Annexes B & C to this Appendix are not for publication as they contain exempt information of the description in Paragraphs 14 and 21 of Schedule 12A of the Local Government Act 1972.

Appendix 1

Treasury Management Annual Report 2022/23

Cardiff Council

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Introduction

1. Treasury management activities are the management of the organisation'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.

2. The Council carries out its treasury management activities in accordance with a code developed for public services and updated in 2021 by the Chartered Institute of Public Finance and Accountancy (CIPFA).

3. The Council has delegated responsibility for treasury management to the Corporate Director of Resources (S151 Officer). The Council's Treasury Management Practices which are updated annually, identifies specific responsibilities of officers as well as setting out schedules highlighting the way in which treasury activities are managed.

4. On 25th February 2010, Council approved policies and adopted the four clauses of the treasury management code which are replicated in **Annexe A** for information. Council received a report in March 2022 on the Council's Treasury Management Strategy for 2022/23 and a mid-year review in November 2022.

5. The Treasury Management is an integral part of the Council's Strategic and Financial planning framework, with borrowing activities primarily because of historic and future capital expenditure approved by Council as part of the Council's Capital Investment programme.

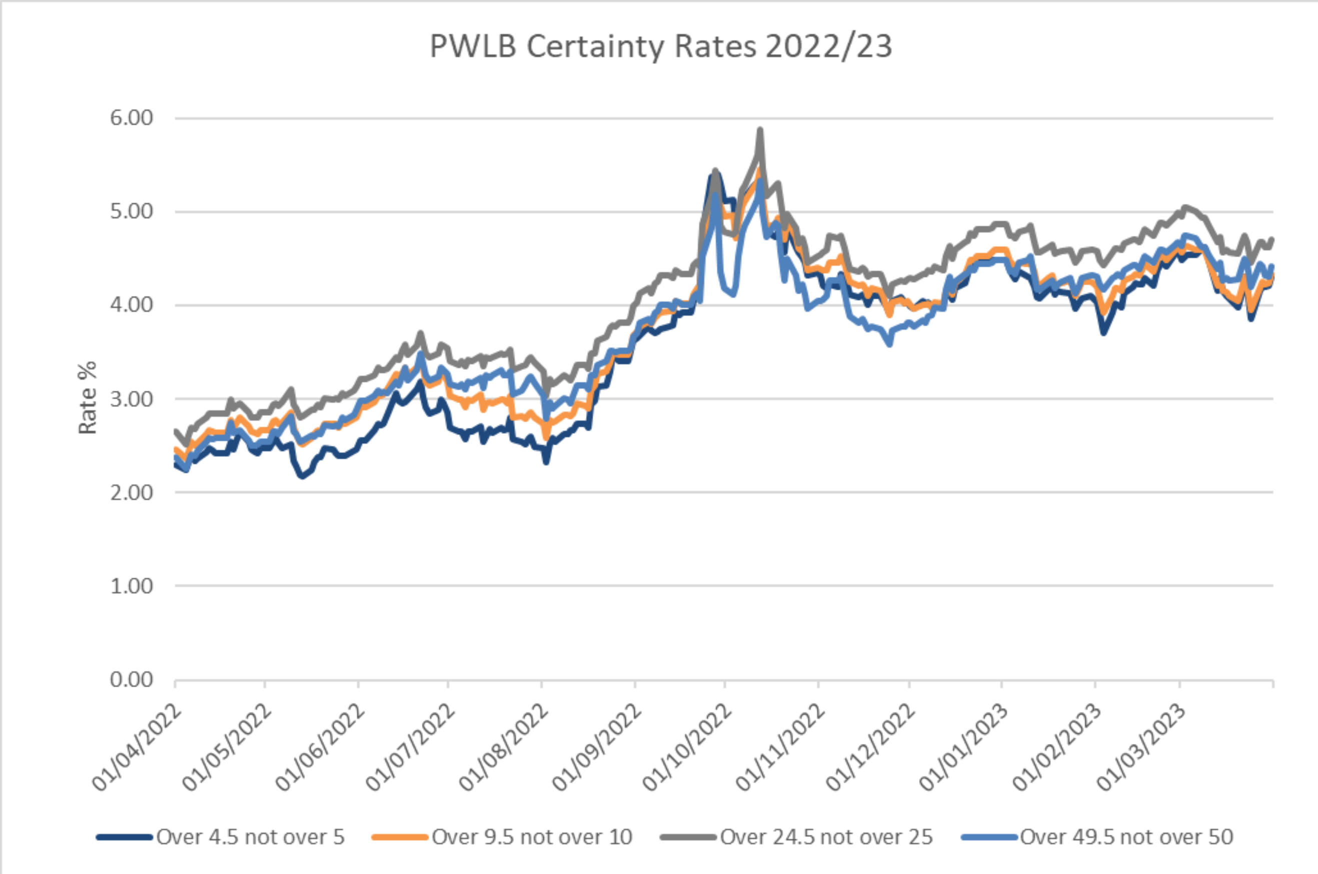
6. This report provides members with an annual report for the Council's Treasury Management activities for 2022/23. It covers:-

