Havering
LONDON BOROUGH

AUDIT COMMITTEE 27 JULY 2023

Subject Heading:	**Annual Treasury Management Report 2022/23**
SLT Lead:	**Dave McNamara** **Interim Section 151 Officer**
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Policy context:	This Authority is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the prudential and treasury indicators for 2022/23. This report meets the requirements of both the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management,(“the CIPFA TM code”) and the CIPFA Prudential Code for Capital Finance in Local Authorities, (“the Prudential Code”)
Financial summary:	**The Treasury Strategy supports the Authority’s Budget strategy.**

The subject matter of this report deals with the following Council Objectives

Communities making Havering	[x]
Places making Havering	[x]
Places making Havering	[x]
Connections making Havering	[x]

SUMMARY

The CIPFA TM Code requires that authorities report on the performance of the treasury management function to Full Council at least twice per year (mid-year and at year-end).

The Authority's Treasury Management Strategy Statement (TMSS) 2023/24 was approved by Full Council on the 1 March 2023. This backward looking report covers the delivery of the TMSS in 2022/23.

The Authority borrowed and invested substantial sums of money and is potentially exposed to financial risk from loss of invested funds and the revenue impact from changing interest rates. This report covers activity on treasury managed investments and borrowings and the associated monitoring and control.

RECOMMENDATIONS

- To note the content of treasury management activities and performance against targets for the financial year 2022-23 as detailed in the report.

KEY HIGHLIGHTS

- Investment income outturn overachieved budget by £2.6
- Interest payable underspent the budget by £1.8m, delivering a net underspend of £4.4m (of which £3.8m relates to the General Fund) for 2022/23.
- The Authority's long term debt are on fixed rates averaging 2.95% and are not affected by the recent increases in the Bank of England bank rate.
- No new long term debt was taken while long term interst rates remain elevated.
- During the year treasury exceeded its benchmark of 3 month SONIA @1.38% delivering a yield of 1.73%.
- During 2022/23 this Authority's treasury activities remained within the treasury limits and prudential indicators set out in the TMSS.

REPORT DETAIL

1. Background

1.1. Introduction

This Authority is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2022/23. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management, (the TM Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

During 2022/23 the minimum reporting requirements were that the Authority should receive the following reports:

- An annual treasury strategy in advance of the year (Council 3 March 2022)
- A mid-year, (minimum), treasury update report (Audit Committee 19 October 2022)
- An annual review following the end of the year describing the activity compared to the strategy, (this report).

