

**REPORT TO:**                   **AUDIT AND GOVERNANCE COMMITTEE**

**MEETING DATE:**           13 June 2023

**BY:**                             Executive Director for Council Resources

**SUBJECT:**                    Annual Treasury Management Review 2022-23

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**1     PURPOSE**

- 1.1   To update the Committee on Treasury Management activity during financial year 2022-23.

**2     RECOMMENDATIONS**

- 2.1   Members are asked to note the report.

**3     BACKGROUND**

- 3.1   The Council is required by regulations issued under the Local Government Scotland Act 2003 to produce an Annual Treasury Management Review, in accordance with the CIPFA Treasury Management Code of Practice and Prudential Code.
- 3.2   The review set out in **Appendix 1** updates members on the Treasury Management activity during 2022-23, and reported relative to the indicators set out in the Treasury Management Strategy approved in March 2022. The figures contained within the report are based on the draft unaudited accounts, and therefore remain subject to change during the course of the audit. Members will be kept informed should there be any significant change arising during this period.

#### **4 POLICY IMPLICATIONS**

- 4.1 There are no direct policy implications associated with this report; however the council's treasury management activity is determined by the policy framework set out in the approved Treasury Management Strategy.

#### **5 INTEGRATED IMPACT ASSESSMENT**

- 5.1 The subject of this report does not affect the wellbeing of the community or have a significant impact on equality, the environment or economy.

#### **6 RESOURCE IMPLICATIONS**

- 6.1 Financial – There are no direct financial implications associated with this report however the Council's Treasury Management activity clearly has a significant impact on the management of the Council's financial resources.
- 6.2 Personnel - none
- 6.3 Other - none

#### **7 BACKGROUND PAPERS**

- 7.1 Treasury Management Strategy 2022-23 to 2026-27 – East Lothian Council 1 March 2022.
- 7.2 Treasury Management Mid-Year Review 2022-23 – Audit & Governance 29 November 2022.

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<b>DATE</b>	05 June 2023



# **Annual Treasury Management Review 2022-23**



# Annual Treasury Management Review 2022-23

## 1. Introduction

This Council is required by regulations issued under the Local Government in Scotland 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 Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code). The review is based on figures contained within the draft unaudited accounts, and should any significant and material changes arise during the course of the audit, updated information will be made available and communicated to members.

The minimum Treasury Management reporting requirements are that members of the Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 1 March 2022)
- a mid-year (minimum) treasury update report (Audit and Governance 29 November 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 Council's policies previously approved by members.

The Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit and Governance Committee with the annual strategy approved by Council.

## 2. The Council's Capital Expenditure and Financing

The Council undertakes capital expenditure on long-term assets. These activities may either be financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), with expenditure in excess of these resources giving rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed. The results from 2021-22 are shown for illustrative purposes.

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	2021-22 Actual £m	2022-23 Budget £m	2022-23 Actual £m
<b>General Services</b>			
Capital expenditure	64.689	94.759	87,955
Financed in year	(27.626)	(38.914)	(50,179)
Net borrowing need in year	37.062	55.845	37,776
<b>HRA</b>			
Capital expenditure	30,841	42,179	40,349
Financed in year	(13,522)	(8,196)	(14,983)
Net borrowing need in year	17.319	33.983	25.366
<b>Total Net Borrowing need in year</b>	<b>54.381</b>	<b>89.828</b>	<b>63.142</b>

### 3. The Council's Overall Borrowing Need

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

**Gross borrowing and the CFR** - in order to ensure that borrowing levels are prudent over the medium term and deemed only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2021-22) plus the estimates of any additional capital financing requirement for the current (2022-23) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure but allows the Council some flexibility to borrow in advance of its immediate capital needs if required.

The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2022 Actual £m	31 March 2023 Budget £m	31 March 2023 Actual £m
<b>General Services</b>			
CFR	257.927	322.602	295.377
External borrowing position	229.464	275.256	243.555
(Under) / over funding of CFR	(28.463)	(47.346)	(51.821)
<b>HRA</b>			
CFR	219.522	252.697	240.066
External borrowing position	195.297	215.610	197.948
(Under) / over funding of CFR	(24.225)	(37.086)	(42.117)
<b>Total</b>			
(Under) / over funding of CFR	(52.688)	(84.433)	(93.939)

## 4. Treasury Position as at 31 March 2023

At the beginning and the end of 2022-23 the Council's treasury, (excluding borrowing by PPP and finance leases), position was as follows:

	31 March 2022 Principal £m	31 March 2023 Principal £m
CFR	477	535
Over / (under) borrowing	( 52)	( 93)
Total external debt	425	442
Total investments	( 8)	( 24)
Net debt	417	418

- **The authorised limit** - the Council has kept within its authorised external borrowing limit as shown in the table below.
- **The operational boundary** – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached. This indicator is set at the start of the financial year and is as per the Treasury Strategy.

