Agenda Item No: 15

# Treasury Management Report – Quarter Four Update and Annual Report 2022-23

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| To: | Strategy & Resources Committee |
| Meeting Date: | 11th July 2023 |
| From: | Executive Director of Finance and Resources |
| Electoral division(s): | All |
| Key decision: | No |
| Forward Plan ref: | Not applicable |
| Outcome: | Through this report the Committee supervises the Council's treasury management, and ensures that public money across the Council's cashflows, borrowing and investments is utilised and deployed effectively and in compliance with the Treasury Management Strategy, and the statutory requirement for Council to consider the treasury management position regularly. |
| Recommendation: | The Committee is recommended to: |

a) note the Treasury Management Quarter Four Update and Annual Report for 2022/23 and endorse it for consideration at Full Council;

b) recommend to Full Council to increase the counterparty limit for the deposits outlined in 4.13 from £10m to £20m; and

c) add training on Treasury Management to the Committee's training plan/

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# 1. Background

1.1 Treasury management is the management of the Council's investments and cash flows, banking and deposits, and borrowings and money market transactions. The Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code 2021 requires reporting on prudential indicators linked to treasury management activity quarterly as part of the authority's integrated revenue, capital and balance sheet monitoring, and consideration in more detail several times a year.

1.2 Updates on treasury management activities are provided quarterly to this committee, either through the Integrated Finance Monitoring Report (IFMR) or through this more detailed biannual report, and are necessarily retrospective in describing the position at the end of a quarter. However, changes to the UK economy and corresponding implications for our treasury management activity can sometimes be fast paced, therefore some of the information relevant to this biannual report may be partially out of date by the time it is reported. Any significant live treasury management information is therefore presented on a regular basis to committee as part of the Integrated Finance Monitoring Reports.

1.3 As part of the Council's Treasury Management Strategy, implementing the requirements of the Prudential Code, the detailed treasury report needs to be considered by Full Council twice annually. The key prudential indicators against which our treasury management activity is assessed are reviewed quarterly by Strategy & Resources Committee though the IFMR and are set out in Appendix 1.

1.4 This report therefore forms the update on treasury management and is the second and final standalone report of 2022/23 for consideration by Council. The information presented is as at the end of the fourth quarter, so reflects a report made at a specific point in time. In the current environment where the economic context and loan rate projections move quickly, it is likely that some of the wider context has moved on by the time this report is reviewed.

1.5 This report covers the management of the Council's cash, investments and borrowing. All three affect the general council budget. This is principally through the level of capital financing costs that we pay as a Council when we need to borrow, but also in the returns we get on managing our cash balances and in returns from investments.

1.6 Treasury Management is a complex area of local authority financial management and governance. While training has been offered to members of the committee, in the current fast changing economic conditions it would be beneficial to schedule more frequent training for members on this subject.

# 2. Compliance with Treasury and Prudential Limits

2.1 The Council's treasury and prudential indicators are summarised in Table 1 and provided in detail in Appendix 1.

2.2 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the quarter and year ended 31st March 2023, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy for 2022/23.

Table 1: Treasury and Prudential Indicators Quarter 4

| Prudential and Treasury Indicators | 31st March 2022 Actual | 2022/23 TMS | 31st March 2023 Actual |
|---|---|---|---|
| Authorised limit for external debt (Inc' loans raised to on-lend to This Land ltd) | £779.3m | £1,074.0m | £737.8m |
| Operational boundary for external debt (Inc' loans raised to on-lend to This Land ltd) | £779.3m | £1,044.0m | £737.8m |
| Capital Financing Requirement (CFR) *[Excluding PFI and Finance Lease Liabilities]* | £922.2m* | £1,006.2m | £904.8m* |
| Ratio of financing costs to net revenue streams – yearly average | 4.6% | 8.4% | 5.3% |
| Upper limit of fixed interest rates based on net debt | 88% | 150% | 80% |
| Upper limit of variable interest rates based on net debt | 12% | 65% | 20% |
| Principal sums invested over 365 days (excluding Third-Party Loans) | £37.9m | £50.0m | £34.2m |
| Maturity structure of borrowing limits: - | | | |
| Under 12 months | 19.6% | Max. 80% Min. 0% | 23.3% |
| 12 months to 2 years | 14.2% | Max. 50% Min. 0% | 10.9% |
| 2 years to 5 years | 9.1% | Max. 50% Min. 0% | 7.3% |
| 5 years to 10 years | 11.5% | Max. 50% Min. 0% | 15.1% |
| 10 years and above | 45.6% | Max. 100% Min. 0% | 43.5% |

*Subject to finalisation of the Statement of Accounts

2.3 All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

2.4 From the table above it is worth noting the increase in borrowing for under 12 months in term compared to last year. While this is still well within the maximum limit for this category of debt set out in the TMS, it does mean that the Council will be seeing higher borrowing costs as these debts mature and need re-financing. The alternative to this, however, is locking borrowing in for longer terms at currently high interest rates and, while rates are expected to rise further in the short-term, national expectations are for rates to reduce to lower levels in the medium-term.

## 3. Summary Treasury Management Position

3.1 The level of net debt borrowing (including third-party loans) expected to be required set in the Treasury Management Strategy (TMS) for 31st March 2023 was £825.0m. On 1st April 2022, net debt (excluding 3rd party loans and equity) was £665.7m; by 31st March 2023 this had reduced to £631.1m. This reflects a decrease in borrowing over the year, due to some loans maturing and not yet being refinanced, combined with slower spend on the Council's Capital Programme than was forecast, plus continuing high levels of cash reserves which have allowed the Council to maintain high levels of internal borrowing.

3.2 Table 2 summarises the Council's debt and investment position. For more in-depth information on borrowing and investment, please refer to sections 4 and 5.

