Overview Select Committee

Review of Treasury Management Activities 2022/23

Date of Meeting: 13th July 2023

Lead director: Amy Oliver Director of Finance

Useful information:

- Ward(s) affected
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1. **Summary**

1.1 This report reviews how the Council conducted its borrowing and investments during 2022/23.

1.2 During 2022/23, the end of lockdowns seemed to suggest a return to more stable times: in practice this was far from the case for treasury management. The Russian invasion of Ukraine created further disruption and uncertainty, in particular leading to inflation which soared into double figures for the first time in 40 years.

1.3 The year started with interest rates at a base rate of just 0.75% and an expectation that they would rise slightly, perhaps to 1.25%. However, the Bank of England has raised interest rates at every meeting of the Monetary Policy Committee during 2022/23 to try to counter high inflation. This rise in interest rates has benefitted the Council from a treasury management perspective (unlike many other authorities) because our debt is held at fixed rates for long periods, and we earn extra interest on our cash balances. The benefits will take some time to fully filter through as fixed term investments with other local authorities mature. However, the Council's net treasury management cost has been reduced by £2.8m compared to the original budget due to the additional income from investments.

1.4 The outlook for the economy remains uncertain with high current inflation (although this is predicted to fall sharply by the end of 2024), and very weak growth predicted.

1.5 The Council takes a prudent approach to investment of its cash balances, prioritising security and liquidity over yield/income. This means that safe investments with lower returns are chosen, rather than riskier options with higher returns. We have limited exposure to long term investments such as property funds. Therefore, we are not exposed to the issues now causing significant financial challenges at some councils which have got into difficulties because they have invested too much in riskier assets such as property, and which have since seen government intervention.

2. **Background**

2.1 Treasury management is the process by which our borrowing is managed, and our cash balances are invested. Whilst there are links to the budget, the sums in this report do not form part of the budget. Cash balances reported here cannot be spent, except to the extent shown in the budget report and revenue outturn report.

2.2 The Council has incurred debt to pay for past capital expenditure.

2.3 The Council also has cash balances. These are needed for day to day expenditure (e.g. to pay wages when they are due). A substantial proportion can only be used to repay debt but (because of Government rules) it has been prohibitively expensive to repay debt early. Thus, they are held in investments.

2.4 The report commences with an overview of treasury management, including loans and investments at key dates. It then reviews the credit worthiness of investments and implementation of our strategy, provides outcomes on key performance measures and concludes by reviewing compliance against limits set by the Council.

2.5 Reports reviewing treasury management activities are submitted twice a year. The previous report was presented to your committee on 15th December 2022.

3. Recommendations

3.1 Members of the Overview Select Committee are recommended to note the report and make comments to the Director of Finance and the Executive as they wish.

4. Overview of Treasury Management

Main elements of Treasury Management

4.1 There are two main elements to treasury management. The first is managing our borrowings which were taken out to finance past capital expenditure. Most capital schemes are now financed by capital grant, and only a limited number of schemes are financed by prudential borrowing (generally those which pay for themselves, together with part-financing the acquisition and construction of new council housing in the Housing Revenue Account). In the past the Government expected us to borrow but allowed for the cost of borrowing in our annual revenue grant settlement, and we still have debt which was taken to meet this capital expenditure.

4.2 Historic debt can sometimes be restructured to save money (i.e. repaying one loan and replacing it with another) and this is always given active consideration. However, Government rules have made it prohibitively expensive to repay loans borrowed from the Public Works Loans Board (PWLB) earlier than the maturity date. However, with the rise in long term interest rates, repaying loans can now be considered for the first time in several years.

4.3 The revenue budget approved by the Council for each financial year includes provision for the interest payable on this borrowing. It also includes a provision for repaying the borrowing over a number of years (broadly speaking over the economic life of the assets acquired).

4.4 The second element of treasury management is cash management which involves managing the Council's investments to ensure the optimum amount of money is in the bank account on a day-to-day basis – so that there is enough money in the account to cover the payments made on the day but no more (as cash held in the bank account earns negligible interest).