	2021-22 Actual £m	2022-23 Budget £m	2022-23 Actual £m
Authorised limit	519	623	601
External Debt	425	491	442
Operational Boundary	477	575	535

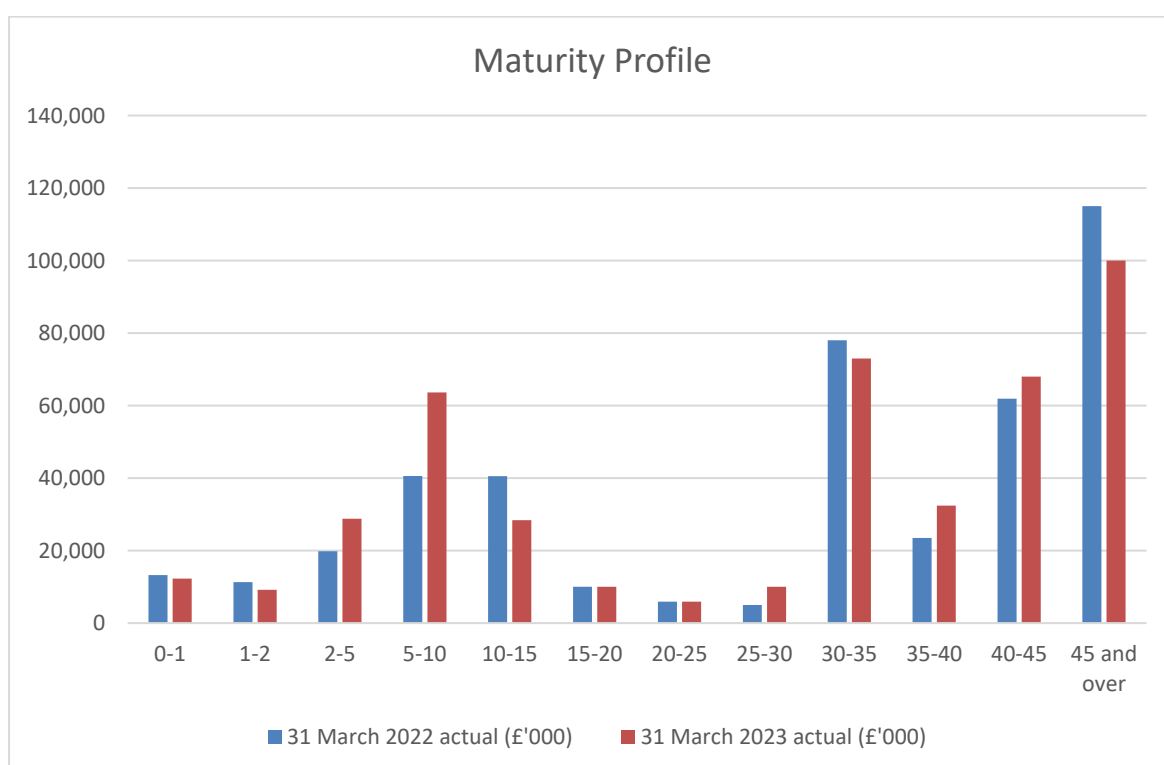
As at 31 March 2023 the average interest rate for all external debt was 3.28% (3.24% as at 31 March 2022). The average life across all loans was 29 years (31 years as at 31 March 2022).