Table 2: Net Borrowing Quarter 4 2022/23

| | Actual as at 1st April 2022 £m | Actual as at 31st March 2023 £m | Change £m |
|---|---|---|---|
| Borrowing repayable in >12mth | 724.3 | 566.1 | -158.1 |
| Borrowing repayable in <12mth | 55.0 | 171.7 | 116.7 |
| **Total Borrowings** | **779.3** | **737.8** | **-41.5** |
| Less Treasury Investment | -113.6 | -106.7 | 6.9 |
| **Total Net Debt/Borrowings** | **665.7** | **631.1** | **-34.6** |
| Less Third-Party Loans and Equity | -124.6 | -124.3 | 0.2 |
| **Total Net Debt/Borrowings (including 3rd party loans and equity)** | **541.1** | **506.8** | **-34.4** |

3.3 Overall borrowing has decreased through the year to date to £737.8m, reflecting the Council’s healthier than expected cash position, caused in part by additional government grants and the profile of capital expenditure. Reflecting the increased medium-/long-term borrowing rates, the Council continued to take out short-term, rather than long-term, borrowing to minimise exposure to higher interest rates while the economic position remained uncertain.

3.4 The Council also reviews its treasury performance alongside near neighbours using CIPFA’s financial resilience index. While the information in this is lagging (most recent is 2021-22) the Council’s gross external debt (equivalent to the total borrowings line in table 2) was rated as higher risk relative to the benchmarking group. This is likely due to relatively high gross borrowing resulting from loans to This Land ltd. We are relatively more average risk in respect of the ‘interest payable divided by net revenue expenditure’ indicator, showing that despite the high level of borrowing, we are in a relatively more sustainable position to service that debt.

3.5 We are anticipating a consultation from CIPFA on updating the prudential code and reviewing councils’ borrowings in light of recent high profile local authority cases. The Council engages with these consultations and implements any required changes resulting from them.

## 4. Investments

4.1 The Treasury Management Strategy for 2022/23, including the Annual Investment Strategy for financial assets, was approved by Council in February 2022. It sets out the Council’s investment priorities as being:

1. Security of capital;
2. Liquidity; and then
3. Yield

4.2 The Council will aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity. As shown by the interest rate forecasts in Section 7, the Money Market Fund (MMF) and Call Account rates are continuing to increase, therefore the Council will receive a better return on short-term, laddered investment.

4.3 At 31st March 2023, the Council's investment balances totalled £106.7m; this is split between Money Market Funds, Call/Notice accounts, Collective Investment Funds and Deposit funds (see Table 3 below). This balance excludes Third-Party Loans and Share Capital (Equity).

### Collective Investment Funds

The revised Prudential Code 2021 states that authorities with an expected need to borrow must review any existing commercial investments annually and report the results of that review; this can be found in Appendix 2. The Council concludes that there is currently no financial benefit from divesting in these funds and that this outweighs any risk from continuing to hold the investments. The dividends delivered by these funds totalled £1.230m in 2022/23, compared to a budget of £1.059m.

4.4 Property Fund:
The Property Fund's investment capital value in quarter 4 was £10.6m compared to the original investment of £12m. The portfolio is actively managed to achieve high income and long-term capital appreciation. Capital values continued to decline over the last quarter of the year, but at nothing like the pace seen towards the end of 2022. Overall, occupier and rental markets remained healthy as economic activity proved more resilient than many commentators had expected, and income flows solid. Total returns are likely to be relatively modest moving forward, but significantly better than in 2022. The dividend rates of return for this fund for quarter 4 was 3.77%, which is lower than the target rate of 4.35%. Over the year to 31st March 2023, the fund has generated a return of 13.3% against a benchmark of 14.1%.

4.5 Diversified Income Fund: At the end of quarter 4, the capital value of the investment was £2.2m compared to an original investment value of £2.5m. The investment objective of the fund is to provide income and the potential for capital growth from an actively managed diversified portfolio. The fund invests in a broad range of assets including fixed income securities and global equities and also less traditional exposures such as student accommodation and music royalties. As the outlook for global economic growth continues to be weak, the fund will maintain the portfolio's emphasis on real assets such as good quality equities and alternatives, adding selectively to fixed income as attractive opportunities are identified. The dividend rate of return on the initial investment for quarter 4 was 2.64%, which is higher than budgeted. Over the year to 31st March 2023, the fund has generated a return of 6.1% against a benchmark of 7.4%.

4.6 Multi-Class Credit Fund: At the end of quarter 4, the valuation of the Cambridgeshire County Council (CCC) share of the fund stood at £13.6m compared to an original investment value of £14.5m. The fund aims to generate positive returns throughout the interest rate and economic cycles by allocating to different credit asset classes and through bottom-up security selection. To reduce the risk elements of the portfolio, the manager has reduced duration to 1.4 years and holds elevated levels of cash and US treasuries, which has reduced spread risk on the portfolio. The manager has also improved the underlying credit quality of the portfolio, with exposure to investment grade securities (BBB and higher) rising from just over 42% at the start of 2022 to nearly 61% by the end of 2022. Performance has remained volatile throughout the rest of the year as uncertainties remain, however a higher yield environment has allowed the fund to continue to maintain the desired income return whilst maintaining tighter risk controls than normal. It is worth noting that the fund size has decreased, meaning the Council makes up a larger part of the fund, a position which will be kept under review. The latest dividend rate of return on the initial investment was 2.6%, which is in line with expectation.

