Portsmouth
CITY COUNCIL

Title of meeting:	Governance and Audit and Standards Committee Cabinet City Council
Date of meeting:	Governance and Audit and Standards Committee 20 September 2023 Cabinet 3 October 2023 City Council 17 October 2023
Subject:	Treasury Management Outturn Report 2022/23
Report by:	Director of Finance and Resources (Section 151 Officer)
Wards affected:	All
Key decision:	No
Full Council decision:	Yes

1. Purpose of report

To inform members and the wider community of the Council's treasury management activities in 2022/23 and of the Council's treasury management position as of 31 March 2023.

2. Recommendations

It is recommended that the actual prudential and treasury management indicators based on the unaudited accounts, as shown in Appendix B, be noted (an explanation of the prudential and treasury management indicators is contained in Appendix C).

3. Background

The Local Government Act 2003 requires local authorities to have regard to the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code for Capital Finance in Local Authorities. The Code requires local authorities to calculate prudential indicators before the start of and after each financial year. The CIPFA Code of Practice on Treasury Management also requires the S.151 Officer to prepare an annual report on the outturn of the previous year. This information is shown in Appendix A of the report.

4. Reasons for recommendations

The net cost of Treasury Management activities and the risks associated with those activities have a significant effect on the Council's overall finances. Consequently, in accordance with good governance, the S.151 Officer is required to report to the Council on those activities.

5. Integrated impact assessment

An integrated impact assessment is not required, as the recommendations do not directly impact on service or policy delivery. Any changes made arising from this report would be subject to investigation in their own right.

6. Legal implications

The S.151 Officer is required by the Local Government Act 1972 and by the Accounts and Audit Regulations 2015 to ensure that the Council's budgeting, financial management, and accounting practices meet the relevant statutory and professional requirements. Members must have regard to and be aware of the wider duties placed on the Council by various statutes governing the conduct of its financial affairs.

7. Director of Finance's comments

All financial considerations are contained within the body of the report and the attached appendices.

………………………………………………
Signed by: Director of Finance & Resources (Section 151 Officer)

Appendices:

Appendix A: Treasury Management Outturn Report
Appendix B: Prudential and Treasury Management Indicators
Appendix C: Explanation of Prudential and Treasury Management Indicators

Background list of documents: Section 100D of the Local Government Act 1972

The following documents disclose facts or matters, which have been relied upon to a material extent by the author in preparing this report:

Portsmouth
CITY COUNCIL

Title of document	Location
Information pertaining to the treasury management outturn	Financial Services

The recommendation(s) set out above were approved/ approved as amended/ deferred/ rejected by ……………………………… on ………………………………

………………………………………………
Signed by:

Portsmouth CITY COUNCIL

APPENDIX A: TREASURY MANAGEMENT OUTTURN REPORT

1. Governance

Treasury management activities were performed within the Prudential Indicators approved by the City Council.

Treasury management activities are also governed by the Treasury Management Policy Statement, Annual Minimum Revenue Provision for Debt Repayment Statement and Annual Investment Strategy approved by the City Council.