The maturity structure and profile of the debt portfolio is set out in the tables below:

	31-Mar-22 Actual £m	(Paid) or New Loan* 2022-23 £m	31-Mar-23 Actual £m	Net movement** 2022-23 £m
Under 12 months	13.23	(12.26)	12.28	(0.95)
12 months and within 24 months	11.28	1	9.16	(2.12)
24 months and within 5 years	19.82	13	28.77	8.95
5 years and within 10 years	40.58	15	63.60	23.02
10 years and within 15 years	40.55		28.39	(12.16)
15 years and within 20 years	10.00		10.00	0.00
20 years and within 25 years	5.90		5.90	0.00
25 years and within 30 years	5.00		10.00	5.00
30 years and within 35 years	78.00		73.00	(5.00)
35 years and within 40 years	23.50		32.40	8.90
40 years and within 45 years	61.90		68.00	6.10
45 years and over	115.00		100.00	(15.00)
<b>Total</b>	<b>424.76</b>	<b>16.74</b>	<b>441.50</b>	<b>16.74</b>

\* More detail on this is set out in Section 6 below

\*\* Net movement shows the change between the maturity bands for existing loans



## 6. The strategy for 2022-23

### 5.1 Investment strategy and control of interest rate risk

The Council's approved investment strategy by priority is Security, Liquidity and then return. The Council adopts a prudent approach to managing risk and followed the approved 2022-23 Strategy where investments were only considered where the type of investment and exposure to risk was low or very low. Limits were set for fixed and variable interest rate exposure which were not exceeded during the year.

Investment return rates increased throughout 2022-23 as the Bank of England realised that inflationary pressures were not transitory, and that tighter monetary policy was called for.

### 5.2 Borrowing strategy and control of interest rate risk

During 2022-23 the Council continued to maintain an under-borrowed position. This meant that the capital borrowing need (the Capital Financing Requirement) was not fully funded by external borrowing as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This was a prudent strategy as interest rates have been rising and subject to volatility and, as always minimising counterparty risk on investments needed to be considered.

The policy of avoiding new borrowing where possible by close monitoring of cash balances is kept under continual review to avoid incurring higher borrowing costs in the future when the Council may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

The bank rate started the financial year at 0.75%, however by August 2022 it was clear that inflation was moving up towards 40-year highs, and the Bank of England engaged in monetary policy tightening at every Monetary Policy Committee (MPC) meeting during 2022 and into 2023, either by increasing Bank Rate by 0.25% or 0.5% each time with the likelihood for further increases in early 2023-24. Inflation was still above 10% at the end of March 2023 but is expected to fall back towards 4% by the end of 2023. However, there are significant risks associated with that forecast.

Forecasts from our Treasury advisors at 31 March 2023 suggest interest rates will stabilise during 2023-24 and gradually reduce over the subsequent 2 years. This remains a very volatile and ever changing position, and the forecast and planning of borrowing will remain under review during 2023-24 and beyond.

Link Group Interest Rate View	27.03.23											
	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26
BANK RATE	4.50	4.50	4.25	4.00	3.50	3.25	3.00	2.75	2.75	2.50	2.50	2.50
3 month ave earnings	4.50	4.50	4.30	4.00	3.50	3.30	3.00	2.80	2.80	2.50	2.50	2.50
6 month ave earnings	4.50	4.40	4.20	3.90	3.40	3.20	2.90	2.80	2.80	2.60	2.60	2.60
12 month ave earnings	4.50	4.40	4.20	3.80	3.30	3.10	2.70	2.70	2.70	2.70	2.70	2.70
5 yr PWLB	4.10	4.10	3.90	3.80	3.70	3.60	3.50	3.40	3.30	3.20	3.20	3.10
10 yr PWLB	4.20	4.20	4.00	3.90	3.80	3.70	3.50	3.50	3.40	3.30	3.30	3.20
25 yr PWLB	4.60	4.50	4.40	4.20	4.10	4.00	3.80	3.70	3.60	3.50	3.50	3.40
50 yr PWLB	4.30	4.20	4.10	3.90	3.80	3.70	3.50	3.50	3.30	3.20	3.20	3.10

PWLB rates are based on gilts (UK Government bonds) yields through H.M.Treasury who determine a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, the ongoing impact of the Ukraine war, inflationary pressures (especially energy and food) and labour market factors.



The margins over gilt yields are:

- **PWLB Standard Rate** - gilt plus 100 basis points
- **PWLB Certainty Rate** - gilt plus 80 basis points
- **PWLB HRA Standard Rate** - gilt plus 100 basis points
- **PWLB HRA Certainty Rate** - gilt plus 80 basis points
- **Local Infrastructure Rate** - gilt plus 60 basis points

There is likely to be a fall in gilt yields and PWLB rates across the whole curve over the next one to two years as Bank Rate first rises to dampen inflationary pressures and a tight labour market, and is then cut as the economy slows and inflation (on the Consumer Price Index (CPI) measure) moves closer to the Bank of England's 2% target.