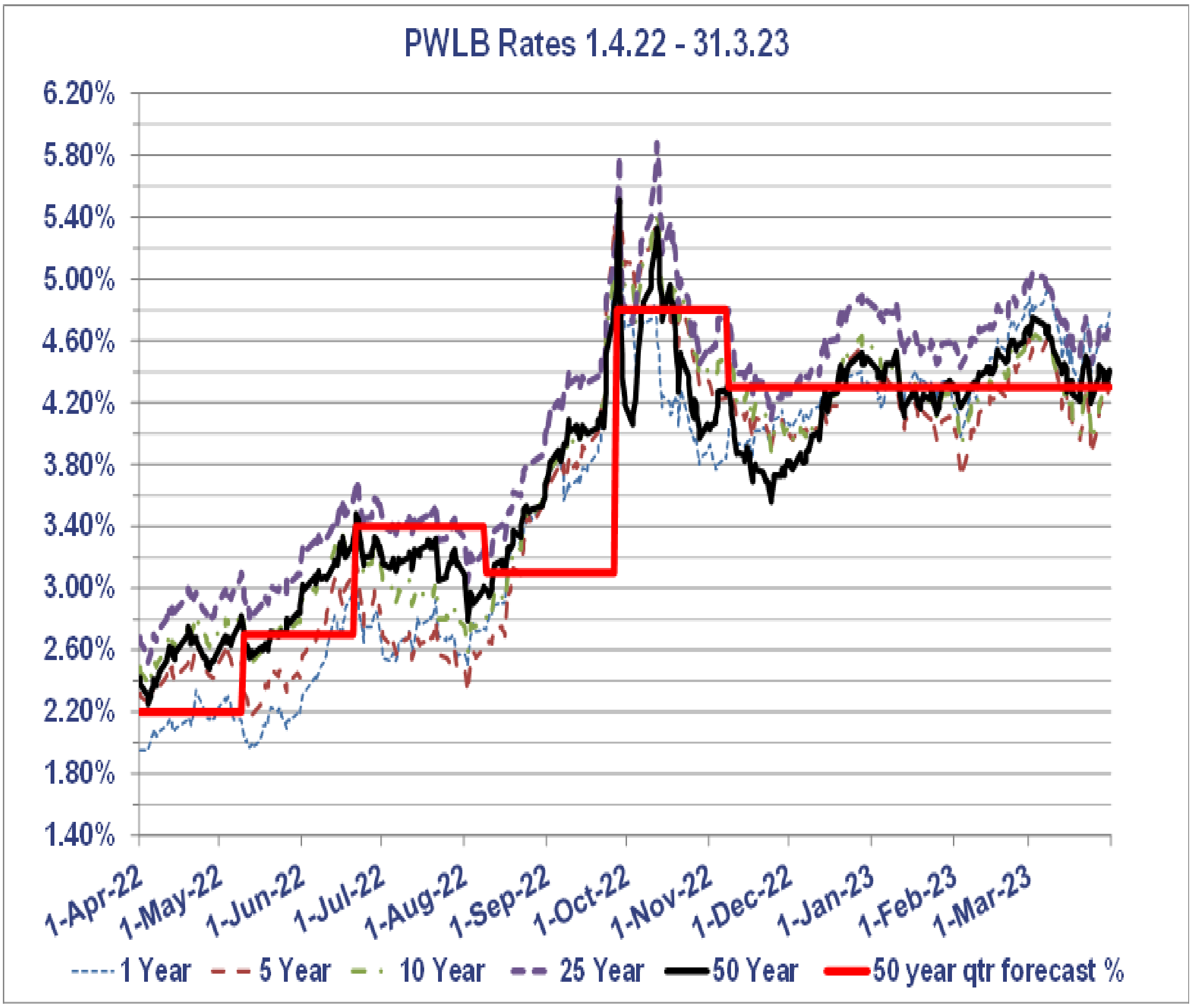
The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Authority's policies previously approved by Members.

1.2. Economic

Starting April 2022 at 0.75%, The Bank of England (BoE) Monetary Policy Committee (MPC) continued to increase the Bank Rate, moving in stepped increases of either 0.25% or 0.50%, reaching 4.25% by the end of the financial year, with the potential for a further one or two increases in 2023/24. UK Inflation measured by the CPI remaided stubornly high during the period ending the year at 10.1%, well above the (BoE) target of 2%. Since early 2022, yields have risen dramatically in all the major developed economies, first as economies opened post-Covid; then because of the inflationary impact of the war in Ukraine in respect of the supply side of many goods. In particular, rising cost pressures emanating from shortages of energy and some food categories have been central to inflation rising rapidly. Furthermore, at present the Bank of England is being challenged by persistent inflation that is exacerbated by very tight labour markets and high wage increases relative to what central banks believe to be sustainable.

UK Gilt yields (which drive PWLB interest rates) rose steadly during the period reaching a peaking in the autumn of 2022, before falling back, currently, Gilt yields are broadly range bound between 3% and 4.25%. As at the 31 March 2023, all gilt yields from 1 to 50 years were between 3.64% and 4.18%, see chart below. The policies pursued by the brief Truss government resulted in the spike in rates during the autumn of 2022. Since April long term rates have increased as inflation remains stubbornly high.