4.7 Infrastructure Income Fund: At the end of quarter 4, the valuation of the CCC share of the fund stood at £7.8m, compared to an original investment value of £8m. The fund's objective is to deliver a regular income, targeted at 4.5% per annum, whilst preserving investor's capital throughout market cycles and with the potential for growth. The fund invests in a diversified portal of global listed securities and offers exposure to companies engaged in the provision, storage, supply and consumption of clean energy. The overarching theme of persistently high inflation and the impact of that on monetary policy and interest rate/yield expectations remains a significant driver of short-term performance of the strategy. The dividend rate of return on the initial investment for quarter 4 was 3.9%. Over the year to 31st March 2023, the fund has generated a return of -5.5% against a benchmark of -1.03%.

4.8 The average investment balance during quarter 4 (excluding Third-Party Loans and Equity) was £72.0m, which carried a weighted average rate of 3.41%; over the whole year, the average investment balance was £118.6m with a weighted average rate of 1.99%. The level of investment funds varies dependent on the timing of precept receipts, grants, the progress of the capital programme and decisions made about timing of borrowing. Table 3 below shows the investment by counterparty on 31st March 2023.

Table 3: CCC Investments allocation by Counterparty Quarter 4 2022/23

| Counterparty | Liquidity | Principal £m | Principal % |
|---|---|---:|---:|
| Insight Liquidity Sterling C3 | Same-Day | 15.963 | 15.0 |
| Aberdeen Liquidity Fund - Sterling Fund Class L-1 | Instant Access | 15.962 | 15.0 |
| Handelsbanken | Instant Access | 14.500 | 13.6 |
| Allianz Global Investors | Notice Period 14 days | 13.605 | 12.7 |
| CCLA Local Authorities Property Fund | Notice Period 6m | 10.564 | 9.9 |
| Goldman Sachs International Bank | Fixed (3-6m) | 10.000 | 9.4 |
| Standard Chartered Bank | Fixed (3-6m) | 10.000 | 9.4 |
| Valu-Trac Administration Services | Same-Day | 7.836 | 7.3 |
| National Westminster Bank plc | Instant Access | 4.318 | 4.0 |
| CCLA Diversified Income Fund | Same-Day | 2.228 | 2.1 |
| Barclays Bank plc | Instant Access | 0.890 | 0.8 |
| Santander UK plc | Instant Access | 0.500 | 0.5 |
| Deutsche Managed Sterling Platinum | Same-Day | 0.360 | 0.3 |
| | | 106.726 | 100.0 |

4.9 The table below summarises the maturity profile of the Council's investment portfolio at the end of quarter 4 (excluding Third-Party Loans and Equity):

Table 4: Investment maturity profile at end of Quarter 4 2022/23

| Product | Access Type | 0d £m | 0-3m £m | 3-6m £m | ~5yrs £m | Total £m | % |
|---|---|---|---|---|---|---|---|
| Money Market Funds | Same-Day | 32.3 | | | | **32.3** | *30.3* |
| Bank Call Account | Instant Access | 20.2 | | | | **20.2** | *18.9* |
| Fixed Deposit Account | 3-6 Months | | 0.0 | 20.0 | | **20.0** | *18.7* |
| Pooled Property Fund | Redemption Period Applies | | | | 10.6 | **10.6** | *9.9* |
| Pooled Diversified Income Fund | Redemption Period Applies | | | | 2.2 | **2.2** | *2.1* |
| Pooled Multi-class credit Fund | Redemption Period Applies | | | | 13.6 | **13.6** | *12.7* |
| Income Fund (Energy) | Redemption Period Applies | | | | 7.8 | **7.8** | *7.3* |
| | Total | **52.5** | **0.0** | **20.0** | **34.2** | **106.7** | ***100.0*** |
| | *%* | *49.2* | *0.0* | *18.7* | *32.1* | ***100.0*** | |

4.10 The tables below set out details of the amounts outstanding on loans and share capital investments classed as capital expenditure advanced to third-party organisations at the end of quarter 4. Where appropriate, the Council holds security over these loans in the form of property charges (fixed and/or floating).

Table 5: Loans/Equity holdings in This Land companies end of Quarter 4 2022/23

| Loan Summary | Amount Outstanding (£m) | Repayment Year |
|---|---|---|
| Land, Construction & Development loans | 113.851 | 2026/27, 2027/28 and 2028/29 |
| Equity holding | 5.851 | N/A |
| Total Loans/Equity in This Land Ltd | 119.702 | |

Table 6: Loans/Equity holdings in Pathfinder Legal Services end of Quarter 4 2022/23

| Loan Summary | Original Amount (£m) | Amount Outstanding (£m) | Repayment Year |
|---|---|---|---|
| Cashflow loan | 0.325 | 0.325 | 2029/30 |
| Equity holding | 0.475 | 0.475 | - |
| Total Loans/Equity in Pathfinder Legal Services | 0.800 | 0.800 | |

Table 7: Third-Party Loans Principal Outstanding end of Quarter 4 2023

| Loan Counterparty | Original Amount (£m) | Amount Outstanding (£m) | Repayment Year |
|---|---|---|---|
| Arthur Rank Hospice Charity | 4.000 | 3.120 | 2042/43 |
| Estover Playing Field 2015 CIC (Guaranteed by March Town Council) | 0.350 | 0.103 | 2024/25 |
| Wisbech Town Council | 0.150 | 0.150 | 2043/44 |
| VIVA Arts & Community Group | 0.300 | 0.028 | 2043/44 |
| Total Third-Party Loans | 4.800 | 3.402 | |

4.11 Investment returns compared to benchmark returns are shown in Table 8 below. The preferred benchmark is SONIA (Sterling Overnight Index Average), which is the risk-free rate for sterling markets administered by the Bank of England. SONIA 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. The Council uses the 30-day backward looking rate on a SONIA basis, as this most accurately reflects the type and length of investments (excluding Collective Investment Funds) that the Council holds. The decision to use backward looking is because this reflects the rates at the time of decision-making, rather than forward looking rates at the time of reporting. Over the whole year, the Council’s returns have slightly under-performed this benchmark as can be seen in the table below. This is due to:

