Part A

Report to: **Audit Committee**

Date of meeting: **Thursday, 28 July 2022**

Report author: **Head of Finance**

Title: **Treasury Management Annual Report 2021/22**

1.0 Summary

1.1 This report gives details of the 2021/22 year-end review of the Treasury Management function.

2.0 Risks

1.2 The Council's Treasury Management Strategy sets out the risks that it is seeking to manage. These risks are:

Liquidity Risk

1.3 That the Council may not have the cash it needs on a day to day basis to pay its bills. This risk is managed through forecasting and the retention by the Council of an adequate working capital balance. In addition, through the Public Works Loan Board and other organisations, the Council is able to access short term borrowing, usually within 24 hours.

Interest Rate Risk

1.4 That the costs and benefits expected do not materialise due to changes in interest rates. This risk is managed through the placing of different types and maturities of investments, the forecasting and monitoring of the interest budget (with assistance from the Council's retained advisors).

Exchange Rate Risk

1.5 That losses or gains are made due to fluctuations in the prices of currency. The Council does not engage in any significant non-sterling transactions.

Credit and Counterparty Risk

1.6 That the entity holding Council funds is unable to repay them when due. This risk is managed through the maintenance of a list of authorised counterparties, with separate limits to ensure that the exposure to this risk is limited

Refinancing Risk

1.7 That the loans taken by the Council will become due for repayment and need replacing at a time when there is limited finance available or interest rates are significantly higher. The timing of loan maturities is monitored along with interest rate forecasts. Officers ensure that due dates are monitored and seek advice from the Council's advisors about when to raise any finance needed.

Legal and Regulatory Risk

1.8 That the Council operates outside its legal powers. This risk is managed through the Council's training and development of Officers involved in Treasury Management, the independent oversight of Internal and External Audit, and the advice (for example on the contents of this strategy) taken from the Council's Treasury advisors.

Fraud, Error and Corruption

1.9 The risk that losses will be caused by impropriety or incompetence is managed through the controls in the Council's financial procedures. For example, the segregation of duties between those making investment decisions and those transferring funds

Market Risk

1.10 That the price of investments held fluctuates, principally in secondary markets. The majority of the Council's investments are not traded, but where they are (e.g. Property investment portfolio) the main investments' value comes from the income they generate which is generally long term and secure

3.0 Recommendations

3.1 That the Committee notes the Annual Treasury Management Report.

Further information:
Robert Thurlow
Robert.Thurlow@threerivers.gov.uk

Report approved by:
Hannah Doney, Head of Finance

4.0 **Detailed proposal**

4.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as: "the management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

4.2 The Council's 2021/22 Treasury Management Strategy (TMS) as approved by Council on 26 January 2021 has the primary objectives of safeguarding the repayment of the principal and interest of its investments on time, and then ensuring adequate liquidity, with the investment return being the final objective.

4.3 This report provides the Committee with an overview of Treasury Management performance for 2021/22.

4.4 The Council has appointed treasury advisors to assist with our treasury management, Link Asset Services.

4.5 **The Council's Capital Position (Prudential Indicators)**

4.5.1 The Council's capital expenditure plans are one of the key drivers of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

4.6 **Capital Financing Requirement (CFR), External Debt and Operational Boundary**

4.6.1 The CFR is the underlying debt in relation to capital expenditure.

4.6.2 The CFR and Operational Boundary estimates are shown below:

Prudential Indicator	2021/22 Original Estimate	2021/22 Revised Estimate (mid-year)	2021/22 Outturn
Capital Financing Requirement*	£146.0m	£108.3m	£58.0m
External Debt / the Operational Boundary			
Borrowing	£135.0m	£35.0m	£49.0m

Note: The CFR is likely to be subject to restatement following the completion of the 2019/20 and 2020/21 audits.

4.6.3 The CFR excludes the liability in relation to the Croxley Park Finance Lease.

4.6.4 External borrowing is well below the operational boundary for external debt predominantly due to re-phasing of the capital programme. The difference between the CFR and external borrowing is met by internal borrowing. This is the use of cash balances (arising from working capital, earmarked reserves and general balances) to finance the expenditure on a short term basis.

