Appendix D

Treasury Management Outturn Report 2022/23

Introduction

In February 2012 the Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports.

The Authority's treasury management strategy for 2022/23 was approved at a meeting on 25th January 2022. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Authority's treasury management strategy.

The 2021 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 25th January 2022.

External Context

Economic background: The war in Ukraine continued to keep global inflation above central bank targets and the UK economic outlook remained relatively weak with the chance of a mild recession. The economic backdrop during the January to March period continued to be characterised by high energy and commodity prices, high inflation, and the associated impact on household budgets and spending.

Central Bank rhetoric and actions remained consistent with combatting inflation. The Bank of England, US Federal Reserve, and European Central Bank all increased interest rates over the period, even in the face of potential economic slowdowns in those regions.

Starting the financial year at 5.5%, the annual CPI measure of UK inflation rose strongly to hit 10.1% in July and then 11.1% in October. Inflation remained high in subsequent months but appeared to be past the peak, before unexpectedly rising again in February. Annual headline CPI registered 10.4% in February, up from 10.1% in January, with the largest upward contributions coming from food and housing. RPI followed a similar pattern during the year, hitting 14.2% in October. In February RPI measured 13.8%, up from 13.4% in the previous month.

Following the decision by the UK government under Rishi Sunak and Jeremy Hunt to reverse some of the support to household energy bills announced under Liz Truss, further support in the form of a cap on what energy suppliers could charge household was announced in the March Budget to run from April until end June 2023. Before the announcement, typical household bills had been due to rise to £3,000 a year from April.

The labour market remained tight albeit with some ongoing evidence of potential loosening at the end of the period. The unemployment rate 3mth/year eased from 3.8% April-June to 3.6% in the following quarter, before picking up again to 3.7% between October-December. The most recent information for the period December-February showed an unemployment rate of 3.7%.

The inactivity rate was 21.3% in the December-February quarter, slightly down from the 21.4% in the first quarter of the financial year. Nominal earnings were robust throughout the year, with earnings growth in December-February at as 5.7% for both total pay (including bonuses) and 6.5% for regular pay. Once adjusted for inflation, however, both measures were negative for that period and have been so throughout most of the year.

Despite household budgets remaining under pressure, consumer confidence rose to -36 in March, following readings of -38 and -45 in the previous two months, and much improved compared to the record-low of -49 in September. Quarterly GDP was soft through the year, registering a 0.1% gain in the April-June period, before contracting by (an upwardly revised) -0.1% in the subsequent quarter. For the October-December period was revised upwards to 0.1% (from 0.0%), illustrating a resilient but weak economic picture. The annual growth rate in Q4 was 0.6%.

The Bank of England increased the official Bank Rate to 4.25% during the financial year. From 0.75% in March 2022, the Monetary Policy Committee (MPC) pushed through rises at every subsequent meeting over the period, with recent hikes of 50bps in December and February and then 25bps in March, taking Bank Rate to 4.25%. March's rise was voted by a majority of 7-2, with two MPC members preferring to maintain Bank Rate at 4.0%. The Committee noted that inflationary pressures remain elevated with growth stronger than was expected in the February Monetary Policy Report. The February vote was also 7-2 in favour of a hike, and again with two members preferring to keep Bank Rate on hold.

After reaching 9.1% in June, annual US inflation slowed for eight consecutive months to 6% in February. The Federal Reserve continued raising interest rates over the period with consecutive increases at each Federal Open Market Committee meetings, taking policy rates to a range of 4.75%- 5.00% at the March meeting.

From the record-high of 10.6% in October, Eurozone CPI inflation fell steadily to 6.9% in March 2023. Energy prices fell, but upward pressure came from food, alcohol, and tobacco. The European Central Bank continued increasing interest rates over the period, pushing rates up by 0.50% in March, taking the deposit facility rate to 3.0% and the main refinancing rate to 3.5%.

Financial markets: Uncertainty continued to be a key driver of financial market sentiment and bond yields remained relatively volatile due to concerns over elevated inflation and higher interest rates, as well as the likelihood of the UK entering a recession and for how long the Bank of England would continue to tighten monetary policy. Towards the end of the period, fears around the health of the banking system following the collapse of Silicon Valley Bank in the US and purchase of Credit Suisse by UBS caused further volatility.

