority decision making in capital investment and financing. Local authorities are required by regulation to have regard to the Prudential Code.

Safer, Cleaner and Greener (SCG) Implications:

None.

Background Papers:

Treasury Management Strategy (including Investment Strategy) 2022/23 (Audit and Governance Committee, 17th January 2022).

(MHCLG) Statutory Guidance on Local Government Investments (3rd Edition). Issued under section 15(1)(a) of the Local Government Act 2003 and effective for financial years commencing on or after 1st April 2018.

Risk Management:

There are a range of inherent financial risks associated with Treasury Management activity; not least the potential for loss of interest and/or deposits. The Council therefore engages the services of external Treasury Management advisors, Arlingclose Ltd.

Borrowing and Investment decisions are made in accordance with the Council's formally adopted Treasury Management Strategy (including Investment Strategy). The Strategy includes several Risk Management features, including – for example – the overriding priority that security of deposit takes precedence over return on investment.

Appendix A

Treasury Management Outturn 2022/23

Introduction

The Council has adopted CIPFA's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Council to approve Treasury Management semi-annual ("mid-year updates") and annual reports.

The Council's Treasury Management Strategy for 2022/23 (including Investment Strategy) was considered at a meeting of the Audit and Governance Committee on 17th January 2022 and was subsequently agreed by full Council on 24th February 2022. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Council's Treasury Management Strategy.

The 2017 Prudential Code included a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's updated Capital Strategy 2022/23 to 2026/27, complying with CIPFA's requirement, was also considered by the Audit and Governance Committee on 17th January 2022, and was also adopted subsequently by full Council on 24th February 2022.

External Context: April 2022 to March 2023

Economic Background: The war in Ukraine continued to keep global inflation above central bank targets and the UK economic outlook remained relatively weak with the chance of a mild recession. The economic backdrop during the January to March 2023 period continued to be characterised by high energy and commodity prices, high inflation, and the associated impact on household budgets and spending.

Starting the financial year in April 2022 at 5.5%, the annual CPI measure of UK inflation rose strongly to hit 10.1% in July 2022 and then 11.1% in October 2022. Inflation remained high in subsequent months but appeared to be past the peak, before unexpectedly rising again in February 2023. Annual headline CPI registered 10.4% in February 2023, up from 10.1% in January 2023.

Quarterly GDP was subdued throughout the year, registering a 0.1% gain in the April to June 2022 period, before contracting by (an upwardly revised) -0.1% in the subsequent quarter (July to September 2022). The October to December 2022 period was revised upwards to 0.1% (from 0.0%), illustrating a resilient but weak economic picture. The annual growth rate in Quarter 4 (January to March 2023) was 0.6%.

The Bank of England increased the official Bank Rate to 4.25% during the financial year. From 0.75% in March 2022, the Monetary Policy Committee (MPC) pushed through rises at every subsequent meeting over the period, with recent hikes of 0.50% in December 2022 and February 2023 and then 0.25% in March 2023, taking the Bank Rate to 4.25%.

Financial Markets: Uncertainty continued to be a key driver of financial market sentiment and bond yields remained relatively volatile due to concerns over elevated inflation and higher interest rates, as well as the likelihood of the UK entering a recession and for how long the Bank of England would continue to tighten monetary policy. Towards the end of the period, fears around the health of the banking system following the collapse of Silicon Valley Bank in the US and purchase of Credit Suisse by UBS caused further volatility.

Over the period the 5-year UK benchmark gilt yield rose from 1.41% to peak at 4.70% in September before ending the financial year at 3.36%. Over the same timeframe the 10-year gilt yield rose from 1.61% to peak at 4.51% before falling back to 3.49%, while the 20-year yield rose from 1.82% to 4.96% and then declined to 3.82%. The Sterling Overnight Rate (SONIA) averaged 2.24% over the period.

Credit review: During the last few months of the reporting period there were only a handful of credit changes by the rating agencies, then in March 2023 the collapse of Silicon Valley Bank (SVB) in the US quickly spilled over into worries of a wider banking crisis as Credit Suisse encountered further problems and was bought by UBS.