- the economic background to treasury activities
- treasury investment strategy and outturn for 2022/23
- borrowing strategy and outturn for 2022/23 including debt rescheduling
- compliance with treasury limits and prudential indicators
- resilience of the Treasury Management function
- treasury management issues for 2023/24.

7. Council requires scrutiny of the accounting, audit and commercial issues of its Treasury Management Strategy and practices to be undertaken by the Council's Governance and Audit Committee. A glossary of key treasury management terms is included at Annexe E. It should be noted that performance and risk in respect to non-treasury management investments such as property are not reported as part of this Annual Report.

Economic Background

8. Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the continued Russian invasion of Ukraine, and a range of different UK Government policies, UK interest rates were volatile across various time periods throughout 2022/23.
9. Inflation was the root cause turmoil in financial markets. Inflation was elevated but labour markets extra-ordinarily tight, making it an issue of fine judgment as to how far monetary policy needed to tighten. Consumer Price Inflation (CPI) picked up to what should be a peak reading of 11.1% in October, although hopes for significant falls from this level will very much rest on the movements in the gas and electricity markets, as well as the supply-side factors impacting food prices. Forecasts expect CPI to drop back towards 4% by the end of 2023.
10. The UK unemployment rate fell through the year to a 48-year low of 3.6%, however without an increase in the labour force participation rate and average wage increases running at over 6% the Monetary Policy Committee was concerned that wage inflation will prove just as sticky and unsustainable as major supply-side shocks to food (up 18.3% y/y in February 2023) and energy that have endured since Russia's invasion of Ukraine.
11. To address inflation concerns, Bank Rate increased steadily throughout 2022/23. Bank Rate moved up in stepped increases of either 0.25% or 0.5%, reaching 4.25% by the end of the financial year, with further increases in 2023/24.
12. UK gilt yields reversed the increases seen as a result of political changes during the year, although they remain elevated in line with developed economies generally due to inflation expectations and as a result of overall increases in debt. The above economic background and political changes in the UK, have resulted in significant volatility in gilt yields and in turn borrowing rates as markets digest daily developments in the financial markets, release of economic data both domestically and internationally. The chart below shows movements and general trend of increase in PWLB certainty rates through the year.
13. The Public Works Loan Board is one source of local authority borrowing and subject to annual review of eligibility. PWLB rates are based on gilt (UK Government bonds) yields, however HM Treasury determine a specified margin to add to gilt yields for any local authority borrowing. Most local authorities can undertake loans at the PWLB Certainty Rate, which is gilt rate plus 80 basis points (G+80 bps). As a general rule, short-dated gilt yields will reflect expected movements in Bank Rate, whilst medium to long-dated yields are driven primarily by the inflation outlook.



Investments and Outturn

14. The Council's treasury investments include those arising from its own temporary cash balances as well as balances held from activities of Joint Committees such as the Cardiff Capital Region City Deal, for which it is the accountable body.

15. The management of the day-to-day cash requirements of the Council is undertaken in-house with credit advice from Link Asset Services, the Council's Treasury Management advisors. This may involve temporary borrowing pending receipt of income or the temporary lending of surplus funds. Investment balances fluctuate daily and arise from a number of sources including differences in timing of revenue and capital cash flows, reserves, provisions and other balances held for future use.

16. The Council invests with institutions approved by Council as part of its Treasury Management Strategy and in accordance with investment guidelines established by the Welsh Government. As part of the Markets and Financial Instruments Directive II, the Council elected for 'professional' status. The categories, names, periods and size limits on the Council's approved investment list can be extended, varied or restricted at any time by the Corporate Director Resources under delegated powers and are monitored closely in conjunction with the Council's treasury advisors.