Graph 1: PWLB Rates 2022/23



HIGH/LOW/AVERAGE PWLB RATES FOR 2022/23

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.95%	2.18%	2.36%	2.52%	2.25%
Date	01/04/2022	13/05/2022	04/04/2022	04/04/2022	04/04/2022
High	5.11%	5.44%	5.45%	5.88%	5.51%
Date	28/09/2022	28/09/2022	12/10/2022	12/10/2022	28/09/2022
Average	3.57%	3.62%	3.76%	4.07%	3.74%
Spread	3.16%	3.26%	3.09%	3.36%	3.26%

2. Treasury Management Summary

2.1 The treasury management activity in year is shown in table 1 below:

Table 1: Treasury management summary as at 31 March 2022

	01.04.22		31.03.23	2022-23	2022-23	2022-23
	Balance outstanding	**Movement**	**Balance outstanding**	**interest**	**Average Balance**	**Weighted Average Rate**
	£m	**£m**	**£m**	**£m**	**£m**	**%**
LONG-TERM BORROWING						
PWLB	307.124	0	307.124	8.861	307.124	2.88
LOBO	7.000	0	7.000	0.252	7.000	3.60
Short-term borrowing	0.853	12.800	13.653	0.107	2.927	3.66
Total borrowing	**314.977**	**12.800**	**327.777**	**9.220**	**317.051**	**2.91**
INVESTMENTS						
Short-term investments	85.000	(85.000)	0	1.157	71.870	1.61
Cash and cash equivalents	52.000	(21.800)	30.200	0.918	48.051	1.91
Total investments	**137.000**	**(106.800)**	**30.200**	**2.075**	**119.921**	**1.73**
Net borrowing	**177.977**	**119.600**	**297.577**	**7.145**	**197.130**	**3.62**

3. Borrowing strategy

3.1 Table 2 sets out the change in the Authority's Capital Financing Requirement (CFR) in 2022/23 – this measures how the Authority's underlying borrowing need has changed in year as a result of activity on its approved capital programme and how it has been financed. The Authority's capital finance budget includes provision to fund the capital programme's expected borrowing requirement from new long term fixed rate debt.

Table 2: CFR and its financing 2022/23

£m	**01/04/22 Act**	**31/03/23 Budget**	**31/03/23 Act**
GF CFR	189	235	**212**
HRA CFR	280	369	**347**
Total CFR	**469**	**604**	**559**

Financed by:			
Internal cash	154	296	**232**
External long term Debt:			
HRA	229	229	**229**
GF	86	79	**85**
External Short term Debt:			
GF	0	0	**13**

3.2 The short term strategy involved using the Authority's cash balances to fund the 2022/23 borrowing requirement in the capital programme. In addition short term borrowings were entered into in February & March 2023 totalling £13m.

3.3 The Authority's debt portfolio is fixed with an average maturity of 24 years, with inflation currently higher than the current cost of debt at 31 March 2023 of 2.95%, the real value of that debt is set to fall.

3.4 The S151 officer balanced the need to minimise the costs from funding the CFR by using internal cash balances and defer the drawdown of more expensive long term debt against the protection it offers in reducing interest rate risk and stabilising capital finance costs in the budget strategy. Slippage on the capital programme in 2022/23 has meant the Authority's cash balances have remained higher than planned. This strategy of deferring long term borrowing resulted in significant savings in the 2022/23 capital finance budget as detailed in table 4 below. This strategy may need to be reviewed should interest rates remain higher for longer.

Table 4: Capital finance outturn 2022/23

Item	HRA £m	General Fund £m
Interest payable		
Budget	8.0	3.8
Outturn	7.4*	2.6
Underspend	**0.6**	**1.2**
Interest receivable		
Budget	0	0.2
Outturn	0	2.8*
Underspend	**0**	**2.6**
Net Underspend	**0.6**	**3.8**

* includes £0.6m HRA adjustment

3.5 Debt Rescheduling

The possibility of debt rescheduling was regularly discussed with our treasury adviser. The current PWLB rules on redemption remain prohibitive and costly.