Credit Default Swap (CDS) prices had been rising since the start of the period on the back of the invasion of Ukraine, and in the UK rose further in September/October 2022 at the time of the then-Government's mini budget. After this, CDS prices had been falling, but the fallout from SVB caused a spike on the back of the heightened uncertainty. However, they had moderated by the end of the period as fears of contagion subsided, but many are still above their pre-March 2023 levels reflecting that some uncertainty remains.

On the back of this, Arlingclose reduced its recommended maximum duration limit for unsecured deposits for all UK and Non-UK banks/institutions on its counterparty list to 35 days as a precautionary measure. No changes were made to the names on the list. As market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Council's counterparty list recommended by Arlingclose remains under constant review.

Local authorities remain under financial pressure, but Arlingclose continues to take a positive view of the sector, considering its credit strength to be high. Section 114 Notices have been issued by only a handful of councils with specific issues.

Local Context

On 31st March 2023, the Council had net borrowing of £267.5 million arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31/03/23 Actual £m
General Fund CFR	159.088
HRA CFR	154.475
Total CFR	**313.563**
Less: Other Debt liabilities	0
Borrowing CFR	**313.563**
Less: External borrowing	(282.681)
Internal borrowing:	**30.882**
Less: Usable reserves	(34.005)
Less: Working capital	(9.673)
Net Investments	**(12.796)**

The Treasury Management position as at 31st March 2023 and the change during the financial year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31/03/22 Balance £m	Movement £m	31/03/23 Balance £m	31/03/23 Rate %
Long-term Borrowing	213.7	34.9	248.6	3.27%
Short-term Borrowing	55.3	(22.3)	33.0	3.76%
Total Borrowing	**269.0**	**12.6**	**281.6**	
Long-Term Investments	0	0	0	N/A
Short-term Investments	0	3.0	3.0	3.95%
Cash and Cash Equivalents	18.7	(7.6)	11.1	3.82%
Total Investments	**18.7**	**(4.6)**	**14.1**	
Net Borrowing	**250.3**	**17.2**	**267.5**	

The Council's cash flows during the financial year were generally stable relevant to the turmoil experienced during Covid and its immediate aftermath. Thus:

- *Long-Term Borrowing (up £35.9 million)* – long-term loans increased during the year, as the Council moved to secure a diminishing number of competitive interest rates at the expense of short-term loans. On-lending to Qualis also further in accordance with committed Capital Investment plans.

- *Short-Term Borrowing (down £22.3 million)* – the level of borrowing obtained from other local authorities was purposely reduced in the year, which enabled long-term replacement debt to be taken out at competitive interest rates as described above. Some short-term borrowing was 'rolled over' on competitive rates with the agreement of lenders.

- *Short-Term Investments (up £3.0 million)* – the use of the "Debt Management Account Deposit Facility" (DMADF) proved successful again this year with the Council securing better returns on short-term deposits (typically two to three weeks) than previously achieved on bank deposits; and

- *Cash and Cash Equivalents (down £8.9 million)* – the use of the DMADF noted above is reducing the need for higher balances on Cash and Cash Equivalents (Bank and MMF deposits).

Borrowing Update

Local authorities can borrow from the PWLB provided they can confirm they are not planning to purchase 'investment assets primarily for yield' in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 Officer. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing.

Acceptable use of PWLB borrowing includes Service Delivery, Housing, Regeneration, Preventative Action, Refinancing and Treasury Management.

The Council is not planning to purchase any investment assets primarily for yield within the next three years and so is able fully access the PWLB.

Borrowing Strategy

At 31st March 2023, the Council held £281.6 million in loans (an increase of £13.6 million compared to the position as at 31st March 2022), as part of its strategy for funding the Capital Programme and is summarised in Table 3 below.