- Prioritising security over yield
- The lagging ability for us to capitalise in the short-term on rising interest rates on deposits due to the fixed-term nature of some deposits
- Our current limit of £10m per counterparty for most types of deposits

Table 8: Average Benchmark versus Council Performance for 2022/23 (excluding Collective Investment Funds)

| | Benchmark | Benchmark Return | Council Performance |
|---|---|---|---|
| Quarter 1 | **30-day backward SONIA** | 0.89% | 0.84% |
| Quarters 1-2 | **30-day backward SONIA** | 1.22% | 1.30% |
| Quarters 1-3 | **30-day backward SONIA** | 1.73% | 1.74% |
| Quarters 1-4 | **30-day backward SONIA** | 2.24% | 1.99% |

4.12 Leaving market conditions aside, the Council's return on investments is influenced by several factors, the largest contributors being the duration of investments and the credit quality of the institution or instrument:

- Credit risk is the consideration of the likelihood of default and is controlled through the creditworthiness policy approved by Council.
- The duration of an investment introduces liquidity risk; the risk that funds cannot be accessed when required.
- Interest rate risk, arising from fluctuating market interest rates.

These factors and associated risks are actively managed by the Council's Finance team. Given the recent volatility of the financial markets, the finance team is keeping a close eye on the credit ratings of institutions we have deposits with, as well as looking to spread deposits across a range of institutions and is also considering the mix of type and duration of deposits.

4.13 The Council currently has a counterparty limit in the TMS of £10m for Certificates of Deposits and Notice Accounts, and Terms Deposits with Banks, Building Societies, Local Authorities and Housing Associations. In order to provide maximum flexibility to target the best rates, whilst maintaining the Council's priorities in investment of security, then liquidity, then yield, it is recommended to increase the counterparty limit for these instruments to £20m. This will enable us to access the best rates available within constraints of maximising security first. The current £10m limit has not been increased for some years and therefore in real terms is lower than in the past. Money-market funds and bank call accounts currently have a counterparty limit of £25m, which is not proposed to be changed.

## 5. Borrowing

5.1 The Council can borrow money to fund its capital program for the betterment of Cambridgeshire. The amount of borrowing required each year is based on plans for capital expenditures, projections of the Capital Financing Requirement, underlying borrowing requirements, forecasted cash reserves, and current and future economic conditions. The following table shows the high, low and average Public Works Loan Board (PWLB) rates for 2022/23:

Table 9: 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% |

5.2 The Council will continue to utilise short to medium-term borrowing from other local authorities and authorised brokers, particularly in the current environment of higher interest rates. In the medium to longer-term, once rates have peaked and eventually start to dip, we will also consider PWLB, particularly if longer-term borrowing is required. For much of 2022/23, however, PWLB rates were relatively high and longer-term borrowing from them was not attractive. The Council intends to continue with the strategy of keeping a reasonable proportion of the borrowing portfolio short-dated to avoid baking in higher interest rates, and is able to do so having taken advantage of the low-interest rate environment of the last few years to extend the average duration of loans in the portfolio by fixing loans for extended maturities at historically low levels. As a result, the Council's overall average interest rate for borrowing is low at around 2.4% by the end of quarter 4, despite incurring higher rates on some historic debt and, now, new debt.

5.3 During the fourth quarter, the Council repaid a total of £39.2m upon maturity. Out of this amount, £28.0m were short-term loans from other local authorities, and £11.1m were longer-term loans from other local authorities and PWLB. The Council raised £34.0m in loans from other local authorities during this period, all of which were short-term borrowing. The following table shows the movement in borrowing over the whole of 2022/23:

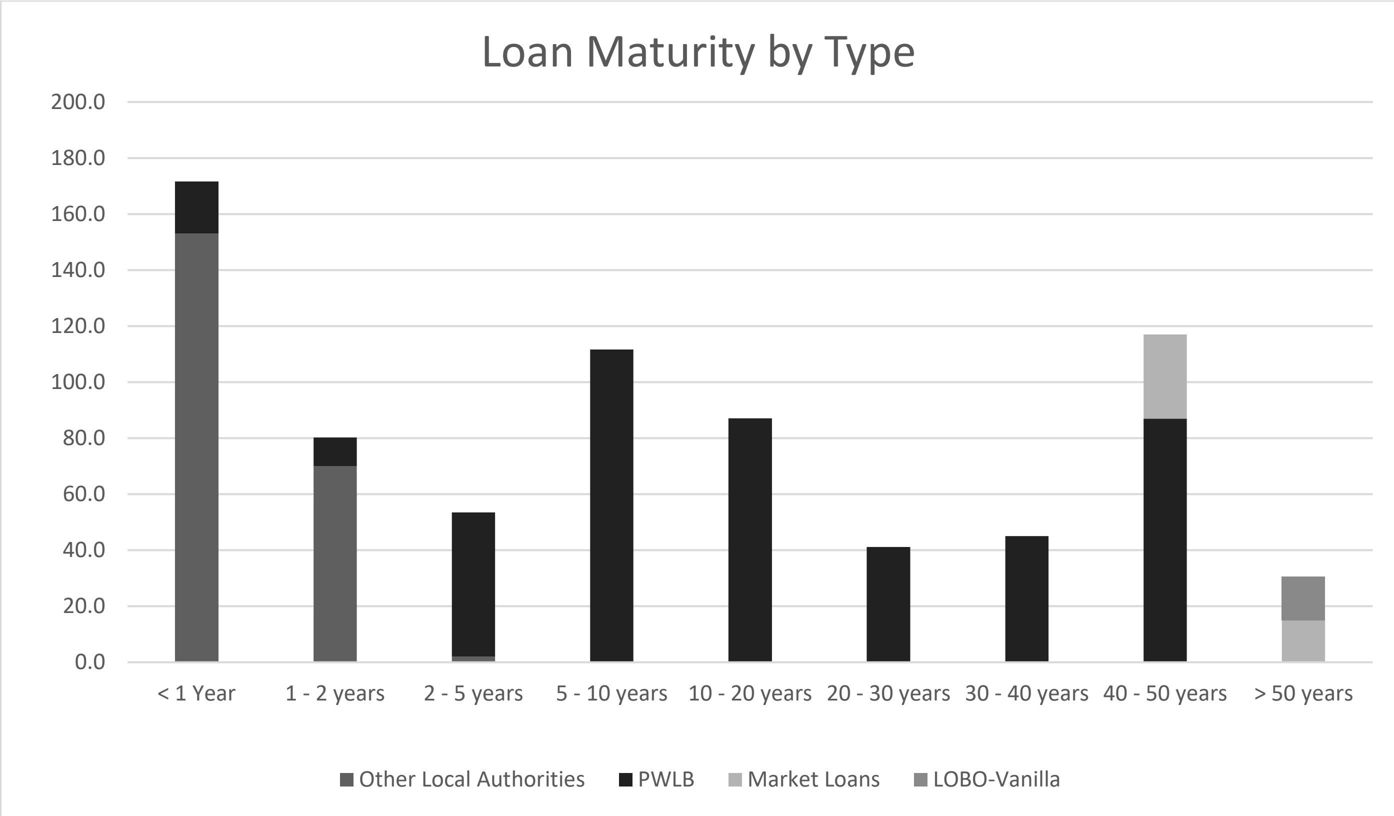
Table 10: Movement in Borrowing for 2022/23