Over the period the 5-year UK benchmark gilt yield rose from 1.41% to peak at 4.70% in September before ending the financial year at 3.36%. Over the same timeframe the 10-year gilt yield rose from 1.61% to peak at 4.51% before falling back to 3.49%, while the 20-year yield rose from 1.82% to 4.96% and then declined to 3.82%. The Sterling Overnight Rate (SONIA) averaged 2.24% over the period.

Credit review: Early in the period, Moody's affirmed the long-term rating of Guildford BC but revised the outlook to negative. The agency also downgraded Warrington BC and Transport for London.

In July Fitch revised the outlook on Standard Chartered and Bank of Nova Scotia from negative to stable and in the same month Moody's revised the outlook on Bayerische Landesbank to positive. In September S&P revised the outlook on the Greater London Authority to stable from negative and Fitch revised the outlook on HSBC to stable from negative.

The following month Fitch revised the outlook on the UK sovereign to negative from stable. Moody's made the same revision to the UK sovereign, following swiftly after with a similar move for a number of local authorities and UK banks including Barclays Bank, National Westminster Bank (and related entities) and Santander.

During the last few months of the reporting period there were only a handful of credit changes by the rating agencies, then in March the collapse of Silicon Valley Bank (SVB) in the US quickly spilled over into worries of a wider banking crisis as Credit Suisse encountered further problems and was bought by UBS.

Credit Default Prices had been rising since the start of the period on the back of the invasion of Ukraine, and in the UK rose further in September/October at the time of the then-government's mini budget. After this, CDS prices had been falling, but the fallout from SVB caused a spike on the back of the heightened uncertainty. However, they had moderated somewhat by the end of the period as fears of contagion subsided, but many are still above their pre-March levels reflecting that some uncertainty remains.

On the back of this, Arlingclose reduced its recommended maximum duration limit for unsecured deposits for all UK and Non-UK banks/institutions on its counterparty list to 35 days as a precautionary measure. No changes were made to the names on the list.

As market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remains under constant review.

Local authorities remain under financial pressure, but Arlingclose continues to take a positive view of the sector, considering its credit strength to be high. Section 114 notices have been issued by only a handful of authorities with specific issues. While Arlingclose's advice for local authorities on its counterparty list remains unchanged, a degree caution is merited with certain authorities.

Local Context

On 31st March 2023, the Authority had net investments of £0.61m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.22 Actual £m
General Fund CFR	53.44
External borrowing	30.33
Internal (over) borrowing	23.11
Less: Balance Sheet Resources	54.05
Net investments	**30.94**

The Authority pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

The treasury management position at 31st March 2023 and the change during the year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.22 Balance £m	**Movement £m**	**31.3.23 Balance £m**	**31.3.23 Rate %**

Long-term borrowing	20.87	-0.54	20.33	2.00
Short-term borrowing	13.00	-3.0	10.00	0.10
Total borrowing	**33.87**	**-3.54**	**30.33**	**1.42**
Long-term investments	10.49	1.00	11.49	4.31
Short-term investments	10.00	8.00	18.00	3.09
Cash and cash equivalents	12.00	-10.55	1.45	4.10
Total investments	**32.49**	**-1.55**	**30.94**	**3.46**
Net investments	**-1.38**	**1.99**	**0.61**	

Borrowing Update

CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the Authority. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield unless these loans are for refinancing purposes.

The Authority is currently reviewing its capital programme in light of changes to the CIPFA Prudential Code and PWLB lending arrangements to ensure that borrowing to invest primarily for commercial return is no longer undertaken.

The Authority currently holds £59.3m in commercial investments that were purchased prior to the change in the CIPFA Prudential Code. Before undertaking further additional borrowing the Authority will review the options for exiting these investments.

Borrowing Strategy and Activity

As outlined in the treasury strategy, the Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing lower interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective. The Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio and, where practicable, to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

The cost of both long and short-term borrowing rose dramatically over the year, with rates at the end of March around 2% - 4% higher than those at the beginning of April. Rate rises have been driven primarily by inflation and the need for central banks to control this by raising interest rates. Particularly dramatic rises were seen in

September after Liz Truss' 'mini-budget' included unfunded tax cuts and additional borrowing to fund consumer energy price subsidies: over a twenty-four-hour period some PWLB rates increased to 6%. Rates have now fallen from September peaks but remain volatile and well above recent historical norms. The PWLB 10 year maturity certainty rate stood at 4.33% at 31st March 2023, 20 years at 4.70% and 30 years at 4.66%.

At 31st March 2023 the Authority held £30.33m of loans, a decrease of £3.54m since 31st March 2022, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 31st March are summarised in Table 3 below.