2. Combined Borrowing and Investment Position (Net Debt)

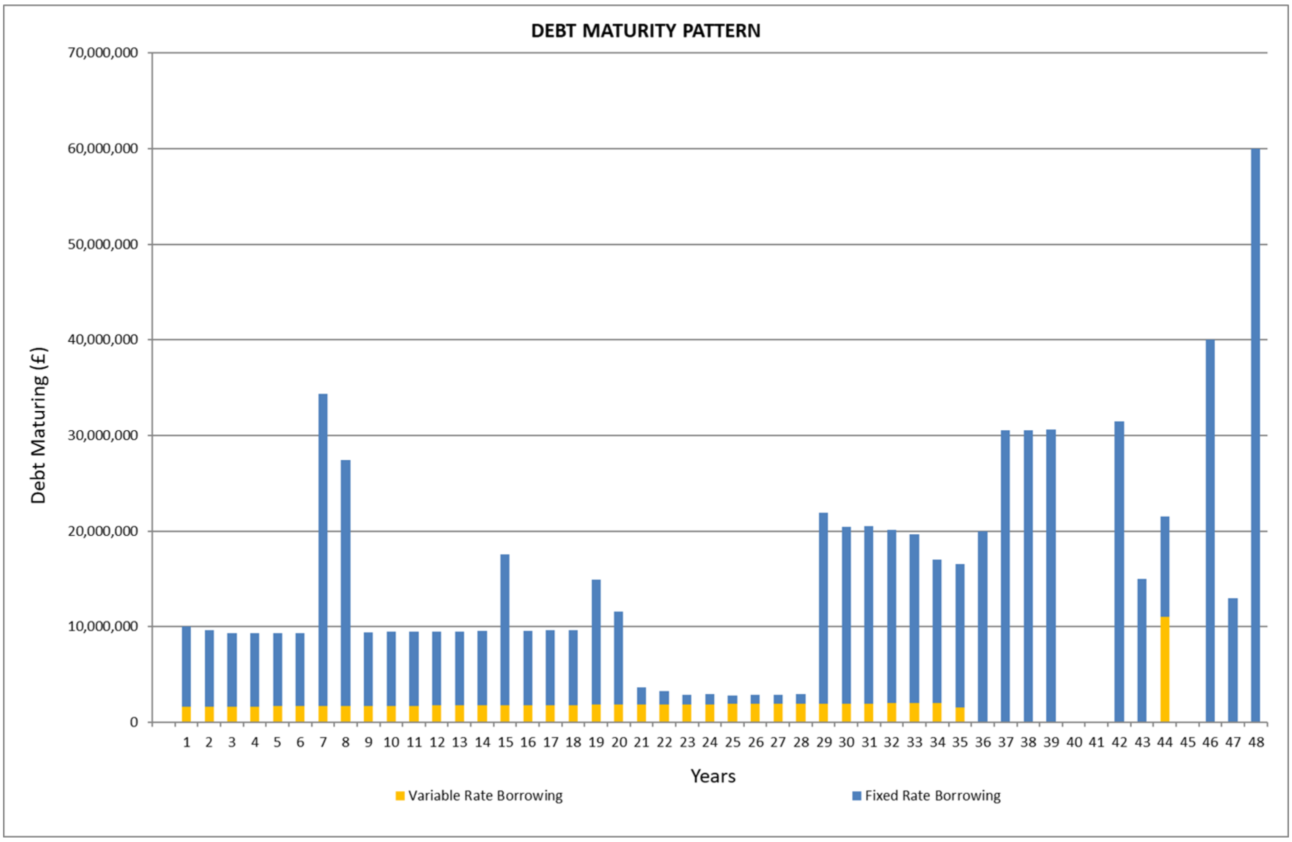
On 31 March 2023, the Council had gross debt including finance leases and private finance initiative (PFI) schemes of £747m and gross investments of £404m giving rise to a net debt of £343m. Major components of the Council's gross investments of £404m are made up of general and earmarked reserves of £241m and capital grants received in advance of capital expenditure of £123m.

3. Borrowing Activity

During 2022/23, no new borrowing was undertaken as the Council maintained an under-borrowed position. This meant that the Council's underlying need to borrow (the Capital Financing Requirement), which was £882m on 31 March 2023, was not fully funded with loan debt, the Council's actual gross debt being £747m at this date. Internal borrowing, from cash supporting the Council's reserves, balances and cash flow, was used as an interim measure to meet this shortfall of £135m. This strategy was prudent as investment returns were initially low and minimising counterparty risk on placing investments also needed to be considered.

Debt rescheduling opportunities have been limited in the current economic climate as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable. Therefore, no debt rescheduling was undertaken during 2022/23.

The Council's gross debt on 31 March 2023 of £747m is within the Council's authorised limit (the maximum amount of borrowing permitted by the Council) of £937m and the Council's operational boundary (the maximum amount of borrowing that is expected) of £906m. The Council aims to have a reasonably even maturity profile so that the Council does not have to replace a large amount of borrowing in any particular year when interest rates might be high. The maturity profile of the Council's borrowing (see graph below) is within the limits contained in the Council's Treasury Management Policy.