Table 3: Borrowing Position

	31/03/22 Balance £m	Net Movement £m	31/03/23 Balance £m	31/03/23 Weighted Average Rate %	31/03/23 Weighted Average Maturity (Years/Days)
Public Works Loan Board	215.0	46.6	261.6	3.39%	15.17 Years
Banks	0	0	0	N/A	N/A
Local authorities (long-term)	0	0	0	N/A	N/A
Local authorities (short-term)	54.0	(34.0)	20.0	3.76%	125 Days
Total Borrowing	**269.0**	**12.6**	**281.6**		

The chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective. The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

The cost of both long and short-term borrowing rose dramatically over the year, with rates at the end of March 2023 around 2% to 4% higher than those at the beginning of April 2022. Rate rises have been driven primarily by inflation and the need for central banks to control this by raising interest rates. Particularly dramatic rises were seen in September 2022 after the Liz Truss 'mini budget' that included unfunded tax cuts and additional borrowing to fund consumer energy price subsidies: over a twenty-four-hour period, some PWLB rates increased to 6.0%. Rates have now fallen from September 2022 peaks but remain volatile and well above recent historical norms. The PWLB 10-year maturity certainty rate stood at 4.33% at 31st March 2023, 20-years at 4.70% and 30-years at 4.66%.

A new HRA PWLB rate of gilt yield plus 0.4% (0.4% below the currently available certainty rate) was announced on 15th March 2023. This discounted rate is to support local authorities borrowing for Housing Revenue Accounts (HRA) and the delivery of social housing and was made available with effect from 15th June 2023, initially for a period of one year. At the time of preparing this report, Housing officers are evaluating the outputs from the independent Stock Condition Survey, which is critical to the future viability of the HRA Business Plan, including the Housebuilding Programme; the availability of discounted financing from the PWLB will be a further consideration in updating the Programme.

Other Debt Activity

The Council did not raise any other capital finance in 2022/23.

Treasury Investment Activity

CIPFA published a revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes on 20th December 2021. These define Treasury Management Investments as investments that arise from the organisation's cash flows or Treasury Risk Management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held, and money borrowed in advance of need. During 2022/23, as is normal, the Council's investment balances varied due to timing differences between income and expenditure.

At 31st March 2023, the Council held £14.1 million in investments (down £4.6 million compared to the position as at 31st March 2022), which are summarised in Table 4 below.

Table 4: Treasury Investment Position

	31/03/22 Balance £m	Net Movement £m	31/03/23 Balance £m	31/03/23 Income Return %	31/03/23 Weighted Average Maturity Days
Banks & Building Societies (unsecured)	1.7	(0.6)	1.1	1.35%	Instant Access
Government (incl. local authorities)	0	3.0	3.0	3.95%	19 Days
Money Market Funds	17.0	(7.0)	10.0	4.10%	Instant Access
Total Investments	**18.7**	**(4.6)**	**14.1**		

Both the CIPFA Code and Government guidance requires local authorities to invest 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 Council'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.

Bank Rate increased from 0.75% at the beginning of the year (April 2022) to 4.25% at the end of March 2023. Short-dated cash rates, which had ranged between 0.7% - 1.5% at the beginning of April 2022, rose by around 3.5% for overnight/7-day maturities and 3.3% for 6 to12-month maturities.

By the end of March 2023, the rates on “Debt Management Account Deposit Facility” (DMADF) deposits ranged between 4.05% and 4.15%.

Non-Treasury Investments

The definition of investments in CIPFA’s Treasury Management Code covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in the Investment Guidance issued by Ministry of Housing, Communities and Local Government (MHCLG), in which the definition of investments is further broadened to also include all such assets held partially for financial return.

The Council also holds a significant commercial property portfolio on its Balance Sheet, which are summarised in Table 5 below.

