Attachment 3

Report to the Audit & Governance Committee

Epping Forest District Council

Date of meeting: 29th September 2022

Portfolio:	**Finance, Qualis Client & Economic Development**	
Subject:	**Treasury Management Outturn Report 2021/22**	
Responsible Officer:	**Andrew Small**	**(01992 564278)**
Democratic Services:	**Laura Kirman**	**(01992 564243)**

Recommendations/Decisions Required:

(1) To note the Treasury Management Outturn Report for 2021/22 ***(Appendix A)*** and pass comment for full Council.

Executive Summary:

The Council's adopted Treasury Management Strategy (including Investment Strategy) for 2021/22 was considered in detail by the Audit and Governance Committee on 22nd March 2021.

In accordance with CIPFA's Treasury Management in the Public Services: Code of Practice (the CIPFA Code 2017) and generally accepted good practice, the Treasury Management Outturn Report for 2021/22 (presented in ***Appendix A***) sets out the Council's actual Treasury Management activity for 2021/22, including the year-end position contained in the Council's (draft) Statement of Accounts for 2021/22.

Appendix A begins by setting the external context for 2021/22 by exploring the Economic Background, Financial Markets, Credit Ratings, and ongoing changes to national Treasury Management practice.

The Borrowing and Investment position for Epping Forest DC as at 31st March 2022 was as follows:

- *Borrowing* – external borrowing rose by £7.3 million (from £261.7 million to £269.0 million) during the period April 2020 to March 2021; and

- *Investments* – there was also an increase of £8.2 million in investments (from £10.5 million to £18.7 million) during the same period.

CIPFA's Treasury Management Code covers all of the financial assets of the Council, as well as other non-financial assets which the Council holds, primarily for financial return. The report therefore also considers the Council's Commercial Property Portfolio, which delivered Net Income of £7.490 million in 2021/22 and remains a key part of Council strategy to minimise Council Tax increases.

Appendix A concludes by considering compliance with the Council's adopted Treasury Management indicators. Full compliance was achieved with most indicators. But cash flows experienced during the latter part of 2021/22 were relatively unusual, being primarily driven by external factors. This led to some short-term technical breaches of Investment Limits. Operational procedure has now been amended to ensure that the Council is better able to cope with future scenarios of a similar kind, without recourse to breaching the adopted Strategy.

Reasons for Proposed Decision:

To enable the robust scrutiny the Council's Treasury Management performance in 2021/22 in compliance with CIPFA's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code 2017) 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 2021/22 (Audit and Governance Committee, 22nd March 2021).

(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 services of external Treasury Management advisors are therefore utilised.

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

Attachment 3

Appendix A

Treasury Management Outturn Report 2021/22

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 2021/22 was considered at a meeting of the Audit and Governance Committee on 22nd March 2021 and was subsequently agreed by full Council. 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 includes 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 Capital Strategy for 2021/22 was also considered by the Audit and Governance Committee on 22nd March 2021 and subsequently agreed by full Council.

External Context: Review of 2021/22

Economic Background: The continuing economic recovery from coronavirus pandemic, together with the war in Ukraine, higher inflation, and higher interest rates were major issues over the year.

The Bank Rate was 0.1% at the beginning of the financial year. April and May 2021 saw the economy gathering momentum as the shackles of the pandemic restrictions were eased. Despite the improving outlook, market expectations were that the Bank of England would delay rate rises until 2022. Rising, persistent inflation changed that.

UK CPI was 0.7% in March 2021 but thereafter began to steadily increase. Initially driven by energy price effects and by inflation in sectors such as retail and hospitality which were re-opening after the pandemic lockdowns, inflation then was believed to be temporary. Thereafter price rises slowly became more widespread, as a combination of rising global costs and strong demand was exacerbated by supply shortages and transport dislocations. The surge in wholesale gas and electricity prices led to elevated inflation expectations. CPI for February 2022 registered 6.2% year on year, up from 5.5% in the previous month and the highest reading in the National Statistic series. Core inflation, which excludes the more volatile components, rose to 5.2% (year on year) from 4.4%.

The Government's jobs furlough scheme insulated the labour market from the worst effects of the pandemic. The labour market began to tighten and demand for workers grew strongly as employers found it increasingly difficult to find workers to fill vacant jobs. Having peaked at 5.2% in December 2020, unemployment continued to fall and the most recent labour market data for the three months to January 2022 showed the unemployment rate at 3.9% while the employment rate rose to 75.6%.