3.6 LOBO Loan

The Authority holds a £7m LOBO loan with Danske Bank that has the option to propose an increase in the interest rate at set dates, while the Authority has the option to either accept the new rate or to repay the loan at no additional cost. The treasury adviser stated there is a possability that the lender may propose an increased rate in the foreseeable future. Officers will continue to monitor and liaise with Danske Bank going forward.

4. Investment strategy

4.1 The Authority's cash investments were utilised during the year to finance the growth in capital expediture met from borrowing (CFR) falling from £137m to end the year at £30.2m, as shown in Table 5 below.

4.2 The Guidance on Local Government Investments in England gives priority to security and liquidity and yield in that order. Officers kept treasury investments in short-term instruments in 2022/23 so they could be used to fund the capital programme whilst maintaining a liquidity buffer of £40m as a contingency against any future credit crisis. The Authority has benefited from this strategy as it has been able to take advantage of the increase in short term interest rates.

Table 5: Treasury investment activity 2022/23

Investments	Balance at 31/03/22 £m	Movement £m	Balance at 31/03/23 £m	Interest Rate * %
Bank & Building Society (fixed unsecured)	50.000	(50.000)	0.000	0.00
Bank & Building Society (Call & Notice Accounts)	20.000	(20.000)	0.000	0.00
Local Authorities	15.000	(15.000)	0.000	0.00
Debt Management Office (DMO)	52.000	(21.800)	30.200	4.05
Total investments	**137.000**	**(106.800)**	**30.200**	**4.05**

* interest rate at 31 March 2023.

4.3 **Appendix A** shows the breakdown of counterparties and investments for the Authority, showing the percentage each investment represents as a part of the total amount invested.

5. Budgeted Income and Return

5.1 The authority measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 6 below:

Table 6: Treasury investment performance 2022-23

	Benchmark Return 3 month SONIA	Budgeted Rate	Budgeted Interest (Full Year)	Weighted Actual Rate of Return	Interest
	%	%	£m	%	£m
2022-23	1.38	0.25	0.25	1.73	2.07

6. Regulatory Changes

6.1 The revised CIPFA code was explained in last year's report and came into effect in 2023/24 financial year. Members received training on this in January 2023 from LINK our treasury advisors.

7. Compliance with Treasury and Prudential Limits

7.1 During the year, the Authority has operated within the treasury limits and Prudential Indicators set out in the authority Treasury Management Strategy Statement and in compliance with the authority's Treasury Management Practices. An update on indicators and limits are reported in Appendix A of this report.

7.2 The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

IMPLICATIONS AND RISKS

Financial implications and risks:

The Authority uses Link Asset Services, Treasury Solutions as its external treasury management advisors.

The Authority recognises that responsibility for treasury management decisions remains with the organisation at all times. All decisions will be undertaken with regards to all available information, including, but not solely our treasury adviser.

Risk is inherent in all treasury activity. The Investment Strategy identifies the risk associated with different classes of investment instruments and sets the parameters within which treasury activities can be undertaken and controls and processes appropriate for that risk.

Treasury operations are undertaken by nominated officers as prescribed by the Treasury Management Policy Statement as approved by the Council.

Legal implications and risks:

There are no apparent legal implications or risks from noting this report.

Human Resources implications and risks:

There are no HR implications from this report

Equalities implications and risks:

There are no Equalities implications arising from this report.

The report has no direct equalities implications.

The Public Sector Equality Duty (PSED) under section 149 of the Equality Act 2010 requires the Council, when exercising its functions, to have 'due regard' to:

(i) The need to eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Equality Act 2010;

(ii) The need to advance equality of opportunity between persons who share protected characteristics and those who do not, and;

(iii) Foster good relations between those who have protected characteristics and those who do not.

Note: 'Protected characteristics' are age, disability, gender reassignment, marriage and civil partnerships, pregnancy and maternity, race, religion or belief, sex/gender, and sexual orientation.