| Actual as at 1st April 2022 £m | Repaid During 2022/23 £m | Raised During 2022/23 £m | Actual as at 31st March 2023 £m |
|---:|---:|---:|---:|
| 779.3 | -155.5 | 114.0 | 737.8 |

5.4 At the end of quarter 4, the Council held £737.8m of borrowing, of which £51.0m was short-term with maturity of less than a year from the issue date. The Council continues to be able to re-finance loans as required, albeit now at higher rates than the maturity loan in the case of more recent loans. Refinancing of maturing PWLB loans is also no longer possible at a lower rate in most cases, as current rates are now comparable to some of the older loans that were also fixed at a time of higher interest rates. Therefore, an increase in our revenue capital financing budget is planned into the business plan.

5.5 Figure 2 below sets out the maturity profile of the Council's borrowing portfolio at the end of quarter 4; £452.3m is held with PWLB, £225.0m from other local authorities, £45.0m in market loans, and a single market Lender Option Borrower Option (LOBO) loan of £15.5m. Out of the total borrowing, £171.7m, including both short-term and longer-term loans, will mature in less than 1 year, therefore potentially requiring refinancing.

**Figure 2: Loan Maturities by Type at 31st March 2023**




5.6 Figure 2 includes the LOBO loan at its final maturity instead of its next possible call date. The chances of the lender raising the loan's interest rate and triggering the Council's option to repay the loan at par have increased due to rising rates in the current environment. However, the probability of this happening is still considered low compared to previous years.

5.7 The Council is in an internally borrowed cash position and balances will need to be replenished at some point in the future (subject to expenditure demands), which is in accordance with our Treasury Management Strategy. This strategy is prudent while investment returns are lower than the cost of servicing debt and also serves to mitigate counterparty risk. The Council therefore plans to maintain this internal borrowing position but will closely monitor those reserves, balances and cashflows supporting this approach.

5.8 Neither during quarter 4, nor earlier during 2022/23, did any rescheduling of borrowing take place. The Council's loan portfolio limits opportunities for rescheduling. In the case of PWLB loans, early redemption rates exceed the carrying rate of existing borrowing, resulting in substantial exit costs. Similarly, market borrowing lenders hedge against forecast interest rate movements using the loans cashflow profile, passing on the cost of unwinding these instruments as an exit premium to the Council. Officers are closely monitoring the situation.

## 6. Debt Financing Budget

6.1 The debt financing budget is held as a central budget within Finance & Resources and complies with the reporting requirement in the Chartered Institute of Public Finance and

Accountancy (CIPFA) Code of Treasury Management Practice. The outturn position is an underspend of £2.4m, summarised in the table below.

Table 11: Debt Financing Budget Outturn 2022/23

| | Budget (£m) | Outturn (£m) | Variance (£m) |
|---|---|---|---|
| Interest payable | 19.810 | 17.943 | (1.867) |
| Interest charged to Other Funds | -6.362 | (6.262) | 99 |
| Interest receivable | -10.338 | (12.171) | (1.833) |
| Interest receivable charged from Other Funds | 10.274 | 12.244 | 2.172 |
| Capitalisation of interest cost | -1.433 | (1.514) | (0.80) |
| Technical & Other | 317 | 234 | (0.83) |
| MRP | 21.006 | 20.221 | (0.785) |
| Total | 33.275 | 30.898 | (2.377) |

6.2 The underspend is comprised of the following elements:

- In the 2022/23 fiscal year, the Council focused on maximising savings and efficiency in money management by using cash balances to undertake internal instead of external borrowing. This, combined with lower capital expenditure than budgeted, resulted in a fall in expected borrowing. In terms of finances, there was an underspend of £1,867k in the Interest Payable on borrowing. This was in the context of a rise in borrowing rates caused by increases in base rates by the Bank of England at various times throughout the year. As of March 2023, the current rate is 4.25%, which is a significant increase from the rate of 0.75% at the same time last year.