With the fading of lockdown – and, briefly, the 'pingdemic' – restraints, activity in consumer-facing sectors improved substantially as did sectors such as oil and mining with the reopening of oil rigs but materials shortages and the reduction in the real spending power of households and businesses dampened some of the growth momentum. Gross domestic product (GDP) grew by an upwardly revised 1.3% in the fourth calendar quarter of 2021 according to the final estimate (initial estimate 1.0%) and took UK GDP to just 0.1% below where it was before the pandemic. The annual growth rate was revised down slightly to 7.4% (from 7.5%) following a revised 9.3% fall in 2020.

Having increased the Bank Rate from 0.10% to 0.25% in December 2021, the Bank of England increased it further to 0.50% in February and 0.75% in March 2022.

In its March 2022 interest rate announcement, the MPC noted that the invasion of Ukraine had caused further large increases in energy and other commodity prices, with the expectation that the conflict will worsen supply chain disruptions around the world and push CPI inflation to around 8% later in 2022, even higher than forecast only a month before in the February 2022 Monetary Policy Report.

Financial Markets: The conflict in Ukraine added further volatility to the already uncertain inflation and interest rate outlook over the period. The Dow Jones started to decline in January 2022 but remained above its pre-pandemic level by the end of the period while the FTSE 250 and FTSE 100 also fell and ended the quarter below their pre-March 2020 levels.

Bond yields were similarly volatile as the tension between higher inflation and flight to quality from the war pushed and pulled yields, but with a general upward trend from higher interest rates dominating as yields generally climbed.

Credit Review: Fitch and Moody's revised upward the outlook on several UK banks and building societies to 'stable', recognising their improved capital positions compared to 2020 and better economic growth prospects in the UK.

The successful vaccine rollout programme was credit positive for the financial services sector in general and the improved economic outlook meant some institutions were able to reduce provisions for bad loans. However, in 2022, the uncertainty engendered by Russia's invasion of Ukraine pushed Credit Default Swap (CDS) prices modestly higher over the first calendar quarter, but only to levels slightly above their 2021 averages, illustrating the general resilience of the banking sector.

Having completed its full review of its credit advice on unsecured deposits, in September 2021, Arlingclose extended the maximum duration limit for UK bank entities on its recommended lending list from 35 days to 100 days; a similar extension was advised in December 2021 for the non-UK banks on this list.

Revised CIPFA Codes, Updated PWLB Lending Facility Guidance

In August 2021 HM Treasury significantly revised guidance for the PWLB lending facility with more detail and 12 examples of permitted and prohibited use of PWLB loans. 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.

CIPFA published its revised Prudential Code for Capital Finance and Treasury Management Code on 20th December 2021. The key changes in the two codes are around permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments.

The principles of the Prudential Code took immediate effect although local authorities could defer introducing the revised reporting requirements until the 2023/24 financial year if they wish. As reported to this Committee in January 2022, this Council already complies with the principles of the new Code and Finance officers are working towards full reporting compliance for 2023/24.

To comply with the new Prudential Code, authorities must not borrow to invest primarily for financial return. The Code also states that it is not prudent for local authorities to make investment or spending decisions that will increase the CFR unless directly and primarily related to the functions of the authority. Existing commercial investments are not required to be sold; however, authorities with existing commercial investments who expect to need to borrow should review the options for exiting these investments.

Borrowing is permitted for cashflow management, interest rate risk management, to refinance current borrowing and to adjust levels of internal borrowing. Borrowing to refinance capital expenditure primarily related to the delivery of a local authority's function but where a financial return is also expected is allowed, provided that financial return is not the primary reason for the expenditure. The changes align the CIPFA Prudential Code with the PWLB lending rules.

Unlike the Prudential Code, there is no mention of the date of initial application in the Treasury Management Code. The TM Code now includes extensive additional requirements for service and commercial investments, far beyond those in the 2017 version.

This Council is following the same process as the Prudential Code by implementing the changes in reporting requirements in 2023/24.

Local Context

On 31st March 2022, the Council had net borrowing of £250.3 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

	31/03/22 Actual £m
General Fund CFR	151.947
HRA CFR	157.552
Total CFR	**309.499**
Less: Other Debt liabilities	0
Borrowing CFR	**309.499**
Less: External borrowing	(268.956)
Internal borrowing:	**40.543**
Less: Usable reserves	(38.482)
Less: Working capital	(20.797)
Net Investments	**(18.736)**

Lower official interest rates reduced the cost of short-term, temporary loans and investment returns from cash assets that can be used in lieu of borrowing. The Council has pursued a strategy of keeping borrowing and investments below their underlying levels – sometimes known as internal borrowing – to reduce risk.

