Appendix 1 - Treasury Management Outturn Report 2022/23

1. Introduction

1.1. The Council has 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 Council to approve treasury management semi-annual and annual reports.

1.2. The Council's treasury management strategy for 2022/23 was approved at a full Council meeting on 1 March 2022. The Council 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 Council's treasury management strategy.

2. External Context (provided by the Council's treasury management advisor, Arlingclose)

Economic background

2.1. The ongoing conflict in Ukraine continued to keep global inflation above central bank targets and the economic outlook for the UK 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.

2.2. Central bank rhetoric and actions remained consistent in combating inflation. During the period, the Bank of England, US Federal Reserve, and European Central Bank all increased interest rates, even in the face of potential economic slowdowns in their respective regions.

2.3. The annual Consumer Prince Index (CPI) measure of UK rose sharply during the financial year, reaching a high of 11.1% in October 2022. The largest upward contributions came from food and housing. The table below shows an extract of the reported CPI inflation throughout the financial year.

	Jun-23	Sep-23	Dec-23	Mar-23
CPI Inflation	9.4%	10.1%	10.5%	10.1%

2.4. In March 2023, the UK government announced further support for household energy bills by placing a cap on what energy suppliers could charge. This was in response to the decision to reverse some of the support previously announced under Liz Truss' leadership, by Rishi Sunak led UK government. The cap, which lasts until the end of June 2023, was announced just in time to prevent typical household bills from rising to £3,000 a year from April 2023.

2.5. The labour market remained tight, although there was some ongoing evidence of potential loosening at the end of the period. The table below shows an extract of the reported annual unemployment rate throughout the financial year.

	Jun-23	Sep-23	Dec-23	Mar-23
Unemployment rate	3.8%	3.6%	3.7%	3.9%

2.6. Nominal earnings were strong throughout the year, with earnings growth in December 2022 to February 2023 at 5.7% for both total pay (including bonuses) and 6.5% for regular pay. However, once adjusted for inflation, both measures were negative for that period and have remained so throughout most of the year.

2.7. Although household budgets remain under pressure, consumer confidence increased in March 2023. Quarterly Gross Domestic Product (GDP) was soft throughout the year, illustrating a resilient but weak economic picture. The annual growth rate in Q4 2022 was 0.6%.

2.8. The Monetary Policy Committee (MPC) implemented rises at every subsequent meeting over the period, with recent hikes of 50bps in December and February, followed by a 25bps increase in March, taking the Bank Rate to 4.25%. The table below shows an extract of the Bank of England's Bank Rates throughout the financial year.

	Jun-23	**Sep-23**	**Dec-23**	**Mar-23**	**Current Rate**
BoE Bank Rate	1.25%	1.75%	3.5%	4.25%	5.00%

2.9. The Monetary Policy Committee (MPC) implemented rises at every subsequent meeting over the period, with recent hikes of 50bps in December and February, followed by a 0.25% increase in March, taking the Bank Rate to 4.25%.

2.10. In May 2023, the MPC voted by a majority of 7-2 to increase the Bank Rate by 0.25% with two MPC members preferring to maintain the Bank Rate at 4.25%. The Committee noted that inflationary pressures remain elevated, and growth is stronger than expected in the May Monetary Policy Report.

2.11. After reaching 9.1% in June, annual US inflation has slowed for eight consecutive months and reached 6% in February. During this period, the Federal Reserve increased interest rates at each Federal Open Market Committee meeting, ultimately bringing policy rates to a range of 4.75% - 5.00% at the March meeting.

2.12. The Eurozone's CPI inflation has decreased steadily from its record high of 10.6% in October to 6.9% in March 2023. Although energy prices have fallen, upward pressure came from food, alcohol, and tobacco. During this period, the European Central Bank continued to increase interest rates, raising rates by 0.50% in March. As a result, the deposit facility rate increased to 3.0% and the main refinancing rate increased to 3.5%.

Financial markets

2.13. Uncertainty continued to drive financial market sentiment, with bond yields remaining relatively volatile due to concerns about elevated inflation and higher interest rates. There were also worries about the likelihood of the UK entering a recession and how long the Bank of England would continue to tighten monetary policy. Towards the end of the period, fears about the health of the banking system increased following the collapse of Silicon Valley Bank in the US and the purchase of Credit Suisse by UBS, causing further volatility in financial markets.

2.14. During the period, benchmark gilt yields in the UK increased significantly. The table below shows the movement of the major benchmark gilt yields throughout the period.