17. Whilst the average daily cash balance was £236.3 million during 2022/23, at 31 March 2023, investments stood at £160.6 million. The latter included £61 million in respect to City Deal deposits. The Council's choice of investments maintained an approach of security, where the amount invested is that repayable, then liquidity and only then yield. **Annexe B** shows with whom these investments were held at 31 March 2023.

18. A selection of charts in relation to investments is included in **Annexe C.** The main areas to highlight at 31 March 2023 are as follows:-

- Counterparty exposure against the maximum allowed directly with an organisation. This shows that at 31 March 2023 no exposure limits set were breached. This was also the case during the year.
- Investments held with different institutions as a percentage of the total shows that investments are diversified over a number of organisations and this was a strategy applied where possible during the year.
- The geographic spread of investments as determined by the country of origin of relevant organisations. All investments are in sterling and countries are rated AA and above as per our approved criteria.

19. Using historic data adjusted for current financial market conditions, the probability of any default is low at circa 0.004% of the investments outstanding, i.e. £3,139

20. All investments held at 31 March 2023 are deemed recoverable. Accordingly, no impairment losses are reflected in the Council's 2022/23 Statement of Accounts arising from the Council's treasury management activities.

21. The overall level of interest receivable from treasury investments totalled £4.134 million in 2022/23. After allowing for interest on balances held on behalf of others, interest receivable for the general fund totalled £2.650 million. The average returns achieved compared to current industry benchmarks are shown in the table below.

	Return on Investment 2022/2023	
	Benchmark 7 day / 3month (%)	**Achieved (%)**
In-house	2.22 / 2.72	1.74

22. For benchmarking purposes, the Sterling Overnight Index Average rate (SONIA) for seven days and 3 months uncompounded is used, with Council performance below such benchmarks during 2022/23. This is not unexpected in a rapidly increasing interest rate environment as deposits already made cannot be re-invested at higher rates until they mature.

23. Investment returns picked up throughout the course of 2022/23 as central banks, including the Bank of England, realised that inflationary pressures were not transitory, and that tighter monetary policy was called for.

24. With uncertainty in bond and financial markets, short term investments of the type used by the Council i.e bank deposits less than one year, offered increased interest rates at Bank Rate or above. This was the particularly the case for maturing deposits entered into in previous years, which would benefit from higher rates, where cash balances allow.

25. The Council continued to take a cautious approach to investing and 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 financial 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.

Borrowing and Outturn

26. Borrowing is undertaken to finance the Council's capital programme and manage any short-term cash flow requirements. The main sources of borrowing are identified in the table below.

27. At 31 March 2023, the Council had £855.1 million of external borrowing. This was predominantly fixed interest rate borrowing from the Public Works Loan Board (PWLB) payable on maturity.

31 March 2022			31 March 2023	
£m	**Rate (%)**		**£m**	**Rate (%)**
763.1		Public Works Loan Board	759.7	
51.0		Market (Lender Option Borrower Option)	51.0	
23.2		Welsh Government	44.4	
18.3		Local Authorities and other	0	
855.6	**4.01**	**Total External Debt**	**855.1**	**3.96**

28. It should be noted that there have been a number of recent changes to PWLB lending criteria which now includes a prohibition to deny access to borrowing from the PWLB for any local authority incurring expenditure on 'assets primarily for yield'.

29. All borrowing is in the name of the Council and a single pool of debt is maintained rather than having separate loans for the Housing Revenue Account. Total interest payable on external debt during 2022/23 was £34.1 million of which £13.5 million was payable by the Housing Revenue Account (HRA). In total £40.5 million was set aside from General Fund and HRA revenue budgets in line with the Councils approved policy on prudent provision for debt repayment.

30. Extracts from the borrowing strategy approved by Council in March 2022 are shown below.

- *Promoting revenue cost stability to aid financial planning and avoid a stop-start approach to service delivery, although it is recognised that this may have a financial impact.*
- *Pooling borrowing and investments to ensure the whole Council shares the risks and rewards of treasury activities.*
- *Ensuring borrowing plans are aligned to known capital expenditure spending plans and financial reserve levels.*
- *Achieving a balanced maturity profile.*
- *Having regard to the effects on current and future Council Tax and rent payers.*

<u>External verses internal borrowing</u>

Whilst interest rates for borrowing are greater than interest rates the Council receives for investments (the cost of carry), it makes financial sense to use any internal cash balances held in the short-term to pay for capital expenditure and minimise costs (internal borrowing), rather than undertake external borrowing. However, there is a risk that the Council may have to borrow at higher rates when it does actually need to borrow in future and so this position is kept under continuous review and delegated to the Corporate Director Resources. Borrowing undertaken is reported as part of reports to Council.