The Treasury Management position as at 31st March 2022 and the change during the financial year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31/03/21 Balance £m	Movement £m	31/03/22 Balance £m	31/03/22 Rate %
Long-term Borrowing	199.0	14.7	213.7	3.11%
Short-term Borrowing	62.7	(7.4)	55.3	0.51%
Total Borrowing	**261.7**	**7.3**	**269.0**	
Long-Term Investments	0	0	0	N/A
Short-term Investments	0	0	0	N/A
Cash and Cash Equivalents	10.5	8.2	18.7	0.06%
Total Investments	**10.5**	**8.2**	**18.7**	
Net Borrowing	**251.2**	**(0.9)**	**250.3**	

The Council's cash flows during 2021/22 were less volatile than 2020/21 (which was heavily affected by Covid-related items):

- *Long-Term Borrowing* – the Council took out further long-term borrowing of £16.0 million in the year, resulting in a net increase in the balance of £14.7 million, after allowing for the repayment of principal on existing loans

- *Short-Term Borrowing* – such borrowing – from other Local Authorities – has remained a prominent feature during the year. This allowed the Council to benefit from the very low short-term interest rates on offer, although longer-term replacement borrowing is being actively considered in 2022/23 in the light of rising interest rates (in consultation with Arlingclose); and

- *Cash and Cash Equivalents* – although cash flows were relatively stable in the year compared to the major volatility experienced in 2020/21, the Government has consistently delayed calling back overpaid/unspent Section 31 and Covid grant balances; this led to the Council temporarily holding slightly higher cash balances than planned towards the latter part of the year (it is a pattern that has carried over into the early part of 2022/23).

Borrowing Update

The Council was not planning to borrow to invest primarily for commercial return and so is unaffected by the recent changes to the Prudential Code.

Borrowing Strategy

As at 31st March 2022 the Council held £269.2 million in loans (an increase of £7.5 million compared to the position as at 31st March 2021), as part of its strategy for funding the Capital Programme. Outstanding loans on 31st March 2022 are summarised in Table 3 below.

Table 3: Borrowing Position

	31/03/21 Balance £m	Net Movement £m	31/03/22 Balance £m	31/03/22 Weighted Average Rate %	31/03/22 Weighted Average Maturity (Years/Days)
Public Works Loan Board (long and short-term)	238.7	(23.7)	215.0	3.13%	18 Years
Banks	0	0	0	N/A	N/A
Local authorities (long-term)	0	0	0	N/A	N/A
Local authorities (short-term)	23.0	31.0	54.0	0.49%	241 Days
Total Borrowing	**261.7**	**7.3**	**269.0**		

The Council's 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.

With short-term interest rates remaining lower than long-term rates (despite recent increases), the Council considered it more cost effective in the short term to use internal resources or borrowed rolling temporary / short-term loans instead. The net movement in temporary / short-term loans is shown in Table 3 above.

Other Debt Activity

The Council did not raise any other capital finance during 2021/22.

Treasury Investment Activity

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 2021/22, the Council's investment balances ranged between £6.4 million and £35.6 million; this was due to timing differences between income and expenditure. The investment position is shown in Table 4 below.

Table 4: Treasury Investment Position

	31/03/21 Balance £m	Net Movement £m	31/03/22 Balance £m	31/03/22 Income Return %	31/03/22 Weighted Average Maturity Days
Banks & building societies (unsecured)	1.4	0.3	1.7	0.01%	Instant Access
Government (incl. local authorities)	0	0	0	N/A	N/A
Money Market Funds	9.1	7.9	17.0	0.06%	Instant Access
Total Investments	**10.5**	**8.2**	**18.7**		

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.

Non-Treasury Investments

The definition of investments in CIPFA's revised Treasury Management Code now 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	**31/03/22 Balance Sheet Value**	**Net Income 2021/22 (12 months April - March)** ***
Shops*	£99.367m	£5.326m
Industrial Units	£43.703m	£1.375m
Other**	£18.936m	£0.789m
Total Value/Net Income	**£162.006m**	**£7.490m**

*Includes Public Houses and a Petrol Station

**Includes North Weald Airfield and Sports Facilities

The Council received total net income of £7.490 million from Commercial Property Investments in 2021/22 (£6.798 million in 2020/21), with the numbers reflecting additional income generated from new and renegotiated tenancies at North Weald Airfield.

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. So far, there have been no write-offs due to the effects of Covid-19, with the Council's portfolio appearing to have weathered the pandemic generally very well. However, 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 financial year complied fully with the CIPFA Code of Practice. However – in 2021/22 – regarding the approved Treasury Management Strategy:

- *Debt Limits* – full compliance achieved
- *Investment Limits* – the Council was forced to carry significantly higher than usual cash balances during the last two months of the year due to a range of – mainly external – factors. This led to some short-term technical breaches of Investment Limits with both the Bank and Money Market Funds (MMFs) limits. Procedures have now been adjusted and are now much more able to cope with any future events of this nature; and
- *Treasury Management Indicators* – compliance achieved in nearly all cases, although the Interest Rate Exposure target (on Interest *Receivable*) was technically missed due to the (aforementioned) carrying of higher cash balances.