Benchmark Gilt Yield	**Apr-22**	**Jun-22**	**Sep-22**	**Dec-22**	**Mar-23**
5 year	1.41%	1.89%	4.70%	3.62%	3.36%
10 year	1.61%	2.35%	4.51%	3.67%	3.49%
20 year	1.82%	2.60%	4.86%	4.03%	3.82%

2.15. The Sterling Overnight Index Average Rate (SONIA) averaged 2.24%

Credit review

2.16. In October 2022, Fitch revised the outlook on the UK sovereign from stable to negative. Moody's made the same revision to the UK sovereign, and swifty followed up with a similar move for a number of local authorities and UK banks, including Barclays Bank, National Westminster Bank (and related entities), and Santander.

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

2.18. Credit default prices had been rising since the beginning of the period due to the invasion of Ukraine. In the UK, prices rose even further in September/October, coinciding with the then-government's mini budget. Although CDS prices had been falling after this, the fallout from SVB caused a spike due to heightened uncertainty. By the end of the period, prices had moderated somewhat as fears of contagion subsided, but many remained above their pre-March 2022 levels, reflecting ongoing uncertainty.

2.19. As a precautionary measure, Arlingclose has reduced its recommended maximum duration limit for unsecured deposits from all UK and Non-UK banks/institutions on its counterparty list to 35 days. However, no changes have been made to the names on the list.

2.20. As market volatility is expected to remain a feature in the near term, the institutions and durations on the Council's counterparty list recommended by Arlingclose are constantly under review.

2.21. Local authorities are still facing financial pressures, but Arlingclose maintains a positive view of the sector and considers their credit strength to be high. Only a handful of authorities with specific issues have issued Section 114 notices. While Arlingclose's advice for local authorities on its counterparty list remains unchanged, a degree of caution is warranted with certain authorities.

3. Local Context

3.1. On 31 March 2023, the Council had net borrowing of £783.3m arising from its revenue and capital income and expenditure. The Capital Financing Requirement (CFR) measures the underlying need to borrow for capital purposes. A breakdown of the CFR is summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.03.22 Actual £m	31.03.23 Actual £m
General Fund CFR	567.9	720.4
HRA CFR	404.6	471.1
Total CFR[1]	**972.5**	**1,191.5**
Less: Other debt liabilities[2]	(26.8)	(22.0)
Borrowing CFR - comprised of:	**945.7**	**1,169.5**
External borrowing	700.4	783.3
Internal borrowing	274.1	386.2

[1]subject to audit
[2]finance leases, PFI liabilities and transferred debt that form part of the Council's total debt

3.2. The Council continued to pursue its long-standing strategy of keeping borrowing and investments below their underlying levels, also known as internal borrowing, in order to reduce risk and keep interest costs low.

3.3. The treasury management position on 31 March 2023 and the change over the year is shown in Table 2 on the next page.

Table 2: Treasury Management Summary

Type of Borrowing/Investment	31.03.22 Balance £m	Movement £m	31.03.23 Balance £m	31.03.23 Weighted Av. Rate %
Long-term borrowing	600.4	117.9	718.3	3.02%
Short-term borrowing	100.0	(35.0)	65.0	3.16%
Total borrowing	**700.4**	**82.9**	**783.5**	**3.03%**
Short-term investment	5.0	10.0	15.0	3.46%
Cash and cash equivalents	66.2	12.7	78.9	4.05%
Total investments	**71.2**	**22.7**	**93.9**	**3.96%**
Net borrowing	**629.2**	**60.2**	**689.4**	

4. Borrowing Activity

4.1. CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial returns. It is not prudent for local authorities to make investment or spending decisions that will increase the capital financing requirement which may result in new borrowing unless they are directly and primarily related to the functions of the local authority. Local authorities can no longer secure PWLB loans to purchase investment assets primarily for yield unless these loans are for refinancing purposes.

Borrowing strategy during the period

4.2. As outlined in the treasury strategy, the Council's primary objective when borrowing is to strike an appropriately low-risk balance between securing lower interest costs and achieving cost certainty over the required period, with the secondary objective of flexibility to renegotiate loans should the Council's long-term plans change. The Council's borrowing strategy continues to address the key issue of affordability without compromising the long-term stability of the debt portfolio. Where feasible, the strategy aims to maintain borrowing and investments below their underlying levels, which is sometimes referred to as internal borrowing.