**High/Low/Average PWLB Rates during 2022-23 over indicative borrowing terms:**

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

## 7. Borrowing Activity during 2022-23

**Borrowing** – the following loans were taken during the year:-

Lender	Principal	Type	Interest Rate	Maturity	Date
PWLB	£ 10m	Fixed interest rate	4.16%	6 years	23/03/2022
PWLB	£ 10m	Fixed interest rate	4.07%	5 years	20/01/2023
PWLB	£ 10m	EIP	4.07%	10 years	20/01/2023
<b>Total</b>	<b>£30m</b>				

As PWLB rates have been increasing during 2022-23 the Council has, in conjunction with our Treasury advisors decided to undertake borrowing at shorter duration than in immediately preceding years. This is to lessen interest costs in future as per Section 5.2 above, as interest rates are expected to drop in the coming years.

### **Borrowing in advance of need**

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.

### **Rescheduling**

No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

### **Repayments**

The following loans were repaid in full during the year:-

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Lender	Principal	Type	Interest Rate	Maturity	Date
PWLB	£10m	Fixed interest rate	3.29%	11 years	24/09/2022
<b>Total</b>	<b>£10m</b>				

Instalments of £2.596m were also paid on 9 loans which are payable as an Annuity or EIP (equal instalments of principal) basis rather than on maturity, noting that 2 of these loan balances have been cleared in 2022-23.

## 8. Investment Activity for 2022-23

### Investment Policy

The Council's investment policy is governed by Scottish Government investment regulations which have been implemented in the annual investment strategy approved by the Council on 1 March 2022. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.).

The investment activity during the year conformed to the approved strategy as set.

### Investments held by the Council

During 2022-23 and in accordance with the approved strategy 3 short term investments were made and repaid. Any other surplus cash balances were held in the Council's bank account, which is an interest bearing account.

Date of Investment	Borrower	Amount	Interest rate	Date repaid
24/08/2022	DMADF (UK Government)	£10m	1.74%	26/09/2022
24/08/2022	Lloyds Corporate Markets	£ 5m	2.23%	24/11/2022
24/08/2022	Standard Chartered Sustainable Deposit	£ 5m	2.27%	24/11/2022
	<b>Total</b>	<b>£20m</b>		

The Council also has the following loans to third parties which fall under the scope of the Council's approved Investment Strategy. During 2022-23, the East Lothian Investments loan balance was cleared.

	Loan balance at 31 March 2022 £m	Loan balance at 31 March 2023 £m
East Lothian Housing Association	8.455	8.189
East Lothian Investments	0.026	0.000

Under accounting standard IFRS9, an expected credit loss for all loans to third parties must be obtained and recognised in the Council's Income and Expenditure account within Surplus/Deficit on Provision of Services.

This was £10k for 2021-22 and was increased to £55k for 2022-23 to reflect the risk profile of the debt in the current financial environment.

### Investments held by fund managers

The Council uses Investec as external fund managers to invest cash balances on behalf of the 4 Common Good Funds and the ELC Charitable Trusts. The performance of the managers against the benchmark return was:

	<b>Investments held 31 March 2022 £m</b>	<b>Investments held 31 March 2023 £m</b>	<b>Return</b>	<b>Benchmark</b>
Charitable Trusts	3.825	3.563	-4.50%	-2.30%
Common Good Funds	3.896	3.598	-5.26%	-2.30%
<b>Total</b>	<b>7.721</b>	<b>7.161</b>	<b>-£0.560m</b>	

The Council's investment advisors have indicated that although corporate earnings expectations have held up well in aggregate, earnings reduced owing to the rising level of both cash interest rates and government bond yields. These, in turn, were driven higher by the tightening of monetary policy in the face of rising inflation. The persistence of higher inflation has been a defining factor as well as the invasion of Ukraine, especially in terms of energy prices in Western Europe, and obstacles for global trade.

Officers continue to engage with Investment Advisers, and consider any necessary action aligned to the Treasury Investment Strategy should there be any significant change to fund projections. The need to ensure the on-going viability of the funds is essential to ensure the long-term benefits of these investments.