- The net interest receivable position was an in-year pressure of £339k across Interest Receivable and Interest charged from Other Funds; there was a £1,833k over achievement of income primarily due to the effect of increased interest rates on our short-term investment income, however, this was more than offset by interest apportioned to other funds due to the higher base rate.

- The Council is required to repay an element of the accumulated General Fund capital spend each year through a revenue charge (the Minimum Revenue Provision). Following analysis of capital schemes completed in 2021/22 and how they were funded, the MRP payment for 2022/23 was recalculated and the year-end position is £785k lower than budgeted.

## 7. Economic Position for 2022/23 and Interest Rate Forecasts

7.1 The economic position for 2022/23 provides context for the monetary policy strategy of central banks, which in turn impacts on historic interest rate movements and forward-looking forecasts. Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022/23. The following summarises the key economic impacts of 2022/23:

- The second quarter of 2022 showed a growth of +0.1% quarter on quarter in UK GDP, however it decreased in the third quarter, partially due to the extra Bank Holiday following the death of the Queen. However, quarter 4 GDP remained positive at 0.1% quarter on quarter. In January, GDP increased by 0.3% month on month as the number of strikes decreased compared to December.
- Real household disposable incomes also rose by 1.3% quarter on quarter at the end of 2022, partly due to £5.7bn payments from the government through the Energy Bills Support Scheme.
- In October, CPI inflation reached a high of 11.1%; whether there will be a significant reduction from this during 2023 will be determined by the gas and electricity markets, as well as supply-side factors impacting food prices. Most commentators expect that by the end of 2023, inflation will likely drop to around 4%. As of February 2023, the CPI inflation rate was 10.4%.
- In 2022, the UK's unemployment rate reached a 48-year low of 3.6%, however the UK labour force has shrunk.
- The Bank Rate rose steadily throughout 2022/23 from 0.75% to 4.25%.
- Following a tumultuous seven-week period during September to October under the then new Prime Minister Liz Truss, the Autumn Statement delivered on 17th November by the new Chancellor Jeremy Hunt under the subsequent new Prime Minister Rishi Sunak announced a £55 billion reduction in government spending; but with most of the major cuts to be delivered under the next Parliament. Despite this, the markets responded positively, and UK gilt yields have improved from previous levels seen in September/October. However, they are still higher compared to other developed countries.
- The FTSE 100 started 2023 strongly, however global equities fell sharply following concerns over the health of the global banking system which emerged in March. The FTSE is now 5.2% below its record high on 20th February, despite UK banks having been less exposed and equity prices in the UK's financial sector not falling as far.

7.2 Due to the Monetary Policy Committee increasing the base rate at all of its meetings in 2022/23, this has led to a significant rise in borrowing rates over the year. While it is anticipated that the peak will soon be reached and that rates will gradually decrease thereafter, there are numerous factors that influence this position and therefore caution should be exercised.

## 8. Alignment with ambitions

8.1 Net zero carbon emissions for Cambridgeshire by 2045, and our communities and natural environment are supported to adapt and thrive as the climate changes

There are no significant implications for this ambition.

8.2 Travel across the county is safer and more environmentally sustainable

There are no significant implications for this ambition.

8.3 Health inequalities are reduced

There are no significant implications for this ambition.

8.4 People enjoy healthy, safe, and independent lives through timely support that is most suited to their needs

There are no significant implications for this ambition.

8.5 Helping people out of poverty and income inequality

There are no significant implications for this ambition.

8.6 Places and communities prosper because they have a resilient and inclusive economy, access to good quality public services and social justice is prioritised

There are no significant implications for this ambition.

8.7 Children and young people have opportunities to thrive

There are no significant implications for this ambition.

## 9. Significant Implications

9.1 Resource Implications

This report provides information on performance against the Treasury Management Strategy. Decisions on treasury management, which are driven by the capital programme and the Council's overall financial position, will impact the Debt Charges Budget and are also reported through the Budget Monitoring process.

9.2 Procurement/Contractual/Council Contract Procedure Rules Implications

There are no significant implications for this category.

9.3 Statutory, Legal and Risk Implications

The Council continues to operate within the statutory requirements for borrowing and investments.

9.4 Equality and Diversity Implications

There are no significant implications for this category.

9.5 Engagement and Communications Implications

There are no significant implications for this category.

9.6 Localism and Local Member Involvement

There are no significant implications for this category.

9.7 Public Health Implications

There are no significant implications for this category.

9.8 Climate Change and Environment Implications on Priority Areas

9.8.1 Implication 1: Energy efficient, low carbon buildings.
Neutral

9.8.2 Implication 2: Low carbon transport.
Neutral

9.8.3 Implication 3: Green spaces, peatland, afforestation, habitats and land management.
Neutral

9.8.4 Implication 4: Waste Management and Tackling Plastic Pollution.
Neutral

9.8.5 Implication 5: Water use, availability and management:
Neutral

9.8.6 Implication 6: Air Pollution.
Neutral

9.8.7 Implication 7: Resilience of our services and infrastructure, and supporting vulnerable people to cope with climate change.
Neutral

Have the resource implications been cleared by Finance? Yes
Name of Financial Officer: E Tod

Have the procurement/contractual/ Council Contract Procedure Rules implications been cleared by the Head of Procurement and Commercial? Not applicable

Has the impact on statutory, legal and risk implications been cleared by the Council's Monitoring Officer or Pathfinder Legal? Yes
Name of Legal Officer: Emma Duncan

Have the equality and diversity implications been cleared by your EqIA Super User?
Not applicable

Have any engagement and communication implications been cleared by Communications?
Not applicable

Have any localism and Local Member involvement issues been cleared by your Service Contact? Not applicable

Have any Public Health implications been cleared by Public Health?
Not applicable

## 10. Source documents

10.1 None

# Appendix 1 – Prudential and Treasury Indicators at 31st March 2023

In this section, we will monitor Prudential and Treasury Indicators to ensure they align with the indicators approved by the Council in February 2022, as outlined in the Treasury Management Strategy.