4. Investment Activity

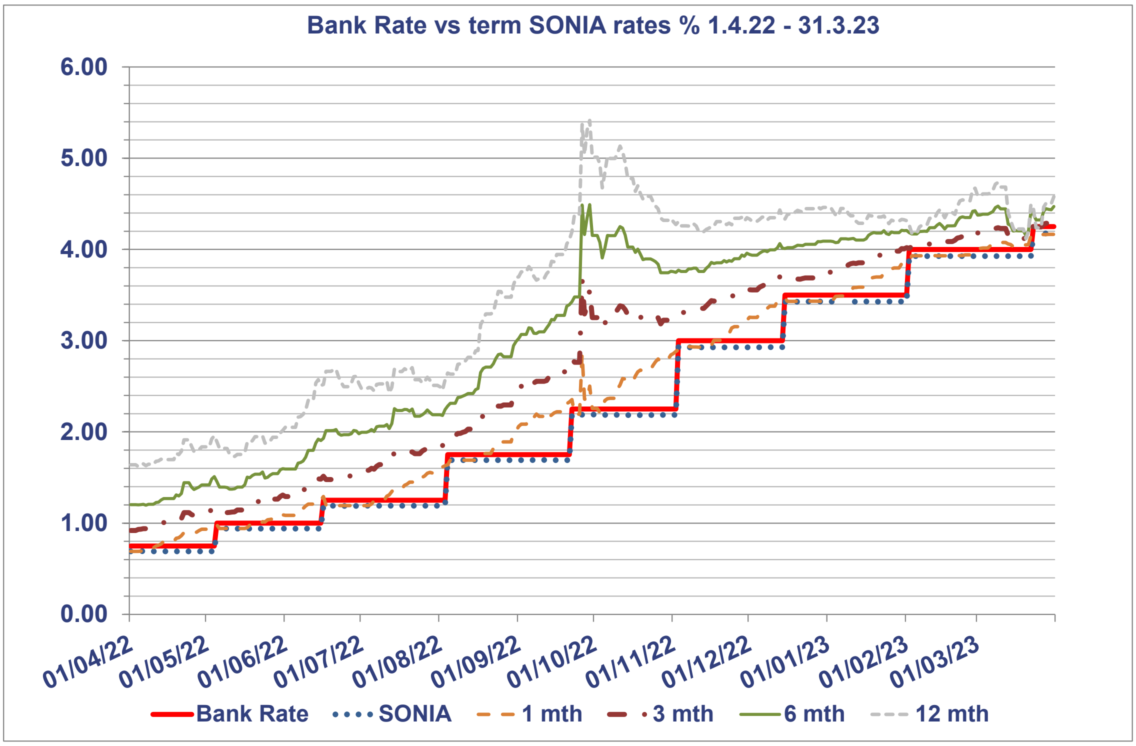
Investment returns rose steadily for much of 2022/23 at a faster rate and to higher levels than forecast. The expectation for interest rates within the treasury management strategy for 2022/23 was that the Bank Rate would increase from an initial rate of 0.25% to 0.50% in quarter 2 of 2022 and to 0.75% by the first quarter of 2023. This was considered sufficient to bring inflation levels back to the MPC's 2% target after a spike expected to peak at around 5%.

However, greater increases came about as central banks, including the Bank of England, realised that inflationary pressures were not transitory and tighter monetary policy was needed as a result. Through the autumn and then in March 2023, the Bank of England maintained various monetary easing measures as required to ensure that specific markets, the banking system and the economy had appropriate levels of liquidity at times of stress. For local authorities with sufficient cash balances, this sea-change in investment rates emphasised the need for an appropriate balance to be achieved between maintaining cash for liquidity purposes and securing investments on a rolling basis to lock in the higher investment rates as they became available.

Whilst the Bank of England base rate started the 2022/23 financial year slightly higher than expected at 0.75%, persistently high inflation levels led to further increases in the Bank Rate of between 0.25% and 0.75% in 8 out of the following 12 months, to bring the base rate to 4.25% by the end of March 2023. At this time, the CPI measure of inflation was still above 10% in the UK but is expected to fall during 2023/24.

The change in the Bank Rate in the year can be seen in the graph below, together with the effect on inter-bank lending rates.

Investment Benchmarking Data – Sterling Overnight Index Averages (Term) 2022/23



While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the budgetary crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between higher borrowing costs and lower investment returns for much of the year as illustrated in the graph above and table below. As this differential has reduced, the Council has sought to avoid taking on long-term borrowing at the elevated levels available and has focused on internal borrowing. Such an approach has also provided benefits in terms of reducing counterparty risk exposure, by having fewer investments placed in the financial markets.

