ITEM NO	

REPORT TO EXECUTIVE

DATE	12th July 2023
PORTFOLIO	Resources and Performance Management
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Annual Treasury Management Report
Review of 2022/23 Activity

PURPOSE

1. To inform members of the Council's treasury management activity during 2022/23.

RECOMMENDATION

2. That the Executive recommends that Full Council note the annual treasury management activity for the year ended 31 March 2023.

REASONS FOR RECOMMENDATION

3. To comply with the regulations issued under the Local Government Act 2003 to produce an annual treasury management report containing a review of activities and the actual prudential and treasury indicators for 2022/23. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code). Performance against the approved prudential and treasury indicators are shown in Appendix 1.

During 2022/23 the minimum reporting requirements were that Full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Full Council, 23rd February 2022)
- a mid-year treasury update report (Full Council, 7th December 2022)
- an annual review following the end of the year describing the activity compared to the strategy (this report).

The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. This report is therefore important, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by Members.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Scrutiny Committee before they were reported to Full Council. Member training on treasury management issues was undertaken during the year on 25th November 2022 in order to support Members' scrutiny role.

SUMMARY OF KEY POINTS

4. **The Economy and Interest Rates (Provided by Link Asset Services)**

UK. Economy.

Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022/23.

Market commentators' misplaced optimism around inflation has been the root cause of the rout in the bond markets with, for example, UK, EZ and US 10-year yields all rising by over 200bps in 2022. Elevated inflation but extra-ordinarily tight labour markets are a conundrum facing central banks, making it an issue of fine judgment as to how far monetary policy (i.e., control of Bank Rate and/or quantitative easing measures) needs to tighten.

Q2 of 2022 saw UK GDP deliver growth of +0.1% q/q, but this was quickly reversed in the third quarter, albeit some of the fall in GDP can be placed at the foot of the extra Bank Holiday in the wake of the Queen's passing. Q4 GDP was positive at 0.1% q/q. Most recently, January saw a 0.3% m/m increase in GDP as the number of strikes reduced compared to December. In addition, the resilience in activity at the end of 2022 was, in part, due to a 1.3% q/q rise in real household disposable incomes. A big part of that reflected the £5.7bn payments received by households from the government under the Energy Bills Support Scheme.

Nevertheless, CPI inflation 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. On balance, most commentators expect the CPI measure of inflation to drop back towards 4% by the end of 2023. As of February 2023, CPI was 10.4%.

The UK unemployment rate fell through 2022 to a 48-year low of 3.6%, and this despite a net migration increase of c500k. The fact remains, however, that with many economic participants registered as long-term sick, the UK labour force shrunk by c500k in the year to June. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity, and with average wage increases running at over 6% the MPC will be concerned that wage inflation will prove just as sticky 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 on 22nd February 2022.

Bank Rate increased steadily throughout 2022/23, starting at 0.75% and finishing at 4.25%.

In the interim, following a Conservative Party leadership contest, Liz Truss became Prime Minister for a short period that ran through September and October 2022. Put simply, the markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng, and their reign lasted barely seven weeks before being replaced by Prime Minister Rishi Sunak and Chancellor Jeremy Hunt. Their Autumn Statement of the 17th of November gave rise to a net £55bn fiscal tightening, although much of the "heavy lifting" has been left for the next Parliament to deliver. However, the markets liked what they heard, and UK gilt yields have reversed the increases seen under the previous tenants of No10/11 Downing Street, although they remain elevated in line with developed economies generally.

As noted above, GDP has been tepid throughout 2022/23, although the most recent composite Purchasing Manager Indices for the UK, US, EZ and China have all surprised to the upside, registering survey scores just above 50 (below suggests economies are contracting, and above suggests expansion). Whether that means a shallow recession, or worse, will be avoided is still unclear. Ultimately, the MPC will want to see material evidence of a reduction in inflationary pressures and a loosening in labour markets. Realistically, that is an unlikely outcome without unemployment rising and wage settlements falling from their current levels. At present, the bigger rise in employment kept the ILO unemployment rate unchanged at 3.7% in January. Also, while the number of job vacancies fell for the ninth consecutive month in February, they remained around 40% above pre-pandemic levels.

Link's economic analysts, Capital Economics, expect real GDP to contract by around 0.2% q/q in Q1 2023/24 and forecast a recession this year involving a 1.0% peak-to-trough fall in real GDP.