The return achieved was lower the benchmark for both portfolios.

## Appendix 1: Prudential and treasury indicators

1. PRUDENTIAL INDICATORS	2021-22	2022-23	2022-23
	Actual £m	Budget £m	Actual £m
<b>Capital Expenditure</b>			
General Services	64,689	94,759	87,955
HRA	30,841	42,179	40,349
TOTAL	95,530	136,938	128,304
<b>Ratio of financing costs to net revenue stream</b>			
General Services	4.11%	5.25%	2.72%
HRA	28.99%	33.28%	30.16%
<b>Gross borrowing requirement – General Services</b>			
brought forward 1 April	225,561	273,318	257,927
carried forward 31 March	257,927	322,602	295,377
in year borrowing requirement	32,366	49,285	37,449
<b>Gross borrowing requirement - HRA</b>			
brought forward 1 April	206,609	223,686	219,522
carried forward 31 March	219,522	252,697	240,066
in year borrowing requirement	12,913	29,011	20,544
<b>CFR</b>			
General Services	257,927	322,602	295,377
HRA	219,522	252,697	240,066
TOTAL	477,449	575,299	535,443
<b>Annual Change in Capital Financing Requirement</b>			
General Services	32,366	49,285	37,449
HRA	12,913	29,011	20,544
TOTAL	45,279	78,296	57,993
<b>Annual Impact of Capital Investment Decisions</b>			
General Services – Debt per Band D equivalent	£5,001	£5,510	£4,943
HRA – Debt per dwelling	£24,364	£27,647	£26,228

	2021-22	2022-23	2022-23
<b>2. TREASURY MANAGEMENT INDICATORS</b>	<b>Actual</b>	<b>Budget</b>	<b>Actual</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>Authorised Limit for External Debt -</b>			
Borrowing	519	623	601
Other long term liabilities	34	33	33
Total	553	656	634
<b>Operational Boundary for External Debt -</b>			
Borrowing	477.448	575.298	535.442
Other long term liabilities	33.775	32.209	32.214
Total	511.224	607.507	450.153
<b>Actual External Debt</b>			
Borrowing	424.761	490.866	441.503
Other long term liabilities	33.779	32.209	32.214
Total	458.540	523.075	473.717
<b>3. LOANS FUND</b>			
<b>General Services</b>			
Opening balance	225	273	257
Add advances	37	21	38
Less repayments	(5)	(12)	(0)
Closing balance	257	282	295
<b>HRA</b>			
Opening balance	207	224	220
Add advances	17	34	25
Less repayments	(4)	(5)	(5)
Closing balance	220	253	220
<b>Total</b>			
Opening balance	432	497	477
Add advances	54	55	63
Less repayments	(9)	(17)	(5)
Closing balance	477	535	535

## ABBREVIATIONS USED IN THIS REPORT

**CFR:** capital financing requirement - the council's annual underlying borrowing need to finance capital expenditure and a measure of the council's total outstanding indebtedness.

**CIPFA:** Chartered Institute of Public Finance and Accountancy – the professional accounting body that oversees and sets standards in local authority finance and treasury management.

**GDP:** gross domestic product – a measure of the growth and total size of the economy.

**HRA:** housing revenue account.

**MPC:** the Monetary Policy Committee is a committee of the Bank of England, which meets for one and a half days, eight times a year, to determine monetary policy by setting the official interest rate in the United Kingdom, (the Bank of England Base Rate, commonly called Bank Rate), and by making decisions on quantitative easing.

**PPP:** Private Public Partnership – capital expenditure financed by the private sector i.e. not by direct borrowing by a local authority.

**PWLB:** Public Works Loan Board – this is the part of H.M. Treasury which provides loans to local authorities to finance capital expenditure.

**RPI:** the Retail Price Index is a measure of inflation that measures the change in the cost of a representative sample of retail goods and services. It was the UK standard for measurement of inflation until the UK changed to using the EU standard measure of inflation – **CPI**. The main differences between RPI and CPI is in the way that housing costs are treated and that the former is an arithmetical mean whereas the latter is a geometric mean. RPI is often higher than CPI for these reasons.

**TMSS:** the annual treasury management strategy statement reports that all local authorities are required to submit for approval by the full council before the start of each financial year.

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