31. During 2022/23 the Council repaid £22.8 million of maturing loans. New interest free loans totalling £22.3 million were received from the Welsh Government in respect of energy efficiency schemes and towards a Welsh Buildings Safety Loan Scheme. The overall effect of these transactions during the year was to decrease the average rate on the Council's borrowing to 3.96% at 31 March 2023.

32. As part of its loan portfolio, the Council has six Lender Option Borrower Option (LOBO) loans totalling £51 million. These are where the lender can request a change in the rate of interest payable by the Council on pre-determined dates. The Council at this point has the option to repay the loan, but this option is conditional and would require the lender to ask for an increase in the current rates to trigger such an event. Apart from the option to increase rates these loans are comparable to PWLB and have no other complications such as variation in interest rates or complex terms. With current elevated interest rates in the market, the likelihood of such an event has increased. The Council has asked for options of early repayment primarily to manage refinancing risk on all loans being triggered at the same time, as set out in previous Treasury Management Reports. However, the premiums requested, do not represent value.

33. Interest rates on the LOBO's held range between 3.81% and 4.35% which are not unreasonable given the council's average rate. Details of the loans are shown in the table below.

34. None of the LOBO's had to be repaid during 2022/23. £24 million of the LOBO loans are subject to the lender having the right to change the rate of interest payable during the next financial year. The Council has the right to refuse the change, triggering early repayment and the need to re-finance. This is a manageable refinancing risk as LOBO's form a relatively low proportion of the Council's overall borrowing at 5.96%.

£m	Rate	Potential Repayment Date	Option Frequency	Full Term Maturity
6	4.28%	22/05/2022	6 months	21/11/2041
6	4.35%	22/05/2022	6 months	21/11/2041
6	4.06%	22/05/2022	6 months	23/05/2067
6	4.08%	01/09/2022	6 months	23/05/2067
22	3.81%	21/11/2025	5 years	23/11/2065
5	4.10%	17/01/2028	5 years	17/01/2078

35. In accordance with the borrowing strategy, the Council is undertaking internal borrowing which is when it uses temporary cash balances it holds in the short term instead of undertaking external borrowing. The level of internal borrowing is £66 million as at 31 March 2023, and this is confirmed by a comparison of the Council's external level of debt and its Capital Financing Requirement at 31 March 2023 as shown later in this report. The borrowing strategy will continue to look at options to manage the Council's future borrowing requirement using a mix of internal and external borrowing, having regard to future interest expectations before entering into longer term borrowing commitments.

Debt Rescheduling

36. No debt rescheduling or early repayment of debt was undertaken during 2022/23. The main obstacle remained the level of premium (penalty) that would be chargeable on early repayment by the PWLB. The net premium payable on the balance of PWLB loans at 31 March 2023, which are eligible for early repayment (£757 million), is £48 million. This premium is payable primarily because:-

- Interest rates on loans of equivalent maturities compared to those held are currently lower
- A penalty rate or lower early repayment rate was introduced by HM Treasury in November 2007, which increased the cost of premiums and reduced flexibility of Local Authorities to make savings. This has been a significant thorn in the ability of local authorities to manage debt more effectively.

37. The Council has previously considered the opportunity for early repayment of LOBO loans. Current elevated interest rates in the market increase the likelihood of a change event triggered by the lender. In addition the Council has asked for options of early repayment primarily to manage refinancing risk on all loans being triggered at the same time, as set out in previous Treasury Management Reports. However, the premiums requested, do not represent value, unless the key aim is to reduce any re-financing risk. The cost of premiums can be spread over future years. Whilst there may have been short terms savings, these may be outweighed by potentially longer-term costs.

Compliance with treasury limits and prudential indicators

38. During the financial year the Council operated within the treasury limits and prudential indicators set out in the annual Treasury Management Strategy. The actual outturn is shown in the following paragraphs and compared to the original estimates contained in the 2022/23 Budget Report. Future year's figures are taken from the Budget Report for 2023/24 and will be updated in the Budget Report for 2024/25.