4.3. The cost of both long and short-term borrowing increased significantly over the year, with rates at the end of March 2023 being around 2%-4% higher than those at the start of the financial year. Rate increases have been driven primarily by inflation, and the need for central banks to control it by raising interest rates. In September 2022, there were particularly dramatic rate increases after the UK government under Liz Truss announced several unfunded tax cuts and additional borrowing to fund consumer energy price subsidies as part of the "mini budget". Over a 24-hour period, the rates offered on some Public Works Loan Board (PWLB) loans increased to as much as 6%. At the time of writing, rates had fallen from the September peaks but remained volatile and well above recent historical norms for the remainder of the financial year.

4.4. The table below shows the increase in rates offered across the various PWLB maturities on 31 March 2023. The rates shown are included the 0.20% certainty discount rate offered by the PWLB to qualifying authorities.

PWLB Maturity	Apr-22	Mar-23
10 year	2.49%	4.33%
20 year	2.67%	4.70%
30 year	2.59%	4.66%

4.5. On 15 March 2023, a new HRA PWLB rate was announced. This rate will offer a further 0.40% discount to the currently available certainty rate. This discounted rate is intended to support local authorities in borrowing for Housing Revenue Accounts and the delivery of social housing. The discounted rate is available from June 2023 for a minimum of one year.

4.6. As part of its strategy for funding previous and current years' capital programmes, the Council held £783.3 million in loans on 31 March 2023, an increase of £82.1 million compared to 31 March 2022. The outstanding loans on 31 March are summarised in Table 3 below.

Table 3: Borrowing Position

Type of Borrowing	31.03.22 Balance £m	Net Movement £m	31.03.23 Balance £m	31.03.23 Weighted Ave. Rate %	31.03.23 Weighted Ave. Maturity years
Public Works Loan Board	475.4	117.9	593.3	2.67%	25.9
Banks (LOBO)	125.0	0.0	125.0	4.72%	37.2
Local authorities	100.0	(35.0)	65.0	3.16%	0.4
Total borrowing	**700.4**	**82.9**	**783.3**	**3.03%**	**25.6**

4.7. In keeping with the Council's treasury management strategy, £130m of new long-term borrowing was undertaken during the period. This amount was reduced by £12.1m in repayments on existing loans which were allowed to mature without immediate replacement.

4.8. The Council has a significant capital program that extends into the foreseeable future. A large proportion of this program will be financed by borrowing, which the Council will have to undertake during the current and upcoming years.

4.9. The Council's borrowing decisions are not based on any single outcome for interest rates, and it maintains a balanced portfolio of short and long-term borrowing.

LOBO Loans

4.10. The Council continues to hold £125m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during the year.

5. Treasury Investment Activity

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

5.2. The Council holds significant invested funds, which represent income received in advance of expenditure, as well as balances and reserves. Throughout the year, the Council's investment balances ranged between £93.3m and £38.0 million due to timing differences between income and expenditure. The investment position on 31 March 2023 is shown in Table 5 on the following page.

Table 4: Treasury Investment Position

Type of Investment	31.03.22 Balance £m	Net Movement £m	31.03.23 Balance £m	31.03.23 Weighted Ave. Rate %	31.03.23 Weighted Ave. Maturity days
Debt Management Office	66.2	27.7	93.9	3.96%	10
Local authorities	5.0	(5.0)	-	-	0
Total borrowing	**71.2**	**22.7**	**93.9**	**3.96%**	10

5.3. Both the CIPFA Code and government guidance require the Council to invest its funds prudently, taking into account the security and liquidity of its treasury investments before seeking the optimum rate of return or yield. The Council aims to strike an appropriate balance between risk and return when making treasury investments, while minimising the risk of incurring losses from defaults and receiving unsuitably low investment income.

5.4. The Bank of England's Bank Rate has increased from 0.75% at the beginning of the financial year to 4.25% at the end of March 2023. Short-date cash rates, which had ranged between 0.70% - 1.50% at the beginning of April 2022, rose by around 3.50% for overnight/7-day maturities and 3.30% for 6–12-month maturities.

5.5. At the end of March 2023, the Debt Management Account Deposit Facility's (DMADF) deposit rates ranged between 4.05% and 4.15%. The sterling Low Volatility Net Asset Value (LVNAV) Money Market Funds offered a return ranging from 0.9% to 1.1% p.a. in early April 2022, increasing to 3.8% and 3.9% by the end of March.

5.6. 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 Ave. Maturity (Days)	Rate of Return
31.03.2022	4.46	AA-	44%	110	0.06%
31.12.2023	3.67	AA-	38%	10	3.96%
Similar Local Authorities	4.71	A+	64%	32	3.81%
All Local Authorities	4.71	A+	60%	12	3.67%

Scoring:
AAA = highest credit quality = 1; D = lowest credit quality = 26
Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

6. Treasury Performance

6.1. The Council measures the financial performance of its treasury management activities in terms of its impact on revenue budget as shown in Table 6 below.