The Council is committed to all of the above in the provision, procurement and commissioning of its services, and the employment of its workforce. In addition, the Council is also committed to improving the quality of life and wellbeing for all Havering residents in respect of socio-economics and health determinants.

Health and Wellbeing implications and risks:

The Council is committed to improving the quality of life and wellbeing for all Havering employees and residents in respect of socio-economics and health determinants. Whilst there are no direct implications to the Council's workforce and residents health and wellbeing as a result of this report.

BACKGROUND PAPERS

None

Appendix A

Compliance Report

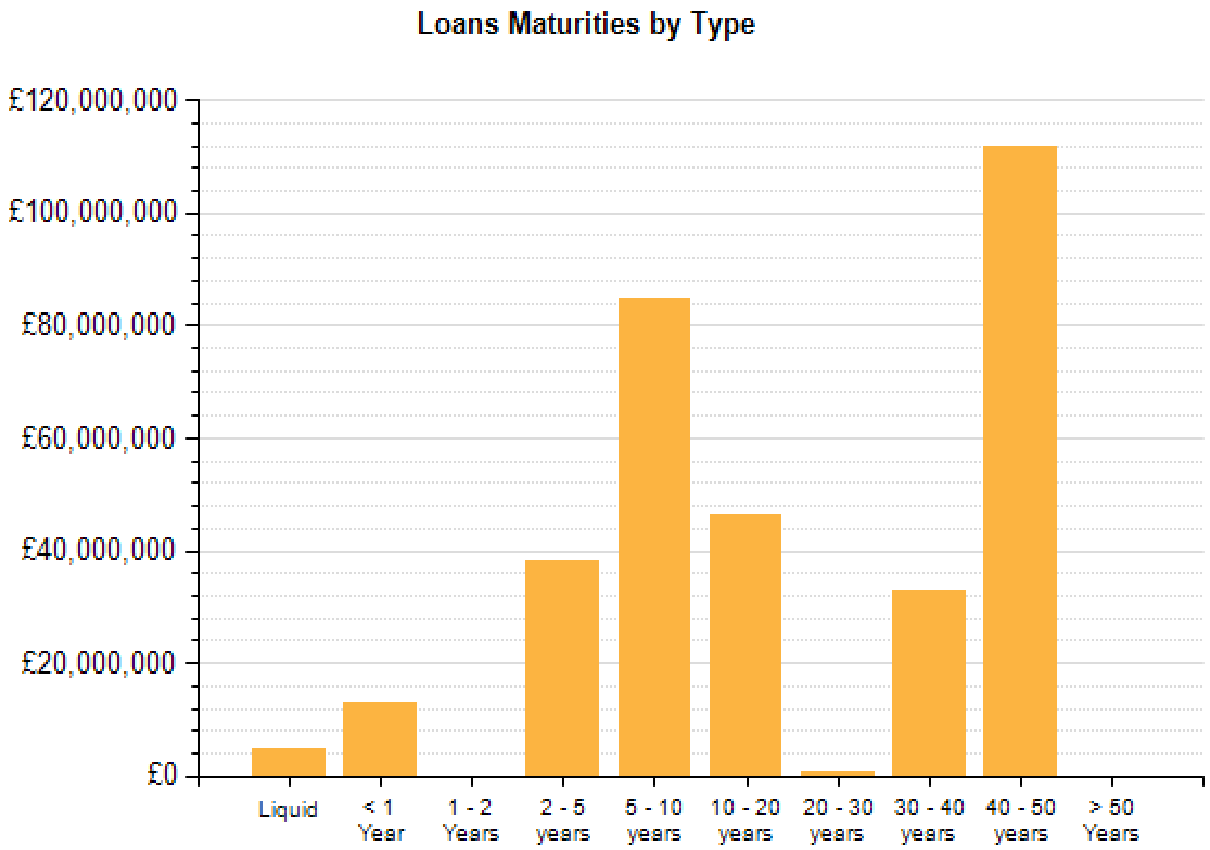
All treasury management activities undertaken during the financial year complied fully with the CIPFA Code of Practice and the authority's approved Treasury Management Strategy. Compliance with specific treasury limits is demonstrated in tables below.

