MEETING:	**GOVERNANCE AND AUDIT COMMITTEE**
DATE:	**7 SEPTEMBER 2023**
TITLE:	**TREASURY MANAGEMENT 2022/23**
PURPOSE:	**CIPFA's Code of Practice requires that a report on the results of the Council's actual treasury management is produced.**
RECOMMENDATION:	**RECEIVE THE REPORT FOR INFORMATION**
AUTHOR:	**DELYTH JONES-THOMAS, INVESTMENT MANAGER**

Executive Summary

During the 2022/23 financial year the Council's treasury management activity remained within the limits originally set and total interest received on deposits was £1.8m which was above the budgeted level of £0.4m. There were no defaults by institutions in which the Council had deposited money.

1. Introduction

The Council's Treasury Management Strategy for 2022/23 was approved at Full Council on 3rd 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 are therefore central to the Council's Treasury Management Strategy.

This report compares the actual performance against the strategy for the financial year 2022/23 and fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the Welsh Government's Investment Guidance.

2. 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 households was announced in the March Budget to run from April until end of 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.

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%.

3. Year End Position

Balance Sheet Summary

At 31 March 2023 the Council had net investments of £50m arising from its revenue and capital activities. 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. The movements are summarised in the following table:

	31.3.22 Actual £m	2022/23 Movement £m	31.3.23 Actual £m
CFR	169	2	171
Less: Other debt liabilities	(1)	0	(1)
Borrowing CFR	**168**	**2**	**170**
Less: Usable reserves	(143)	9	(134)
Less: Working capital	(18)	(68)	(86)
Net borrowing/ (investment)	**7**	**(57)**	**(50)**

The Council 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.

Treasury Management Summary

	31.3.22 Balance £m	Movement £m	31.3.23 Balance £m
Long- term borrowing	101.8	(0.9)	100.9
Short-term borrowing	1.6	(0.5)	1.1
PFI	1.4	(0.2)	1.2
Total borrowing	**104.8**	**(1.6)**	**103.2**
Short-term investments	(79.8)	(10.1)	(89.9)
Cash and cash equivalents	(18.1)	(44.7)	(62.8)
Total investments	**(97.9)**	**(54.8)**	**(152.7)**
Net borrowing/ (investment)	**6.9**	**(56.4)**	**(49.5)**

4. Borrowing Activity

At 31st March 2023, the Council held £102.0m of loans, a decrease of £1.4m on the previous year, as part of its strategy for funding previous years capital programmes.

The debt interest paid in 2022/23 was £5.6 million on an average debt portfolio of £101.5 million at an average interest rate of 5.47%.

The year-end borrowing position and the year-on-year change is summarised in the following table:

	31.3.22 Balance £m	2022/23 Movement £m	31.3.23 Balance £m	31.3.23 Rate %	31.3.23 WAM* years
PWLB	85.6	(1.3)	84.3	5.71	17.48
Bank (Fixed term)	16.2	0.0	16.2	4.22	55.36
Other	1.6	(0.1)	1.5	0.0	3.38
Total borrowing	**103.4**	**(1.4)**	**102.0**		

*Weighted average maturity

The Council's main objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with a 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 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%.

No new long-term borrowing was undertaken in 2022/23, with existing loans maturing without replacement. This strategy enabled the Council to reduce net borrowing costs (despite foregoing investment income) and reduce overall treasury risk.

5. Treasury Investment Activity

CIPFA published a revised Treasury Management in the Public Services Code of Practices and Cross- Sectoral Guidance Notes on 20th December 2021. These define treasury management 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 Council has held significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Council's investment balances have ranged between £82.3 million and £170.8 million.