4.5 The Council has substantial investments, but this is not "spare cash". There are four reasons for the level of investments:-

(a) Whilst the Government no longer supports capital spending with borrowing allocations, we are still required to provide money in the budget each year to repay debt on past capital spending. Because of the punitive rules described above, we have not been able to repay any long-term PWLB debt early, and therefore have to invest the cash;

(b) We have working balances arising from our day to day business, such as council tax received before we have to pay wages, and capital grants received in advance of capital spending;

(c) We have reserves as shown in the budget report and annual outturn report, which are held in cash until we need to spend them. These include the managed reserves strategy which supports future years' budgets, earmarked reserves, significant sums for NHS joint working and funds set aside for the capital programme; and

(d) We manage funds for the Combined Fire Authority and the Leicester & Leicestershire Enterprise Partnership.

4.6 There has been a significant reduction in cash balances during the second half of the financial year. Balances usually reduce due to the differing profile of receipts and payments in the first and second halves of the year. However, the reduction was higher this year, as for example grants received earlier for items such as bus electrification have been spent, social housing has continued to be acquired and funds were repaid to Government relating to business rates reliefs.

Treasury Management Policy and Monitoring

4.7 The activities to which this report relates were governed by the treasury strategy for 2022/23 which was approved by the Council on 23rd February 2022. This established an outline plan for borrowing and investment. The treasury strategy is drawn up in the light of the Council's expected borrowing requirements, its expected cash balances, the outlook for interest rates and the credit worthiness of the banks with whom the Council might invest its cash balances.

4.8 A twice-yearly report is submitted to your committee reviewing the treasury activity undertaken in the year. This report is the final report for 2022/23.

Loans and Investments at Key Dates

4.9 Table 1 overleaf shows the loans (money borrowed by the Council) and investments (money invested by the Council) as at 30/09/2022 and at 31/03/2023. The rates shown are the averages paid and received during 2022/23.

4.10 The level of gross debt (total loans borrowed) increased by £10 million, which was due to very short-term additional borrowing for 6 weeks approaching the financial year end. This additional borrowing was fully repaid as planned in April 2023. No new long-term loans have been borrowed and no debt restructuring has taken place during the year.

4.11 Our historic borrowing is predominantly from the Public Works Loans Board, plus two historic bank loans. As discussed at para. 6.4 below, one of these was repaid in April 2023, shortly after the year end. The other is a "LOBO" loan (Lender Option, Borrower Option). This loan is fixed rate, but permits the lender to ask for a rate rise. We have the option to repay if they do. Members may be aware of some criticism of LOBOs nationally, principally in respect of authorities which have complex mechanisms for calculating interest rates (we do not). We do not expect the lender to ask us for a rate rise, though we would be pleased to receive a request as we would then consider taking the opportunity to repay.

4.12 Investments have decreased significantly by £81m from £320m at 30 September 2022 to £238m at 31 March 2023. This change reflects the usual pattern of balances declining towards the end of the financial year as grant income is spent. However, as noted above, the decline in balances during the second part of the year was somewhat greater than experienced in recent years.

4.13 Since 2019/20, we have generally invested with other local authorities, rather than banks which have less protection for institutional investors. At the end of the 2022/23 financial year, the Council had no exposure to banks except to Barclays who act as our bankers. We may in the future look to increase our deposits with banks if they can be secured by other assets.

4.14 The Council has continued to make use of money market funds which comprise a basket of short-dated loans to financial institutions. The funds that we use are very low risk and have very high credit ratings. We also use them because they are liquid (we can get money back when we need it). We have never lost any money in investing in these funds, but the downside of their safety is that returns are generally quite low.

Table 1- Loans & Investments

	Position at 30/09/2022 Principal £M	**Position at 31/03/2023 Principal £M**	**Average Rate**
Long Term Fixed Rate Loans			
Public Works Loan Board (PWLB)	134	134	4.2%
Bank Loan *	25	25	4.4%
LOBO Loans			
Bank Loans	20	20	4.6%
Short Term (less than 6 months) Loans			
Local Authority Loans *	NIL	10	4.75%
Gross Debt	**179**	**189**	**4.3%**
Treasury Investments			
Banks	0	0	
Other Local Authorities	221	197	
Money Market Funds	91	34	
Property Funds	8	7	
Total Treasury Investments	**320**	**238**	**2.39%**
NET INVESTMENTS	**141**	**50**	

* These loans were repaid in April 2023

4.15 The investments include property unit trusts valued at £7m. These are unit trusts which invest in property (as opposed to more traditional unit trusts that invest in shares). These trusts have fallen in value by over £1.6m in the past year, having previously risen in value by over £1m in 2021/22. The capital value has tended to move and is £1.3m below their original purchase price of £8.3m in 2018, although this has been largely offset by £1.1m of income over the period. Our strategy is to hold these investments long term for income; and short-term changes in capital values are not the prime focus of our investment.