Table 3A: Borrowing Position

	31.3.22 Balance £m	**Net Movement £m**	**31.3.23 Balance £m**
Public Works Loan Board	20.87	-0.54	20.33
Local authorities (short-term)	13.00	-3.00	10.00
Total borrowing	**33.87**	**-3.54**	**30.33**

Table 3B: Long-dated Loans borrowed

Long-dated Loans borrowed	**Principal Amount £m**	**Rate %**	**Period (Years)**
PWLB Maturity Loan 1	11.00	2.35	40
PWLB Maturity Loan 2	3.00	2.47	40
PWLB EIP Loan 1	5.00	1.05	15
PWLB EIP Loan 2	3.00	1.80	15
Total borrowing	22.00	2.00	

The Authority's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short- and long-term borrowing was maintained.

Treasury Investment Activity

CIPFA published a revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes on 20th December 2021. These define treasury management investments as investments that arise from the organisation's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances ranged between £28.9 and £46.2 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.22 Principal Outstanding £m	**Net Movement £m**	**31.3.23 Principal Outstanding £m**
Banks & building societies (unsecured)	0.00	0.00	0.00
Government (incl. local authorities)	15.50	2.50	18.00
Money Market Funds	6.50	-5.05	1.45
Registered Providers	1.00	1.00	2.00
Real Estate Investment Trusts	0.50	0.00	0.50
Other Pooled Funds	8.99	0.00	8.99
Total investments	**32.49**	**-1.55**	**30.94**

Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

Bank Rate has increased from 0.75% at the beginning of the year to 4.25% at the end of March 2023. Short-dated cash rates, which had ranged between 0.7% - 1.5% at the beginning of April, rose by around 3.5% for overnight/7-day maturities and 3.3% for 6-12 month maturities.

By end March 2023, the rates on DMADF deposits ranged between 4.05% and 4.15%. The return on the Council's sterling Low Volatility Net Asset Value (LVNAV) Money Market Funds ranged between 0.9% - 1.1% p.a. in early April and between

3.8% and 3.9% at the end of March

Given the risk of short-term unsecured bank investments, the Authority has invested in alternative and/or higher yielding asset classes as shown in table 4 above. £9.49m that is available for longer-term investment invested in pooled property/equity/multi-asset funds. T*he Authority has maintained the amount invested in these funds over the past year.*

The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below.

Table 5: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	**Credit Rating**	**Bail-in Exposure**	**Weighted Average Maturity (days)**	**Rate of Return %**
31.03.2022	4.33	AA-	28%	128	1.61
31.03.2023	5.09	A+	7%	104	3.46
Similar LAs	4.52	A+	63%	56	3.55
All LAs	4.56	A+	59%	12	3.66

Externally Managed Pooled Funds: £9.49m of the Authority's investments is invested in externally managed strategic pooled equity, multi-asset, and property funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds generated an average total income return of 4.19%, providing a £398k income return which is used to support services in year.

For fixed income bond investors, 2022 was a very difficult year - bonds had their worst year of performance in several decades; long-term government bonds had their worst year ever as central banks delivered larger interest rates hikes than initially expected and promised more to combat inflation. As policy rates rapidly rose from very low levels, bond investors suffered large crystalised or unrealised losses from rising sovereign and corporate bond yields (i.e. falling prices) as well as from widening credit spreads as concern grew over the risk of defaults in a recessionary environment. The return on the All-Gilts index was -16.3% over the 12 months to March 2023. Negative yielding bonds all but disappeared globally.

UK and global equities remained volatile against a backdrop of high and sticky inflation, rapid policy rates tightening and an increasing risk of recession. There was a large sell-off in global equities in April, and again in June and September for both

UK and global equities. The total return on the FTSE All Share index for the 12 months ending March 2023 was 2.9% and 5.4% for the FTSE 100.

The negative correlation between bonds and equities, which had featured for some years, turned positive in 2022 as both bonds and equities sold off simultaneously against an outlook of sticky inflation and high interest rates. Simultaneously, tighter financial conditions, higher bond yields and challenges in some segments of commercial real estate (e.g. offices post-COVID, high street shops and shopping centres) saw commercial property values fall during 2022, with a large fall in the final calendar quarter.

Dividends continued to be received from the Authority's equity, multi-asset and property funds, the payout increasing for most funds in the portfolio.

The change in the Authority's funds' capital values and income earned over the 12-month period is shown in Table 4.

Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's medium- to long-term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns should exceed cash interest rates.