Compliance with the Operational Boundary and Authorised Limit for external debt is demonstrated in Table 7 below.

Table 7: Debt Limits

	2021/22 Maximum	**31/03/22 Actual**	**2021/22 Operational Boundary**	**2021/22 Authorised Limit**	**Complied? (Yes/No)**
Borrowing	£302.1m	£269.0m	**£353.7 million**	**£363.7 million**	**Yes**
Finance Leases	0	0			
Total Debt	**£302.1m**	**£269.0m**			

Since the Operational Boundary is a management tool for in-year monitoring it is not significant if it is breached on occasions due to variations in cash flow; this is not counted as a compliance failure. Total debt did not breach the Operational Boundary during the year.

Table 8: Investment Counterparties and Limits

Sector	Time		Value		Sector	
	Limit	**Actual**	**Limit**	**Actual**	**Limit**	**Actual**
The UK Government	50 years	Instant	Unlimited	£29.0 million	N/A	£29.0 million
Local authorities & other government entities	25 years	None	£10.0 million	£0	Unlimited	£0
Banks (unsecured)	13 months	Instant	£5.0 million	**£13.6 million***	£20.0 million	£13.6 million
Building Societies (unsecured)	13 months	None	£2.0 million	£0	£2.0 million	£0
Registered Providers (unsecured)	5 years	None	£3.0 million	£0	£3.0 million	£0
Money Market Funds	N/A	Instant	£10.0 million	£10.0 million	Maximum of 3 Funds (see below)	**4****

Note - excludes Qualis loans

Table 8 above shows two technical breaches to the Council's adopted Investments Limits as follows:

- ***Banks (Unsecured)*** – Limit £5.0 million (Actual £13.6 million) – the limit was briefly exceeded on Saturday 26th and Sunday 27th March 2022 due to the late receipt of external funding of £13.0 million on Friday 25th March 2022 (the Council was assembling funds to repay a Variable Rate PWLB loan of £31.8 million); the timing of the receipt prevented any temporary transfers to other funds for the duration of the weekend. The matter was immediately rectified on Monday 28th March 2022, with the repayment of the PWLB loan; and

- ****Money Market Funds (MMFs)*** – Limit 3 (Actual 4) – the Council has for some time operated with access to four MMFs, but only investing in three at a single point in time in accordance with the Strategy. However, the Council was carrying much higher than usual cash balances in early February 2022 due to the combined impact of drawing down PWLB loans for on lending to Qualis (£16.0 million) and ensuring cash was available to repay the Government Section 31 (Business Rates) grants on demand (£9.7 million). This led to the 'emergency' use of the fourth MMF on a temporary basis. The Council has subsequently opened a (UK Government) "Debt Management Account Deposit Facility" and has closed one of the MMF accounts, which will prevent this situation occurring again in the future.

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.

	31/03/22 Actual	2021/22 Target	Complied?
Portfolio average credit rating	A	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.

	31/03/22 Actual	2021/22 Target	Complied?
Total cash available within 3 months	£18.7 million	£3.0 million	Yes

At no time during 2021/22 (or subsequently at the time of preparing this report), did the Council go overdrawn at the Bank.

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	31/03/22 Actual	2021/2022 Limit	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates (Borrowing)	£9,000	£318,000	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates (Investments)	(£169,000)	(£120,000)	No*

Explained above within Investment Limits. Outturn a function of – unavoidably – higher cash balances being carried.

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 table above shows a very different outturn profile from that of recent years following the repayment of the Council's only remaining Variable Rate Loan in March 2022. Net interest rate exposure of £160,000 (£169,000 minus £9,000) is now focussed on Lending (Investments) as opposed to Borrowing.

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 all borrowing were:

Refinancing Rate Risk Indicator	31/03/22 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	20%	50%	0%	Yes
12 months and within 24 months	0%	50%	0%	Yes
24 months and within 5 years	0%	50%	0%	Yes
5 years and within 10 years	11%	50%	0%	Yes
10 years and within 15 years	4%	50%	0%	Yes
15 years and within 20 years	45%	50%	0%	Yes
20 years and within 25 years	13%	50%	0%	Yes
25 years and above	8%	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:

Price Risk Indicator	2021/22
Actual principal invested beyond year end	£0
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.