Capital Expenditure

39. The "Prudential Code" requires the Council to estimate the capital expenditure that it plans to incur over the Medium Term. The actual capital expenditure incurred in 2022/23 and estimates of capital expenditure for the current and future years as set out in the Budget Report of March 2023 are as follows:-

Capital Expenditure							
	2022/23 Actual £m	2022/23 Original Estimate £m	2023/24 Estimate Month 4 £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m
General Fund	140	189	223	348	231	93	30
Housing Revenue Account	76	74	108	102	186	89	119
Total	**216**	**263**	**331**	**450**	**317**	**182**	**149**

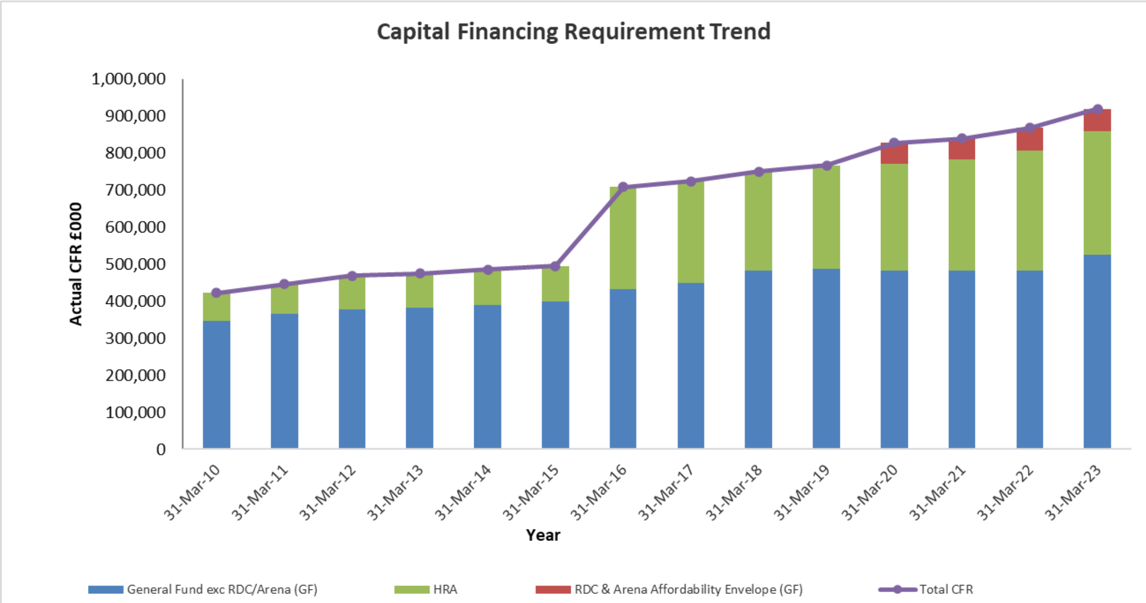
Capital Financing Requirement (CFR) – The Borrowing Requirement (Excluding Landfill Provision)

40. Where capital expenditure has been incurred without a resource to pay for it i.e. when proposed to be paid for by supported or unsupported borrowing, this will increase what is termed the Council's Capital Financing Requirement (CFR) which is the Council's underlying need to borrow. The Council is required to make a prudent provision for the repayment of historic capital expenditure from its revenue budget in line with its agreed policy which reduces the CFR. Calculation of the CFR is summarised in the table below and results in the need to borrow money.

Movement	Opening Capital Financing Requirement (CFR)
+	Capital expenditure incurred in year
-	Grants, contributions, reserves and receipts used for capital expenditure
-	Prudent Minimum Revenue Provision and Voluntary Repayment
=	**Closing Capital Financing Requirement (CFR)**

41. The chart below shows the trend in the CFR including the Housing Revenue Account. The latter includes the £187 million payment made from the HRA to HM Treasury to exit the subsidy system in 2015/16. As highlighted in the Treasury Management Strategy, the CFR is expected to grow in future years, requiring an increase in borrowing to pay for planned expenditure commitments, including those assumed to pay for themselves from future income or savings. These include indoor arena, new affordable housing, City

Deal and the 21st century school's financial model. Forecasts are to be updated as part of the budget report for 2024/25.