The Authority had budgeted £415k income from these investments in 2022/23. Income received was £324k, whist a further £74k has been declared and is due to be paid by April/May.

The DLUHC published a consultation on the IFRS 9 pooled investment fund statutory override for English authorities for fair value gains and losses on pooled investment funds which was due to expire with effect from 2023/24. The options under evaluation were to allow the override to lapse, to extend it, or to make it permanent. The override will be extended for two years and therefore remain in place for the 2023/24 and 2024/25 financial years. Under the Regulations, gains and losses resulting from unrealised fair value movements relating to treasury pooled investment funds, that otherwise must be recognised in profit or loss under IFRS 9, are not charges to the revenue account, and must be taken into an unusable reserve account.

Non-Treasury Investments

The definition of investments in CIPFA's revised 2021 Treasury Management Code covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).

*I*nvestment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) and Welsh Government also broadens the definition of investments to include all such assets held partially or wholly for financial return.

The Authority also held £59.3m of such investments in directly owned property as shown in the table below:

Property	Purchase date	Purchase Price	Sector
Challenge House, Tewkesbury	Dec-16	£9,083,736	Office
Challenge House, Tewkesbury	Dec-16	£6,055,024	Industrial
Retail units, Clevedon	Jul-06	£2,299,110	Retail
The Chase, Hertford	Nov-17	£3,937,861	Office
SPL House, Ellesmere Port	Nov-17	£3,770,482	Industrial
Wickes, Trowbridge	Dec-17	£5,929,910	Retail
Edmund House, Leamington	Aug-18	£3,862,877	Office
M&S, Walton on the Naze	Oct-18	£4,653,141	Retail
Vaughan Park, Tipton	May-20	£9,688,943	Industrial
Volvo, Crawley	Dec-20	£10,050,365	Alternatives
Total		**£59,333,248**	

These investments generated £3.05m of investment income for the Authority after taking account of direct costs, representing a rate of return of 5.14%.

Treasury Performance

The Authority measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 6 below.

Table 6: Performance

	Actual £	Budget £	Over/ Under £
Treasury Investments	933k	439k	494k
Borrowing	449k	467k	18k
GRAND TOTAL	**483k**	**-28k**	**511k**

Compliance

The Chief Finance Officer reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 7 below.

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 7 below.

Table 7: Debt Limits

	H1 Maximum	30.9.22 Actual	2022/23 Operational Boundary	2022/23 Authorised Limit	Complied? Yes/No
Borrowing	£33.87m	£30.6m	£40.0m	£50.0m	Yes
Total debt	**£33.87m**	**£30.6m**	**£40.0m**	**£50.0m**	**Yes**

Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

Table 8: Investment Limits

	2022/23 Maximum	31.3.23 Actual	2022/23 Limit	Complie Yes/N
Local authorities & other government entities	£2.0m	£2.0m	£2.0m	Yes
Secured investments	£0.0m	£0.0m	£2.0m	Yes
Banks (unsecured)	£2.0m	£2.0m	£2.0m	Yes
Building societies (unsecured)	£0.0m	£0.0m	£1.0m	Yes
Registered providers (unsecured)	£2.0m	£1.0m	£2.0m	Yes
Money market funds	£2.0m	£2.0m	£2.0m	Yes
Strategic pooled funds	£3.93m	£3.93m	£4.0m	Yes
Real estate investment trusts	£0.5m	£0.5m	£2.0m	Yes
Any group of pooled funds under the same management (limits per manager)	£3.93m	£3.93m	£5.0m	Yes
Negotiable instruments held in a broker's nominee account (limits per broker)	£0.0m	£0.0m	£5.0m	Yes
Foreign countries (limits per country)	£2.0m	£2.0m	£2.0m	Yes

Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	30.9.22 Actual	2022/23 Target	Complied?
Portfolio average credit rating	A+	A	Yes

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	31.3.23 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	33.0%	100%	0%	Yes
12 months and within 24 months	0.0%	100%	0%	Yes
24 months and within 5 years	0.0%	100%	0%	Yes

5 years and within 10 years	0.0%	100%	0%	Yes
10 years and above	67.0%	100%	0%	Yes

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment..

Principal Sums Invested for Periods Longer than a year: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2022/23	**2023/24**	**2024/25**
Actual principal invested beyond year end	£11.5m	£11.5m	£9.5m
Limit on principal invested beyond year end	£14m	£13m	£12m
Complied?	Yes	Yes	Yes