Table 5: Commercial Property Investments

Category	31/03/23 Balance Sheet Value	Net Income 2022/23	Net Income 2021/22
	£Ms	£Ms	£Ms
Shops*	93.479	5.736	5.326
Industrial Units	38.114	1.689	1.375
Other**	16.890	1.022	0.789
Total Value/Net Income	**148.483**	**8.447**	**7.490**

*Includes Public Houses and a Petrol Station

**Includes North Weald Airfield and Sports Facilities

The Council received total net income of £8.447 million from Commercial Property Investments in 2022/23 (compared to £7.490 million for 2021/22). Significantly stronger returns were achieved this year from Industrial Units especially (reflecting a range of renegotiated leases) and “Other” investments (following a significant increase in Market rents).

The Committee should note that the numbers reflect the accrued position currently in the Council's books, which does not take account of the collectability of income, although – so far – the Council's portfolio has weathered both the pandemic and the early stages of the 'cost of living crisis' generally very well. Nevertheless, an increase in write-offs cannot be ruled out in the future given the current economic climate.

Compliance

The Strategic Director and Section 151 Officer reports that all Treasury Management activities undertaken during the first six months of the year complied fully with the CIPFA Code of Practice. Compliance with the approved Treasury Management Strategy was as follows:

- *Investment Limits* – full compliance achieved
- *Security* – full compliance achieved
- *Liquidity* – full compliance achieved
- *Interest Rate Exposure* – full compliance achieved
- *Maturity Structure* – full compliance achieved; and
- *Long-Term Investments* – full compliance achieved.

Table 8: Investment Limits

Sector	Time Limit	Counterparty Limit	Sector limit	31/03/23 Actual	Complied? (Yes/No)
The UK Government	50 years	Unlimited	N/A	£3.0 million	Yes
Local authorities & other government entities	25 years	£10.0 million	Unlimited	£0	Yes
Banks (unsecured)*	13 months	£4.0 million	£20.0 million	£1.1 million	Yes
Building Societies* (unsecured)	13 months	£2.0 million	£2.0 million	£0	Yes
Registered Providers* (unsecured)	5 years	£3.0 million	£3.0 million	£0	Yes
Money Market Funds*	N/A	£10.0 million	Maximum of 3 Funds (£10m each)	£10.0 million	Yes

** Minimum Credit Rating*

Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken account of.

Treasury Management Indicators

The Council measures and manages its exposures to Treasury Management risks using the following indicators.

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	2022/23 Actual	2022/23 Target	Complied?
Portfolio average credit rating	AA	A-	Yes

Liquidity: The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

	2022/23 Actual	2022/23 Target	Complied?
Total cash available within 3 months	£12.8 million	£3.0 million	Yes

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

Interest rate risk indicator	2022/23 Actual	2022/23 Limit	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates (Borrowing)	£0.35 million	£1.0 million	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates (Investments)	£0.10 million	£0.5 million	Yes

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates. The Council no longer has any Variable Rate Exposure on Borrowing.

Maturity Structure of Borrowing: This indicator is set to control exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	31/03/23 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	12%	50%	0%	Yes
12 months and within 24 months	3%	50%	0%	Yes
24 months and within 5 years	5%	50%	0%	Yes
5 years and within 10 years	18%	50%	0%	Yes
10 years and within 15 years	15%	50%	0%	Yes
15 years and within 20 years	45%	50%	0%	Yes
20 years and within 25 years	1%	50%	0%	Yes
25 years and above	2%	50%	0%	Yes

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal Sums Invested for Periods Longer than a year: 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 long-term principal sum invested to final maturities beyond the period end were:

	2022/23
Actual principal invested beyond year end.	£3.0 million
Limit on principal invested beyond year end.	£15.0 million
Complied?	Yes

Other

IFRS 16: The implementation of the new IFRS 16 Leases accounting standard was due to come into for force for local authorities from 1st April 2022. Following a consultation, CIFPA/LASAAC announced an optional two-year delay to the implementation of this standard; the decision which was confirmed by the Financial Reporting Advisory Board (FRAB) in early April 2022. Authorities can now choose to adopt the new standard on 1st April 2022, 1st April 2023, or 1st April 2024. IFRS16 is unlikely to have a material impact on Epping Forest District Council; on that basis, the intended local adoption of the new standard is on 1st April 2024.