Treasury Investment Position

	31.3.22 Balance £m	2022/23 Movement £m	31.3.23 Balance £m	31.3.23 Rate %	31.3.23 WAM* days
Banks & building societies (unsecured)	23.1	6.0	29.1	3.83	51.4
Local Authorities	30.0	(9.9)	20.1	3.91	78.0
Money Market Funds	17.0	43.8	60.8	4.08	1.0
Debt Management Office	18.0	16.0	34.0	4.09	51.3
Pooled Funds	9.8	(1.1)	8.7	4.60	365+
Total investments	**97.9**	**54.8**	**152.7**		

*Weighted average maturity

Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return or yield. The Council'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 of March 2023, the rates on DMADF deposits ranged between 4.05% and 4.15%. The return on the Council's Money Market Funds ranged between 0.57%-0.61% in early April and between 4.04% - 4.08% at the end of March.

£8.7m of the Council's investments are held in externally managed strategic pooled equity and property funds where short term liquidity are lesser considerations, and the objectives instead are regular revenue income and long- term price stability. These funds generated an income return of 4.6% and an unrealised capital loss of £1.1m in this financial year.

UK and global equities remained volatile against a backdrop of high and 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 Council's funds, the payout increasing for most funds in the portfolio.

Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued stability in meeting the Council'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 with exceed cash interest.

Investment Benchmarking

	Credit Score	**Credit Rating**	**Bail-in Exposure**	**WAM* (days)**	**Income Rate of Return**
31.03.2022	4.82	A+	54%	31	0.62%
31.03.2023	**4.63**	**A+**	**62%**	**33**	**4.04%**
Similar LAs	**4.41**	**AA-**	**25%**	**96**	**3.78%**
All LAs	**4.71**	**A+**	**59%**	**12**	**3.66%**

*Weighted average maturity

6. Compliance Report

The section 151 officer reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practic and the Council's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in the following tables:

Debt Limits

	2022/23 Maximum	**31.3.23 Actual**	**2022/23 Operational Boundary**	**2022/23 Authorised Limit**	**Complied**
Borrowing	£103.4m	£102.0m	£190m	£200m	✓

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.

Investment Limits

	2022/23 Maximum	31.3.23 Actual	2022/23 Limit	Complied
The UK Government	£61.1m	£34m	Unlimited	✓
Local authorities & other government entities	£5m	£5m	£10m	✓
Secured investments	£0m	£0m	£10m	✓
Banks (unsecured)	£5m	£5m	£5m	✓
Building societies (unsecured)	£5m	£5m	£5m	✓
Registered providers (unsecured)	£0m	£0m	£5m	✓
Money Market Funds	£10m	£10m	£10m	✓
Strategic pooled funds	£5m	£5m	£10m	✓
Real estate investment trusts	£0m	£0m	£10m	✓
Other investments	£0m	£0m	£5m	✓

7. Treasury Management Indicators

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

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the time-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment and taking the arithmetic average, weighted by the length of each investment. Unrated investments are assigned a score based on their perceived risk.

	31.3.23 Actual	2022/23 Target	Complied
Portfolio average credit score	4.63	A score of 6 or lower	✓

Liquidity: The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

	31.3.23 Actual	2022/23 Target	Complied
Total cash available within 3 months	£133.8m	£10m	✓

Interest Rate Exposures: 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 interest rates was:

	31.3.23 Actual	2022/23 Limit	Complied
Upper limit on one year revenue impact of a 1% rise in interest rates	£1,255,000	£643,000	x
Upper limit on one year revenue impact of a 1% fall in interest rates	£1,255,000	£643,000	x

This indicator has not been complied with because the indicator was set when interest rates were low, but interest levels have risen significantly in the year without warning and therefore it is reasonable that the amounts are above the limit.

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

	31.3.23 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	1.1%	25%	0%	✓
12 months and within 24 months	6.7%	25%	0%	✓
24 months and within 5 years	9.6%	50%	0%	✓
5 years and within 10 years	9.2%	75%	0%	✓
10 years and above	73.4%	100%	0%	✓

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 364 days: 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	£10m	£0	£0
Limit on principal invested beyond year end	£20m	£20m	£20m
Complied	✓	✓	✓