4.16 The dividends received on the units in the year totalled £290k (a return of 3.5% on the original investment).

4.17 The treasury strategy permits additional investments in property funds up to a total value of £30m, but no further such investments have been made during the last year. However, we shall continue to review this position.

4.18 The Council's (Non-Treasury) Investment Strategy also allows the authority to spend capital or make loans to a third party where it is intended to (at least partly) achieve a return. Since 30th September 2022, the Council has made two further loans to third parties, namely to Leicester Hockey Club CIC and Leicester Community Sports Arena Ltd. A summary of loans and investments made under the Investment Strategy is shown in table 2 below.

Table 2- Loans & Investments under the Investment Strategy

Investment	Total Capital Expenditure or loans outstanding £m	Percentage Return 2022/2023
Loans		
Ethically Sourced Products Ltd	1.2	4%
Leicestershire County Cricket Club Ltd	2.1	5%
Leicester Hockey Club CIC	0.4	n/a
Leicester Community Sports Arena Ltd	1.5	n/a
Other Investments		
Haymarket Centre Redevelopment	10.4	2.7%
Pioneer Park*	5.4	4%
Total All Loans & Investments	**21.0**	**3.2%**

* It should be noted that Pioneer Park received grant funding towards the £5.4m capital cost, so the actual return on the Council's own funding was much greater than the 4% shown.

4.19 The repayments of loans to Ethically Sourced Products and Leicestershire County Cricket Club are up to date. The loans to Leicester Hockey Club and Leicester Community Sports Arena were made towards the end of the financial year, and start repayments early in 2023/24.

The Haymarket Centre investment refers to the investment in the hotel accommodation leased to Travelodge, together with new lifts and refurbishment of the car park. Some £8.4m was funded by prudential borrowing. The investment does not refer to the subsequent purchase of the whole centre, which was not funded by borrowing.

5. **Credit Worthiness of Investments & Interest Rate Outlook**

5.1 During 2022/23 we continued to see uncertainty in the economy as a consequence of the Russian invasion of Ukraine and increasing inflationary pressures. However, despite this, we did not see the financial system like fail in the UK like it did in the financial crisis of 2008. This indicated that the corrective measures undertaken then to strengthen the banks have worked so far.

5.2 The governments of the largest world economies, including the UK, have implemented measures to make banks less likely to fail but also to reduce the impact on the financial system and on taxpayers if they do fail. The measures for dealing with a failing bank see investors who are not protected by the Financial Services Compensation scheme (which includes us) who have lent or deposited money, taking significant losses before there is any taxpayer support ("bail in"). These developments are reflected in the Council's approach to managing credit risk in its treasury strategies and the very low level of lending to banks.

5.3 The position is continually under review. One factor is that other regulatory developments are continuing to require or push banks towards greater financial robustness. Banks are now required to "ring fence" bank deposits from other riskier activities.

5.4 The Council has an indirect exposure to banks (including non-UK banks) through its investment in money market funds. Money market funds are like "unit trusts" but rather than investing in company shares these funds make interest bearing investments such as bank deposits. When we open such funds, they are vetted to ensure that they have strong investment and risk management processes, and we receive advice from our treasury advisor, Arlingclose.

5.5 Investments valued at £7m are held in two property funds, the Lothbury Property Trust and the Threadneedle Property Unit Trust. Further details are given at para. 4.15 above.

6. **Implementation of Borrowing & Investment Strategy**

6.1 The strategy approved by Council for 2022/23 envisaged using cash balances to underpin new prudential borrowing and HRA social housing acquisitions and new build, instead of borrowing externally. This strategy has been adhered to.

6.2 Total investment income during 2022/23 was £4.35m. This was significantly greater than the £1.6m originally budgeted due to sharply rising interest rates, though most of this difference was taken into account within the period 6 and period 9 budget monitoring reports.

6.3 Given that the Council continues to have a high level of investments, active consideration is given to the possible early redemption of a limited amount of debt. In previous years repaying debt was not considered to be financially viable because of high premia costs, but in 2022/23 for the first time in over 15 years, it came under serious consideration.