42. The CFR as at 01 April 2022 was £869 million. The actual CFR as at 31 March 2023, estimates for current and future years (estimated in the March 2023 budget) are shown in the table below and exclude non-cash backed provisions in relation to Landfill after care provision:-

Capital Financing Requirement (Excludes landfill provision)							
	2022/23 Actual £m	**2022/23 Original Estimate £m**	**2023/24 Estimate Month 4 £m**	**2024/25 Estimate £m**	**2025/26 Estimate £m**	**2026/27 Estimate £m**	**2027/28 Estimate £m**
General Fund	526	564	587	624	646	646	662
General Fund (Arena Affordability Envelope)	60	97	59	141	217	236	233
Housing Revenue Account	335	369	373	446	480	532	618
Total CFR	**921**	**1,030**	**1,019**	**1,211**	**1,343**	**1,414**	**1,473**
External Debt	**855**						
Over / (Under) Borrowing	**(66)**						

43. By comparing the CFR at 31 March 2023 (£921 million) and the level of external debt at the same point in time (£855 million), it can be seen that the Council is internally or under borrowed i.e. it is using some internal cash balances to finance its capital expenditure as at 31 March 2023 (£13 *million at 31 March 2022).*

Actual External Debt

44. The Code requires the Council to indicate its actual external debt at 31 March 2023 for information purposes. This was £855 million as shown in the earlier paragraphs.

Affordable Borrowing Limit

45. The Council has a statutory duty under section 3 of the Local Government Act 2003 and supporting regulations to determine and keep under review how much it can afford to borrow and to enter into credit arrangements (the “Affordable Borrowing Limit”). This cannot be breached without Council approval. Council must have regard to the Prudential Code when setting this limit which is intended to ensure that total capital investment remains within sustainable limits and that the impact upon future council tax/rent levels is affordable.

46. During 2022/23 the Council remained within the authorised limit of £1,457 million set for that year.

Operational Boundary

47. The operational boundary is the estimated level of external borrowing set at the start of the year and is subject to the level and timing of borrowing decisions during the year. The actual level of borrowing can therefore be below or above this initial estimate, but what cannot be breached is the affordable borrowing limit mentioned above. The boundary was estimated to be £1,030 million at 31 March 2023, to match the forecast for the CFR when setting the 2022/23 budget in March 2022.

Maturity Structure of Fixed Rate Borrowing

48. The maturity structure remains within the limits below approved as part of the 2021/22 strategy below. These limits are set to avoid having large amounts of debt maturing in a short space of time, thus being exposed to significant liquidity risk and interest rate risk.

	31-Mar-22			31-Mar-23			
		Loans to Maturity	Upper limit		Loans to Maturity	Loans if LOBO's Paid Early	
	%	£m	%	%	£m	%	£m
Under 12 months	2.66	22.8	10	0.51	4.4	3.32	28.4
12 months and within 24 months	0.53	4.5	10	0.51	4.4	0.51	4.4
24 months and within 5 years	2.13	18.2	15	3.45	29.5	6.61	56.5
5 years and within 10 years	8.95	76.6	20	11.74	100.4	11.74	100.4
10 years and within 20 years	20.40	174.5	30	20.40	174.4	18.99	162.4
20 years and within 30 years	20.66	176.8	35	21.38	182.8	21.38	182.8
30 years and within 40 years	25.47	217.9	35	25.05	214.2	25.05	214.2
40 years and within 50 years	18.62	159.3	35	16.37	140.0	12.40	106.0
50 years and within 60 years	0.58	5.0	15	0.59	5.0	0.00	0.0

49. The maturity profile of the Council's borrowing as at 31 March 2023 is also shown in a chart in **Annexe D**. In the medium to long term, efforts will be made to restructure loans maturing in 2056/57 and to review LOBO maturities in order to reduce refinancing risk.

Ratio of financing costs to net revenue stream

50. This indicator identifies the trend in the cost of capital financing, showing the percentage of the Council's revenue budget that is committed for this purpose. Financing costs include:

- interest payable on borrowing and receivable on treasury investments
- penalties or any benefits receivable on early repayment of debt
- prudent revenue budget provision for repayment of capital expenditure paid for by borrowing and
- re-imbursement of borrowing costs from directorates in respect of Invest to Save/Earn schemes.

51. For the General Fund, net revenue stream is the amount to be met from non-specific WG grants and Council Tax, whilst for the HRA it is the amount to be met from rent payers.