Table 6: Treasury Performance

	Actual £m	Budget £m	Over/under £m
General Fund borrowing	8.6	11.3	(2.7)
HRA borrowing	13.6	14.9	(1.3)
Total borrowing	**22.2**	**26.2**	**(4.0)**
Total treasury investments	**1.4**	**0.1**	**1.3**

6.2. The budget for treasury investment income for 2022/23 was set at £75k, based on a treasury investment portfolio of £15m at an interest rate of 0.50%. However, over the course of the year, treasury investments generated an average rate of return of 2.05% with an average investment portfolio balance of £73.9m. This was largely due to the Bank of England increasing the base rate during the year, as well as the Council holding larger cash balances as a result of new long-term borrowing and receiving larger than expected government grants.

7. Non-Treasury Investments

7.1. The definition of investments in CIPFA's revised 2021 Treasury Management Code includes all the financial assets of the local authority, as well as other non-financial assets that the local 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 or (made explicitly to further service objectives) or for commercial purposes (made primarily for financial return).

7.2. The Investment Guidance, issued by the Department for Levelling Up Housing and Communities (DLUHC) and Welsh Government, broadens the definition of investments to include all assets held partially or wholly for financial return.

8. Compliance

8.1. The Chief Finance Officer reports that all treasury management activities carried out during the year complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

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

Table 7: Debt Limits

	31.03.23 Actual £m	2022/23 Operational Boundary £m	2022/23 Authorised Limit £m	Complied?
Borrowing	783.3	1,236.0	1,286.0	Yes
PFI and Finance Leases	23.4	23.4	25.7	Yes
Total debt	**806.9**	**1,259.4**	**1,311.7**	**Yes**

8.3. The operational boundary is a management tool for in-year monitoring. Therefore, it is not significant if the operational boundary is breached on occasion due to variations in cash flow, and this is not considered a compliance failure. However, the council's debt remained well below this limit throughout the entire financial year.

9. Treasury Management Indicators

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

Security

9.2. The Council has adopted a voluntary measure to assess its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. To calculate this score, a value is assigned to each investment based on its credit rating (AAA=1, AA+=2, etc.), and the arithmetic average is taken, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	31.03.23 Actual	2022/23 Target	Complied?
Portfolio average credit score	3.67 (AA-)	7.0 (A-)	Yes

Liquidity

9.3. The Council has adopted a voluntary measure to monitor its exposure to liquidity risk. This is done by tracking the amount of cash available to meet unexpected payments over a rolling three-month period, without borrowing additional funds.

	31.03.23 Actual	2022/23 Target	Complied?
Total cash available within 3 months	88.9	10.0	Yes

Interest Rate Exposures

9.4. This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

	31.03.23 Actual	2022/23 Target	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	£0.3m	£1m	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	£0.3m	£1m	Yes

9.5. The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at current rates.

Maturity Structure of Borrowing

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

	31.03.23 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	15.7%	50%	0%	Yes
12 months and within 24 months	5.6%	40%	0%	Yes
24 months and within 5 years	4.3%	40%	0%	Yes
5 years and within 10 years	6.8%	40%	0%	Yes
10 years and within 20 years	12.5%	40%	0%	Yes
20 years and within 30 years	5.8%	40%	0%	Yes
30 years and with 40 years	19.2%	50%	0%	Yes
40 years and within 50 years	30.0%	50%	0%	Yes
50 years and above	0.0%	40%	0%	Yes

9.7. 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.

9.8. In the past, the Council has extensively used short-term borrowing (less than 1 year in duration) from other local authorities as an alternative to longer-term borrowing from the PWLB. This was due to lower interest rates at the time, resulting in revenue savings.

9.9. However, short-term borrowing exposes the Council to refinancing risk. This is the risk that rates will rise quickly over a short period of time, and will be at significantly higher rates when loans mature and new borrowing is required. With this in mind, the Council has set a limit on the total amount of short-term local authority borrowing as a proportion of all borrowing.

	31.03.23 Actual	2022/23 Target	Complied?
Upper limit on short-term borrowing from other local authorities as a percentage of total borrowing	8.3%	30%	Yes

Principal Sums Invested for Periods Longer than a year

9.10. The purpose of this indicator is to control the Council'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	nil	nil	nil
Limit on principal invested beyond year end	£10m	£10m	£10m
Complied?	**Yes**	**Yes**	**Yes**