## Did the Council adopt the CIPFA code of practice for Treasury Management in Public Services?

Yes, the Council has adopted the CIPFA's Treasury Management in the Public Services: Code of Practices and Cross-sectoral Guidance Notes.

## Limit for exposure to fixed and Variable rate of net borrowing (Borrowing less investments)

| | **2022/23 TMS Limit** | **Q4 21-22** | **Q2 22-23** | **Q4 22-23** |
|---|---:|---:|---:|---:|
| Fixed rate | 150% | 88% | 92% | 80% |
| Variable rate | 65% | 12% | 8% | 20% |

The interest rate exposure is calculated as a percentage of net debt. Due to the mathematical calculation, exposures could be greater than 100% or below zero (i.e., negative) depending on the component parts of the formula. Where the indicator is negative, it is due to investment income of that category exceeding debt of that category. The formulas are shown below:

Fixed rate calculation:

$$\frac{\text{Fixed rate borrowing* – fixed rate investments}}{\text{Total borrowing – total investments}}$$

Variable rate calculation:

$$\frac{\text{Variable rate borrowing** – fixed rate investments}}{\text{Total borrowing – total investments}}$$

* Defined as greater than 1 year to run
** Defined as less than 1 year to remaining to maturity, or in the case of LOBO borrowing, the next call date falling within 12 months.

## Total Principal sums invested for the periods longer than 364 days

| | **2022/23 TMS Limit** | **Q4 21/22** | **Q2 22-23** | **Q4 22-23** |
|---|---:|---:|---:|---:|
| Investment longer than 354 days to run* | £50m | £37.9m | £36.9m | £34.2m |

**Treasury Management Investment only*

Limit for maturity structure of borrowing

| | 2022/23 TMS Upper Limit | Q4 21-22 | Q2 22-23 | Q4 22-23 |
|---|---|---|---|---|
| < 1 Year | 80% | 19.6% | 13.5% | 23.3% |
| 1 - 2 years | 50% | 14.2% | 19.5% | 10.9% |
| 2 - 5 years | 50% | 9.1% | 10.6% | 7.3% |
| 7.5 - 10 years | 50% | 11.5% | 13.2% | 15.1% |
| >10 years | 100% | 45.6% | 43.2% | 43.5% |

*Note: The guidance for calculation of this indicator requires that LOBO loans are shown as maturing at the next possible call date rather than at final maturity.*

Ratio of financing cost to net revenue stream

| 2022/23 TMS | Q4 21/22 | Q2 22-23 | Q4 22-23 |
|---|---|---|---|
| 8.8% | 4.6% | 3.8% | 5.3% |

Prudence

Gross borrowing and the Capital Financing Requirement (estimated) borrowing liability excluding PFI.

| Capital Financing Requirement in 2022/23 TMS £m | Actual Borrowings (1st April 22) £m | Actual Gross Borrowings (31st March 23) £m | Decrease in borrowing during 2022/23 £m | Difference between CFR & Borrowings (31st March 23) £m |
|---|---|---|---|---|
| 1006.2 | 779.3 | 737.8 | -41.5 | 268.4 |

**Capital Expenditure**

Estimates of Capital

| | 2022/23 TMS £m | Q4 21/22 £m | Q4 22-23 £m |
|---|---|---|---|
| Unsupported Capital Expenditure (Borrowing) | 81.1 | 31.7 | 38.3 |
| MRP and other financing movements | -21.3 | -22.7 | -20.2 |
| **Net Borrowing Requirement to fund Capital Programme** | **59.8** | **9.0** | **18.1** |

For the detail of capital expenditure and funding please refer to the capital outturn in the Integrated Finance Monitoring Report.

## External Debt

Authorised Limit for external debt

| 2022/23 Authorised TMS Limit £m | Actual Borrowings £m | Headroom compared to Authorised Limit £m |
|---:|---:|---:|
| 1,067.0 | 737.8 | 329.20 |

The Authorised Limit is the legal cap on the amount of debt the Council can have, and it must not be exceeded. This means that the Council cannot have more debt than this limit in any given year.

Operational boundary for external debt

| 2022/23 Authorised TMS Limit £m | Actual Borrowings £m | Headroom compared to Operational Boundary £m |
|---:|---:|---:|
| 1,037.0 | 737.8 | 299.2 |

The operational boundary serves as a warning that the debt is approaching the authorised limit and requires close monitoring.

## Appendix 2: Collective Investment Funds Annual Review

**Local Government Capital Finance Framework**
The revised Prudential Code 2021 states that authorities with an expected need to borrow must review any existing commercial investments annually and report the results of that review. The relevant extract of the Code is as follows:

*Authorities with existing commercial investments (including property) are not required by this Code to sell these investments. Such authorities may carry out prudent active management and rebalancing of their portfolios. However, authorities that have an expected need to borrow should* ***review options for exiting their financial investments*** *for commercial purposes and summarise the review in their annual treasury management or investment strategies. The reviews should* ***evaluate whether to meet expected borrowing needs by taking new borrowing or by repaying investments, based on a financial appraisal that takes account of financial implications and risk reduction benefits****. Authorities with commercial land and property may also invest in maximising its value, including repair, renewal and updating of the properties*.

**CCC Position on Commercial Financial Investments**
The Council currently holds four financial commercial investments, which we refer to as Collective Investment Funds. These were entered into over a period of time between 2019 and 2021 as a way of providing an ongoing yield from a diverse range of investment classes – this provided for an income stream to the Council that reduced the need to make savings. Currently, we hold a reasonably diversified range of funds - property, diversified income, multi-class credit and infrastructure income and these have performed well.