4.7 Limits to Borrowing Activity

4.7.1 The first key control over the treasury activity is a Performance Indicator (PI) to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. External borrowing should not exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and next two financial years. This allows some flexibility for limited early borrowing for future years.

4.8 The Authorised Limit

4.8.1 This PI, which is required to be set and revised by Members, controls the overall level of borrowing and represents the limit beyond which borrowing is prohibited. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised Limit For External Debt	2021/22 Original Indicator	2021/22 Revised Limit	2021/22 Outturn
Borrowing	£150.0m	£150.0m	£49.0m

4.9 Investment Portfolio 2021/22

4.9.1 In accordance with the CIPFA Prudential Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in Section 2 of the Code, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low, in line with the Bank of England base rate.

4.9.2 In response to the Covid-19 public health emergency, the Bank reduced base rate to 0.10% in March 2020 in order to support the UK economy. Market rates remained extremely low during the first three quarters of 2021/22, improving later in the year as a result of action by the Bank of England. Overnight rates with the

UK Government's Debt Management Office (DMO) were nil or negative in September 2021, and were as high as 0.55% by March 2022.

4.9.3 During 2021/22, significant inflationary pressures, resulting from the impacts of the pandemic on supply chains, increasing energy costs and the war in Ukraine, led the bank of England to increase the base rate three times. Consequently investment returns have improved.

4.9.4 Base Rates were 0.10% in March 2021. The rate remained at 0.10% until they changed to 0.25% in December 2021 and 0.50% in February 2022, and then again to 0.75% in March. This upward trend is reflected in our returns from short term cash deposits used to manage normal operations.

4.9.5 Given the ongoing conflict in Ukraine, and the long-term impact of the pandemic on supply chains, the outlook is for continued elevated volatility and risk in financial markets.

4.9.6 As part of the acquisition of Croxley Park, the council received £24.0m in respect of Rent Guarantee and £68.0m in respect of future planned programme maintenance.

4.9.7 The Council's treasury advisers, Link, provided advice to the Council on the investment of this sum in order to best match the drawdown profile under the financial model and to balance the inflation and property risks inherent in the underlying investment. Following a tender process, this cash was invested in a range of Money Market Funds managed by Royal London Asset Management from November 2020.

4.9.8 The Croxley Park cash is ring-fenced from the Council's day-to-day treasury activities, and the performance of the investments is excluded from this report. Performance reports will be made to the Property Investment Board

4.9.9 The Council held £8.4m of investments as at 31 March 2022 (see table below). This information is reported in the monthly Members Information Bulletin.

Institution	**Principal (£'000)**
Lloyds Bank – Current Account	8,379
Total	**8,379**

4.9.10 This excludes reserved balances related to the Croxley Business Park investment held with Royal London Asset Management. Performance of these investments is reported to and monitored by Commercial Investment Board

4.9.11 There was one breach of the approved limits within the Annual Investment Strategy during 2021/22. Details are provided at 4.17 – 4.20, below.

4.10 **Security**

4.10.1 The Council uses benchmarks as simple guides to maximum risk, and these may be breached from time to time, depending on movements in interest rates and counterparty criteria. Any breach of the benchmarks will be reported, with supporting reasons, in this report. There were no breaches to report during 2021/22.

4.10.2 There have been no breaches of the Council's counterparty limit with Lloyds bank during the period. The Council has made use of the DMO to deposit cash in excess of the counterparty limit for short periods during the period, as this offers the best possible security.

4.10.3 Members are invited to note that the definition of the security of an investment is defined as receiving contractually agreed amounts at the contractually agreed date. When a negative return is applicable on an investment the amount repaid on maturity will be lower than originally invested but not less than contractually agreed. This represents the prioritisation of security over investment yield, in line with the principals of the Treasury Management Code.