The Council's investments averaged £445m during 2022/23. As of 31 March 2023, the Council had, £404m invested. The investment activities in the year conformed to the approved strategy, with the Council having no liquidity difficulties. The performance of the investment portfolio is summarized in the tables below.

Year	Overall Return
2020/2021	0.99%
2021/2022	0.31%
2022/2023	1.42%

	Average Value (Proportion) of Portfolio	Return to December 2022	Return to March 2023
Externally Managed Funds - Tradable Instruments	£12M (3%)	-12.09%	-6.52%
Tradable Structured Interest-Bearing Deposit	£20M (4%)	0.36%	-0.1%
Vanilla Interest Bearing Deposits	£413M (93%)	1.31%	1.72%
Overall Return	**100%**	**0.91%**	**1.42%**

There was a notable improvement in the overall performance of the portfolio in the last quarter of 2022/23. This was due to the bulk of the investment portfolio, 93%, being invested in vanilla interest-bearing deposits that have generated an average return of 1.72% through 2022/23.

This higher return was partly offset by a decline in the market value of externally managed funds consisting of tradable instruments such as corporate bonds which make up 3% of the portfolio. This fall in the market value of existing tradable instruments is driven by the increase in current interest rates. When a tradable instrument is paying interest at a rate below current market rates, its reduced market value reflects its actual value at the point at which it is traded. However, if a tradable instrument is not traded but is held to maturity, then its value will still remain equal to the original principal sum invested plus accrued interest.

The Council also has £20m invested in tradable structured interest-bearing notes. One £10m note, maturing on 07 June 2023, pays SONIA[1] (ranging from a low of 0.69% during April 2022 to a high of 4.18% on 31 March 2023) plus 0.12% with a floor of 1.65% and a cap of 3.50%. This note has paid between 1.65% and 3.50% during the year as SONIA has increased. This was a good rate when the note was purchased in June 2018. The other two tradable notes are £5m each, invested until December 2024, at fixed interest rates of 3.76% and 3.82%. These tradable structured interest-bearing notes make up the remaining 4% of the investment portfolio.

24% of the investment portfolio matures in the first quarter of 2023/24, providing an opportunity to re-invest any surplus funds at the higher rates available at the time.

[1]SONIA stands for Sterling Overnight Index Average Rate - it is the average of the interest rates that banks pay to borrow overnight from other financial institutions and acts as an important benchmark.

5. Revenue Costs of Treasury Management Activities in 2022/23

Expenditure on treasury management activities in both the General Fund and the HRA against the revised budget is shown below.

	Revised Estimate 2022/23 £000	Actual 2022/23 £000	Variance +/- £000
Interest Payable:			
PWLB	18,971	18,971	-
Other Long-Term Loans	1,279	1,370	91
HCC Transferred Debt	422	436	14
Interest on Finance Lease	191	189	(2)
Interest on Service Concession Arrangements (including PFIs)	4,622	4,647	25
Interest Payable to External Organisations	108	151	43
Premiums and Discounts on Early Redemption of Debt	101	101	-
	25,694	**25,865**	**171**
Deduct			
Investment Income:			
Interest on Investments	(5,397)	(6,298)	(901)
Other interest receivable	(1,571)	(1,660)	(89)
	18,726	**17,907**	**(819)**
Provision for Repayment of Debt	**9,934**	**10,354**	**420**
Debt Management Costs	**619**	**662**	**43**
	29,279	**28,923**	**(356)**

Interest on investments was £901,000 higher than the budget due to the higher returns available on surplus cash invested in the latter part of the year. This was partly offset by a small increase in interest payable compared to the budget of £171,000 due to a higher rate of interest being applied to some of the Council's borrowing and on balances held for certain external bodies.

The provision for the repayment of debt was £420,000 higher than the budget. This was largely due to additional provision having to be made because of decreases in the market value of some investment properties. However, the market value of the investment property portfolio has increased when compared to the original purchase price of these properties.

Overall net treasury management costs were £356,000 below the revised budget.