1.1 Maturity Structure of Borrowing

1.1 This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

Table 1: Loan maturity structure

	Upper %	**Lower %**	**Actual %**
Under 12 months	40	0	4
12 months and within 24 months	60	0	0
24 months and within 5 years	80	0	12
5 years and within 10 years	100	0	26
10 years and above	100	0	58



Tenor Bucket	Amount	Rate
< 1 Year	£13,000,000	4.17%
1 - 2 Years		
2 - 5 years	£38,057,412	3.13%
5 - 10 years	£84,582,212	3.30%
10 - 20 years	£46,524,800	3.45%
20 - 30 years	£653,158	2.27%
30 - 40 years	£32,959,855	5.03%
40 - 50 years	£112,000,000	1.66%
> 50 Years		
Total	£327,777,437	2.95%

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. The average maturing life of the long term debt is 24 years.

1.2 Principal Sums Invested for Periods Longer than 364 days

1.2.1 The purpose of this indicator is to control the authority's exposure to the risk of incurring losses by seeking early repayment of its investments.

1.2.2 The limits set in the 2022/23 treasury management strategy in comparison to the quarter one is set below. It is the authority's policy to classify investments with maturities exceeding one year as Long term investments.

Table 3: Investments for periods longer than 364 days

	2022/23 Limit £m	2022/23 Actual £m	2023/24 Limit £m
Limit on principal invested beyond year end	120	-	50

1.3 Security Treasury Indicator

1.3.1 The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio.

Table 5: Security Treasury Indicator

	31.03.23 Actual	2022/23 Target
Portfolio average credit rating	A+	A+

1.4 Gross Debt and the Capital Financing Requirement (CFR)

1.4.1 In order to ensure that over the medium term debt will only be for a capital purpose, the Authority should ensure that debt does not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. This is a key indicator of prudence. The estimates below are based on those set out in the approved TMSS 2023/24 – the capital programme is currently under review and are likely to change.

Table 6: Gross debt and the CFR at 31st March 2023

	31.03.23 Actual £m	31.03.23 Estimate £m	31.03.24 Estimate £m	31.03.25 Estimate £m
Long-term External Debt	315	345	556	665
Short-term External Debt	13	0	0	0
Total debt	**328**	**345**	**556**	**665**
General Fund	142	147	169	173
Housing HRA	347	369	456	478
Regeneration	70	88	190	274
TOTAL CFR	**559**	**604**	**815**	**925**
Internal Borrowing	231	259	259	260

1.4.2 Total debt is expected to remain below the CFR. Officers will draw down long term debt when conditions merit it. Actual debt levels are monitored against the Operational Boundary and Authorised Limit for External Debt as below.

1.5 Operational Boundary for External Debt

1.5.1 The operational boundary is based on the authority's estimate of most likely, i.e. prudent, but not worst case scenario for external debt. These limits may be reviewed as part of mid-year TMSS report in the event of a change in the interest rate outlook and the decision is made to fund the increase in CFR from external debt.

Table 7: Operational Boundary

Operational Boundary	2022/23 £m	31.03.23 Actual	2023/24 £m	2024/25 £m
Borrowing	650	328	890	1,025
Other long-term liabilities	0	0	10	10
Total	**650**	**328**	**900**	**1,035**

1.6 Authorised Limit for External Debt

1.6.1 The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the authority can legally borrow. The authorised limit provides headroom over and above the operational boundary for unusual cash movements

Table 8: Authorised limit for external debt

Authorised Limit	**2022/23 £m**	**2023/24 £m**	**2024/25 £m**
Borrowing	690	940	1,075
Other long-term liabilities	0	10	10
Total Debt	**690**	**950**	**1.085**
Long Term Debt	315	315	315
Headroom available (amount)	**375**	**625**	**760**

Glossary of Terms **Appendix C**

A bond is a debt instrument in which an investor lends money for a specified period of time at a fixed rate of interest. The issuing entity could be corporate, financial or government.