4.11 **Liquidity**

4.11.1 The Council set liquidity facilities/benchmarks to maintain:

- Authorised bank overdraft of £nil.
- Liquid short term deposits of at least £1m available with a week's notice.

4.11.2 The liquidity arrangements were adequate during the year to date.

4.12 **Yield**

4.12.1 Yield on treasury investments is benchmarked against SONIA – The Sterling Overnight Index Average. This is a measure of market rates for short-term investments. The average yield for the year was 0.04% against Sonia average of 0.10% for the year. The following tables shows performance against benchmark for each quarter of 2021/22.

Period	Benchmark Rate (%)	Actual Rate (%)	Difference (%)
Q1: April-June	0.05	0.01	-0.04
Q2: June-July	0.05	0.01	-0.04
Q3: July-December	0.07	0.01	-0.06
Q4: January-March	0.12	0.10	-0.02
2021-22	**0.10**	**0.04**	**-0.06**

4.12.2 The Council keeps all treasury investments short term. There are no sums within the TMS invested for greater than 364 days. Due to uncertainty over the impact of the Covid-19 pandemic on the creditworthiness of Counterparties, and the need to increase liquidity of cash balances to ensure prompt payment of suppliers and emergency grant funding, investing activity has been limited to short-term deposits with the UK debt management office. This has resulted in lower interest rates being achieved.

4.13 **Compliance**

4.13.1 The current investment counterparty criteria selection approved in the TMS was met throughout the year, with the exception an overnight breach of the approved counterparty limit with the Council's own bank, Lloyds Bank Plc.

4.13.2 On 8th March 2022, the Council had an overnight balance of £26.03m with Lloyds. This exceeded the counterparty limit of £10m. The breach occurred as a result of the failure to execute a repayment of S.31 Grant, paid on account by DHCLG (as was) in 2019/20.

4.13.3 The payment was not executed, due to a breakdown in email communication related to the Mimecast implementation which was identified at around 5pm. Despite the probably being identified, it was not possible to execute the CHAPS payment prior to the 5.15pm cut-off.

4.13.4 There was no financial loss resulting from this breach. In order to mitigate a recurrence of such an issue, Treasury Officers are required to verify that all CHAPS payments are executed by the earlier of the counterparty's cut-off or 3pm.

4.14 **Credit Ratings**

4.14.1 Credit rating information is supplied by our treasury consultants, Link Asset Services, on all counterparties that comply with the Council's criteria. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing.

5.0 **Implications**

5.1 **Financial**

5.1.1 The Shared Director of Finance comments that this report provides formal assurance on the Council's compliance with its Treasury Management Strategy during the year. The financial implications are set out in the main body of the report and the impact of interest rates on investment income and borrowing costs have been reported through the financial monitoring report during the year.

5.2 **Legal Issues** (Monitoring Officer)

5.2.1 The Group Head of Democracy and Governance comments that there are no legal implications arising from this report.

5.3 **Equalities, Human Rights and Data Protection**

5.3.1 Under s149 (1) of the Equality Act the council must have due regard, in the exercise of its functions, to the need to –

- eliminate discrimination, harassment, victimisation and any other conduct prohibited by the Act
- advance equality of opportunity between persons who share relevant protected characteristics and persons who do not share them
- foster good relations between persons who share relevant protected characteristics and persons who do not share them.

Having had regard to the council's obligations under s149, it is considered that there are no equalities or human rights implications.

5.4 **Staffing**

5.4.1 There are no staffing implications arising from this report.

5.5 **Accommodation**

5.5.1 There are no accommodation implications arising from this report.

5.6 **Community Safety/Crime and Disorder**

5.6.1 There are no community safety/crime and disorder implications arising from this report.

5.7 **Sustainability**

5.7.1 There are no sustainability implications arising from this report.

Appendices

None

Background papers

The following background papers were used in the preparation of this report. If you wish to inspect or take copies of the background papers, please contact the officer named on the front page of the report.

- Capital Strategy and Treasury Management Strategy 2021/22 (published as part of the 2021/22 Budget)