These investments are monitored on a monthly basis by the Finance team, the income generated from them is monitored monthly through the Integrated Finance Monitoring Report and they are also reported to Strategy & Resources Committee and Full Council on a twice-yearly basis through the Treasury Management Reports.

A summary of the position as at 31st March 2023 is provided below:

| Fund | Purchase date | Purchase Amount £000 | Current Value £000 | Net Yield % | Budgeted Dividends 2023-24 £000 | Actual Dividends 2023-24 £000 |
|---|---|---|---|---|---|---|
| Property Fund: CCLA | 27/02/2019 | 11,000 | 10,564 | 3.09 | -420 | -508 |
| | 27/02/2020 | 1,000 | | | | |
| Diversified Income Fund: CCLA | 03/12/2019 | 1,500 | 2,236 | 2.88 | | |
| | 29/02/2020 | 600 | | | | |
| | 06/09/2021 | 350 | | | | |
| Multi-Class Credit: Allianz | 11/09/2020 | 14,000 | 13,605 | 3.02 | -354 | -357 |
| | 15/09/2020 | 500 | | | | |
| Infrastructure Income Fund: Valu-Trac Gravis | 06/05/2021 | 4,000 | 7,836 | 4.82 | -285 | -365 |
| | 21/05/2021 | 4,000 | | | | |
| | | **36,950** | **34,242** | | **-1,059** | **-1,230** |

Some of the factors that the team consider in assessing each of these funds are; the longevity of the fund, whether there are active managers in place, the types of asset class involved and the Council's percentage holding of the fund.

**CCC Position on Borrowing**

The Council has a significant capital financing requirement for 2023-24 of £95.1m, with a further £39.4m in the following two years; following this, some of the Council's 3rd party loans start to be repaid which reduces the borrowing requirement from 2026-27 onwards. The detail of this can be found in the Council's Treasury Management Strategy, published as part of the 2023-24 Business Plan; it is anticipated that these figures will reduce slightly once the rebaselining exercise has been completed for the 2023-24 Capital Programme, and taking into account the final borrowing position of 2022-23.

**Options for exiting financial investments**

The notice periods for exiting each of the four investments is provided below:

| Fund | Notice Period |
|---|---|
| Property Fund: CCLA | 6 months |
| Diversified Income Fund: CCLA | Same-Day |
| Multi-Class Credit: Allianz | 14 days |
| Infrastructure Income Fund: Valu-Trac Gravis | Same-Day |

As at 31st March 2023, each of the four funds was valued at slightly less than the purchase price, therefore disinvestment at this point would result in a capital loss to the Council of up to £2.2m. The Council was aware on entering into these investments that they should be held for the medium to long term, precisely to mitigate against short-term fluctuations in value as determined by the state of the economic environment and market factors, which have been somewhat turbulent over the last year. Approval to invest in these funds was given, taking into account a recommended minimum hold period for each fund, ranging between 3 and 5 years. The funds are at the following points in the minimum hold period:

| Fund | Recommended Min. Hold Period | Duration Held to Date |
|---|---|---|
| Property Fund: CCLA | 5 years | 4 years |
| Diversified Income Fund: CCLA | 3-5 years | 3.25 years |
| Multi-Class Credit: Allianz | 3-5 years | 2.5 years |
| Infrastructure Income Fund: Valu-Trac Gravis | 3-5 years | 2 years |

**Options for repaying debt**

If the Council had divested of these funds as at 31st March 2023, £34.2m of cash would have been released that could have been used to internally borrow, avoiding the need to take out that amount of external borrowing. However, part of the reason for holding these investments is for treasury management purposes, as 3 of the 4 funds are very/reasonably liquid. Therefore, full divestment from all of these funds would require an increase in the average deposit balance the Council aims to hold by around £20m to top our liquid cash balances up to the level we aim to hold, actually only leaving £14.2m available for internal borrowing. The £20m additional deposit balance would then likely be invested in short-term money market funds (standard day to day treasury management activity to ensure a modest return on fully liquid funds) at a rate of around 4.38% currently. This would generate around £876k of interest per year.

In the current high-interest rate environment, the Council is only taking out short-term (1 year) borrowing, most recently at a rate of 4.85%. Reducing external borrowing by £14.2m would therefore save the Council around £689k per year.

The trade-off between the income currently generated by the funds, and saving the one-year cost of funding that borrowing/investing the remainder in liquid deposits is therefore currently as follows:

Income generated through CIF = £1.2m, versus:

| Reduced cost of borrowing £14.2m @ 4.85% £m | Interest Receivable on £20m @ 4% £m | Total saved/additional income £m |
|---:|---:|---:|
| 0.7 | 0.9 | **1.6** |

However, due to the loss in capital value, we would also be required to recognise a one-off £2.2m loss on disinvestment. At the above rates, this would take over 6 years to recoup that loss (and these rates are very unlikely to remain at these levels).

**Conclusions**

Therefore, there is currently no financial benefit from divesting in these funds. In addition, the cost of borrowing is particularly high at the moment due to high interest rates; these are expected to peak in the next few months, then start to fall over the coming years. Likewise, the eventual reduction in interest rates will impact on the interest received from short-term liquid treasury management activity. Conversely, the dividend return received from these funds currently remains reasonably stable, irrespective of the interest rate environment. Therefore, in the longer-term, the financial benefit is likely to continue to be higher from remaining invested in these funds.

The risk from continuing to hold these funds is further drops in capital value. However, taking into consideration the long-term nature of these investments and where we are in the recommended periods, combined with the assessment of other factors such as the longevity of the funds, having active fund managers in place, and given the types of asset class involved, the Treasury team are comfortable that the risks of holding do not outweigh the financial benefit from continuing to hold these investments and therefore at this point, the Council should remain invested in these funds.