6.4 In April 2023 we repaid the Barclays loan of £25m at 4.4% which was due for repayment in the year 2077. The repayment will save £1.1m interest p.a. although this will be offset to some extent by the loss of interest on the funds used for the repayment. A premium of £2.18m was payable, which will be written down at £40k p.a. over the next 54 years (to 2077). In practice, this equates to a 4% p.a. overall return on the funds used. The precise long term effect of this repayment is of course impossible to predict, though our advisors' model suggested potential savings of £6m using a discount rate of 3% (or even £18m applying no discount for inflation). A major reason, however, for repaying the loan was to reduce risk if interest rates fall back again in the future, and hence the interest received on the funds that would have been retained by the Council once again fell below the interest payable on the loan.

7. Key Performance Measures

7.1 The most important performance measures are the rate of interest on the Council's borrowings, the timing of borrowing decisions, the timing of decisions to prematurely repay debt, the return on investments and the full repayment of the principal amounts invested.

7.2 The following table compares our performance against that of participating authorities. It is a "snapshot" of investments held at 31st March 2023 (table 2 above shows the average for the year).

Table 3 – Key Performance Data

Investment	Leicester City Council	All Authorities [1]
Income return on short-term investments	2.38%	3.67 %
Income return on long-term strategic investments	2.81%	3.93%
Total Income return	**2.39%**	**3.66%**
Strategic funds capital gain/(loss)	(19.57)%	(11.85)%
Total Return	**1.81%**	**1.57%**

1. Data compiled by our treasury advisors

7.3 The average rate of interest on all investments for participating authorities at 31st March 2023 is 3.66%, whilst the Council's own rate was lower at 2.39%. This is partly explained by differences on income from longer term investments, in that the Council has no investments in unsecured bank deposits and fewer longer dated strategic funds invested in assets such as property and equities than many other authorities. This reflects a prudent approach to security of our investments. However, the overall return including capital gains/losses was 1.81% for the Council, compared to 1.57% for all authorities.

7.4 The Council has a lower proportion of higher risk longer-term investments such as property funds than the average authority. Whilst this will reduce income returns, it also reduces our risk from capital losses which is particularly important following recent events. A few authorities have got into major difficulties because they have invested too much in riskier assets, and have since seen government intervention.

7.5 Higher investment returns are always available if higher risk is accepted. Risk can take the form of credit risk (money due is not paid) or market risk (the value of investments fall). However, the trade-off between risk and reward was considered when investment strategies were set for 2022/23 and in the current economic climate continues to be a most important consideration.

7.6 In practice, there is no such thing as a representative "average" authority. The benchmarking data shows a division between the authorities that use longer term and more risky assets (about half of all authorities) and those adopting a more cautious approach. We fall nearer to the cautious side of the two as we have only a small proportion of longer-term assets.

8. Use of Treasury Advisors

8.1 The Council is advised by Arlingclose Ltd. They advise on all aspects of treasury management, but their main focus is on providing advice on the following matters:

- the creditworthiness of banks
- the most cost effective ways of borrowing
- appropriate responses to Government initiatives
- technical and accounting matters.

9. **Compliance with the Council's Treasury Strategy**

9.1 As required by the statutory borrowing framework, the Council is required to set a number of prudential limits and indicators. These limits are set annually and can be found within the budget and treasury strategy.

9.2 For the operational implementation of the Council's treasury management strategy the most important limits and indicators that need to be monitored throughout the year are:

- The authorised limit – the maximum amount of borrowing that the Council permits itself to have outstanding at any one time
- The operational limit – a lower limit to trigger management action if borrowing is higher than expected.
- The maximum proportion of debt that is fixed rate.
- The maximum proportion of debt that is variable rate.
- Limits on the proportion of debt maturing in a number of specified time bands.
- Limits on sums to be invested for more than 364 days.

9.3 These limits have been complied with.

10. **Financial and Legal Implications**

10.1 This report is solely concerned with financial issues. Kamal Adatia, Legal Services, has been consulted as Legal Advisor and there are no legal issues.

11. **Other Issues**

OTHER IMPLICATIONS	YES/NO	Paragraph References Within Supporting information
Equal Opportunities	No	
Policy	No	
Sustainable and Environmental	No	
Crime and Disorder	No	
Human Rights Act	No	
Elderly/People on Low Income	No	
Corporate Parenting	No	
Health Inequalities Impact	No	

12. **Background Papers**

12.1 The Council's Treasury Management Strategy - "Treasury Strategy 2022/2023" (Council 23rd February 2022); and The Council's Treasury Policy Document – "Framework for Treasury Decisions" – Council 19th February 2020.

13. **Consultation**

13.1 Arlingclose Ltd (the Council's Treasury Management advisers).

14. **Author**

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