Ratio of financing costs to Net Revenue Stream							
	2022/23 Original Estimate %	**2022/23** Actual %	**2023/24** Estimate %	**2024/25** Estimate %	**2025/26** Estimate %	**2026/27** Estimate %	**2027/28** Estimate %
General Fund – **Net** Capital Financing Budget	4.58	4.05	4.26	4.48	4.75	5.00	5.15
General Fund – **Gross** Capital Financing Budget	6.90	6.09	6.64	7.38	8.44	8.90	9.02
HRA	32.16	29.29	28.97	30.66	32.84	34.34	36.57

52. Although there may be short term implications, invest to save/earn schemes are intended to be net neutral on the capital financing budget. However, there are risks that the level of income, savings or capital receipts anticipated from such schemes will be delayed or will not materialise. This would have a detrimental long-term consequence on the Revenue budget and requires careful monitoring when considering future levels of additional borrowing.

53. An increasing percentage indicates that a greater proportion of the budget is required for capital financing costs which are committed in the long term. The requirement to meet these additional costs can only come from future savings or from increases in Council Tax. An increasing ratio limits the scope for additional borrowing in future years and reduces the Council's overall flexibility when making decisions on the allocation of its revenue resources. The percentages consider the impact on the base budget of the level of savings having to be found in 2023/24 and over the medium term as set out in the budget report for 2023/24. They are based on future assumptions in respect to Aggregate External Financing, council tax income and housing rents at a point in time, so are

extremely variable as an indicator.

Principal Invested for over 364 days

54. An upper limit for principal invested over 364 days was set at £90 million and this was not breached during the year, primarily due to the strategy adopted of minimising the period for which investments were made during 2022/23

Resilience of the Treasury Management Function

55. The Treasury function performs a key role including ensuring that sufficient funds are available to meet the Council's financial commitments and is currently the payment mechanism of last resort for the Council. The CIPFA Treasury Management Code requires all organisations to have a formal and comprehensive knowledge and skills or training policy for the effective acquisition and retention of treasury management knowledge and skills for those responsible for management, delivery, governance and decision making. The Section 151 Officer and Head of Finance are responsible for ensuring that Treasury Management activities are resourced with relevant skills and experience, consistent with the complexity and size of the activity undertaken. The requirements to meet high standards, accuracy and governance requirements are significant for a small specialist team.

56. Treasury Management activities continue to be the subject of regulatory change and economic uncertainty. Changes in the profile of the Council's projected balance sheet, including an ambitious capital investment programme which increases the level of existing borrowing, will place the emphasis on ensuring borrowing at the most appropriate structure and timing to reduce risk to the council. The treasury team will need to consider focusing allocating resources towards short and long-term tactical borrowing decisions to manage the borrowing requirement and support minimisation of longer-term costs, whilst identifying and managing risk in a proportionate way. This will require the use of external services, where appropriate to provide the tools and / or expertise to support the implementation of the borrowing strategy and the risk management framework. This and some of the other issues and challenges outlined below continue to test skills and resilience, something that will need to continue to be monitored closely by the S151 Officer.

Treasury Management issues for 2023/24 and future years

57. Whilst this report is primarily backward looking in relation to Treasury Activities for 2022/23, some key issues for 2023/24 are:

- Encouraging a greater focus on predicting cash flow forecasts and encouraging the prompt collection of cash balances e.g submitting and following up grant claims, accurate forecasts of reserves and capital expenditure projections.
- Managing reducing cash balances and maintaining liquidity by seeking short term opportunities to manage the council's borrowing requirement in line with the 2023/24 strategy and interest rate forecasts.
- Ensuring compliance with HM Treasury revised lending policies and processes aimed to prevent borrowing undertaken to fund investment purely for financial gain. It should be noted that any such expenditure would preclude any borrowing from the PWLB.
- Updating the Treasury Management Strategy for the 2023/24 budget in line with any updates to the Capital Investment Programme forecasts and scheme delivery including the impact of borrowing requirements in respect to major regeneration projects.

58. In accordance with the Council's Treasury Management Policy, Council will receive a further update on Treasury Management issues as part of the 2023/24 Mid-Year Treasury Management report in November 2023.

Christopher Lee
Corporate Director Resources
26 October 2023

The following Annexes are attached:-
Annexe A – Treasury Management Policy and Four Clauses of Treasury Management
Annexe B – Investments at 31 March 2023 - Confidential
Annexe C – Investment charts at 31 March 2023 - Confidential
Annexe D – Maturity analysis of debt as at 31 March 2023
Annexe E – Glossary of Treasury Management terms