Portsmouth CITY COUNCIL

APPENDIX B - Prudential and Treasury Management Indicators

1. Capital financing requirement	Original Estimate	Revised Estimate	Actual
	£'000	£'000	£'000
General Fund	735,647	645,488	628,218
Housing Revenue Account (HRA)	259,214	260,213	253,818
Total	994,861	905,701	882,036

2. Authorised Limit	Original Limit	Revised Limit	Actual
	£'000	£'000	£'000
Long Term Borrowing	962,550	891,429	701,229
Other Long Term Liabilities	46,032	46,032	46,032
Total	1,008,583	937,461	747,261

3. Operational Boundary	Original Limit	Revised Limit	Actual
	£'000	£'000	£'000
Long Term Borrowing	948,829	859,669	701,229
Other Long Term Liabilities	46,032	46,032	46,032
Total	994,861	905,701	747,261

4. Ratio of financing costs to net revenue stream	Original Estimate	Revised Estimate	Actual
General Fund	17.4%	14.5%	12.0%
Housing Revenue Account (HRA)	7.6%	5.9%	6.0%

5. Maturity Structure of Fixed Rate Borrowing	Lower Limit	Upper Limit	Actual
Under 12 months	0%	10%	1%
12 months and within 24 months	0%	10%	1%
24 months and within 5 years	0%	10%	4%
5 years and within 10 years	0%	20%	13%
10 years and within 20 years	0%	30%	15%
20 years and within 30 years	0%	40%	8%
30 years and within 40 years	0%	40%	31%
Over 40 years	0%	40%	27%

6. Maturity Structure of Variable Rate Borrowing	Lower Limit	Upper Limit	Actual
Under 12 months	0%	10%	2%
12 months and within 24 months	0%	10%	2%
24 months and within 5 years	0%	10%	7%
5 years and within 10 years	0%	20%	11%
10 years and within 20 years	0%	30%	24%
20 years and within 30 years	0%	30%	26%
30 years and within 40 years	0%	30%	13%
Over 40 years	0%	30%	15%

7. Principal sums invested over 365 days	Original Limit	Revised Limit	Actual
	£'000	£'000	£'000
Maturing after 31/3/2024	50,000	130,000	14,000
Maturing after 31/3/2025	50,000	50,000	7,700
Maturing after 31/3/2026	-	50,000	4,800

Portsmouth CITY COUNCIL

APPENDIX C - Explanation of Prudential and Treasury Management Indicators

1. Actual Capital Financing Requirement
This represents the underlying requirement to borrow for capital expenditure. It takes the total value of the City Council's fixed assets and determines the amount that has yet to be repaid or provided for within the Council's accounts.

The capital financing requirement is increased each year by any new borrowing and reduced by any provision for the repayment of debt. Broadly, the higher the capital financing requirement, the higher the amount that is required to be set aside for the repayment of debt in the following year.

2. Authorised Limit
The authorised limit for external debt is the maximum amount of debt which the authority may legally have outstanding at any time. The authorised limit includes headroom to enable the Council to take advantage of unexpected movements in interest rates and to accommodate any short-term debt or unusual cash movements that could arise during the year.

3. Operational Boundary
The Operational Boundary is based on the probable external debt during the year. It is not a limit but acts as a warning mechanism to prevent the authorised limit (above) being breached.

4. Ratio of financing costs to net revenue stream
This ratio reflects the annual cost of financing net debt as a proportion of the total revenue financing received. It therefore represents the proportion of the City Council's expenditure that is largely fixed and committed to repaying debt. The higher the ratio, the lower the flexibility there is to shift resources to priority areas and/or reduce expenditure to meet funding shortfalls.

For the General Fund, this is the annual cost of financing debt as a proportion of total income received from General Government Grants, Non-Domestic Rates and Council Tax.

The ratio of Housing Revenue Account (HRA) financing costs to net revenue stream is the annual cost of financing capital expenditure, as a proportion of total gross income received including housing rents and charges.

5. Maturity Structure of Fixed Rate Borrowing
The Council aims to have a reasonably even debt maturity profile so that it is not unduly exposed to refinancing risk in any particular year when interest rates may be high. The maturity structure of fixed rate borrowing matters less in future years as inflation will reduce the real value of the sums to be repaid.

6. Maturity Structure of Variable Rate Borrowing
Variable rate borrowing could expose the Council to budgetary pressure if the interest rates increase. The maturity structure of variable rate borrowing matters less in future years as inflation will reduce the real value of the liability.

7. Principal Sums Invested over 365 Days
Investing long term at fixed rates provides certainty of income and reduces the risk of interest rates falling.