A floating rate note (FRN) is a money market instrument with a Floating/variable rate of interest, which re-fixes over a reference rate, for example 3 month LIBOR.

Bail in is rescuing a financial institution on the brink of failure by making its creditors and depositors take a loss on their holdings. A **bail**-in is the opposite of a **bail**-out, which involves the rescue of a financial institution by external parties, typically governments using taxpayer's money.

Certificates of deposit (CDs) are a negotiable form of fixed deposit, ranked pari passu with fixed deposits. The difference is that you are not obligated to hold the CD to maturity, you can realise the cash by selling in the secondary market.

Coupon is the total amount of interest a security will pay. The coupon period depends on the security. A CD will often pay interest at maturity, while a bond may pay semi-annually or annually and an FRN will most likely pay every 3 months.

Covered bond Covered bonds are conventional bonds (fixed or floating) issued by financial institutions, that are backed by a separate group of loans, usually prime residential mortgages. This lowers the creditor's exposure to default risk, enhancing the credit. This is why the issue is usually rated AAA, higher than the rating given to the issuer reduces exposure to bail-in risk.

Credit rating A measure of the credit worthiness of a borrower. A credit rating can be assigned to country, organisation or specific debt issue/ financial obligation. There are a number of credit ratings agencies but the main 3 are Standard & Poor's, Fitch or Moody's.

MIFID is the Markets in Financial Instruments Directive. A European Union Directive.

Principal is the total amount being borrowed or lent.

Spread is the difference between the buy and sell price of a security. It can also be the gap, usually in basis points, between the yield of a security and the benchmark security.

SONIA sterling overnight interest average rate, the average rate at which banks offer funds in the overnight sterling market.

Monetary Policy Committee (**MPC**) is a committee of the Bank of England, which meets for three and a half days, eight times a year, to decide the official interest rate in the United Kingdom (the Bank of England Base Rate).

CPIH (Consumer Prices Index including owner occupiers' housing costs) The new additional measure of consumer price inflation including a measure of owner occupiers' housing costs (OOH). CPI inflation measure excludes housing costs.

CPI (Consumer Prices Index) this measure excludes housing costs.

Treasury bills (T-bills) are UK government rated, short-dated form of Government debt, issued by the Debt Management Office (DMO) via a weekly tender. T-bills are normally issued for one, three or six month duration.

Borrowing Requirements The principal amount the Council requires to borrow to finance capital expenditure and loan redemptions.

Capital Financing Requirement (CFR) Capital Financing Requirement- a measure of the Council's underlying need to borrow to fund capital expenditure.

Counterparties Organisations or Institutions the Council lends money to e.g. Banks; Local Authorities and MMFs.

Credit Default Swap (CDS) A kind of protection that can be purchased by MMF companies from insurance companies (for their investment) in exchange for a payoff if the organisation they have invested in does not repay the loan i.e. they default.

Credit Watch A scoring system issued by credit rating agencies such as Fitch, Moody's and Standard & Poors that indicate the financial strength and other factors of a bank or similar Institution.

DMO (Debt Management Office) a department in the treasury where deposits can be placed with the government.

Interest Rate Exposures A measure of the proportion of money invested and what impact movements in the financial markets would have on them.

Market Loans Loans from banks available from the London Money Market including LOBOS (Lender Option, Borrowing Option) which enable the authority to take advantage of low fixed interest for a number of years before an agreed variable rate comes into force.

Money Market Fund (MMF) A 'pool' of different types of investments managed by a fund manager that invests in lightly liquid short term financial instruments with high credit rating.

Minimum Revenue Provision (MRP) This is the amount which must be set aside from the revenue budget each year to cover future repayment of loans.