The £ has remained resilient of late, recovering from a record low of $1.035, on the Monday following the Truss government's "fiscal event", to $1.23. Notwithstanding the £'s better run of late, 2023 is likely to see a housing correction of some magnitude as fixed-rate mortgages have moved above 4.5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.

As for equity markets, the FTSE 100 started 2023 strongly, rising to a record high of 8,014 on 20th February, as resilient data and falling inflation boosted earnings. But global equities fell sharply after concerns over the health of the global banking system emerged early in March. The fall in the FTSE 100 was bigger than the drop in the US S&P 500. Indeed, at around 7,600 now, the FTSE is 5.2% below its record high on 20th February, while the S&P 500 is only 1.9% lower over the same period. That's despite UK banks having been less exposed and equity prices in the UK's financial sector not falling as far. It may be due to the smaller decline in UK interest rate expectations and bond yields, which raise the discounted value of future earnings, compared to the US.

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.

UK. Interest Rates.

Bank Rate in April 2022 was 0.75%, then moved up in stepped increases of either 0.25% or 0.5%, reaching 4.25% by the end of the financial year, with the potential for a further one or two increases in 2023/24.

The sea-change in investment rates meant local authorities were faced with the challenge of pro-active investment of surplus cash for the first time in over a decade, and this emphasised the need for a detailed working knowledge of cashflow projections so that the appropriate balance between maintaining cash for liquidity purposes, and "laddering" deposits on a rolling basis to lock in the increase in investment rates as duration was extended, became an on-going feature of the investment landscape.

With bond markets selling off, equity valuations struggling to make progress and, latterly, property funds enduring a wretched Q4 2022, the more traditional investment options, such as specified investments (simple to understand, and less than a year in duration) became more actively used.

Meantime, through the autumn, and then in March 2023, the Bank of England maintained various monetary policy easing measures as required to ensure specific markets, the banking system and the economy had appropriate levels of liquidity at times of stress.

5. The Strategy for 2022/23

5.1 Investment Strategy and control of interest rate risk

The expectation for interest rates within the approved treasury management strategy for 2022/23 was that Bank Rate would peak at 0.75%. This was subsequently revised by Link to 5.0% and reported to Members as part of the Mid-Year Report in November 2022. At that time the forecast for interest receivable on surplus balances was estimated at £350k. As part of the Q3 revenue budget monitoring cycle reported in February 2023, the approved Capital programme was revised downwards by c£18.5m, re-profiling the anticipated timing of Capital spend, giving rise to additional surplus cash balances available for investment. The final outturn position for interest receivable being £658k.

As noted in Link's commentary, the Council's strategy was one of pursuing specified investments on a more pro-active basis, given a rising interest rate environment, having due regard to preservation of principal sums and for Security, Liquidity and then Yield ('SLY') in compliance with the Prudential Code and CIPFA Treasury Management Code of Practice.

While the Council has taken a more pro-active yet cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the 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. This should provide some resilience in support of the Council's approved list of counterparties for investment of deposits, noting that the approved list is maintained under review throughout the year. However, such regulatory changes and a requirement for financial institutions to retain liquid sums themselves to manage market volatility, can reduce the returns on offer for 'ultra-short' deposits e.g., the Council's 'sweep' account balances.

To date, investment balances have been managed through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates, known as 'cost of carry', but as the Council maintains an under-borrowed position (see 5.2 Borrowing Strategy), this position remains under review.

5.2 Borrowing Strategy and control of interest rate risk

During 2022/23, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were very low in the first half of the year, although continued to rise in the second half of the year.

The policy of avoiding new borrowing by running down spare cash balances has previously been adopted and has served well over the last few years. However, this will be kept under review. Whilst this strategy aims to avoid incurring high borrowing costs, the Council may find itself in a position to borrow to finance (deferred) capital expenditure in the future.

Forecast capital expenditure was reprofiled at Q3 of 2022/23 into future years, with associated additional borrowing also deferred. In the current climate of high PWLB borrowing rates, to control risk around interest rates, surplus cash will be invested in liquid and/or short-term deposits to ensure cash can be accessed as capital and other commitments fall due. Given the regulatory impact on short-dated deposits as outlined above, the impact on the budgeted interest receivable from deposits will also be monitored and reported regularly through the established budget monitoring cycle.

6. The Borrowing Requirement and Debt

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). The table below shows the Council's CFR for 2022/23. The closing CFR for 2022/23 represents net Capital expenditure not financed from other sources eg Capital Receipts, grants or reserves.

Table 1: Capital Financing Requirement (CFR) as at 31st March 2023

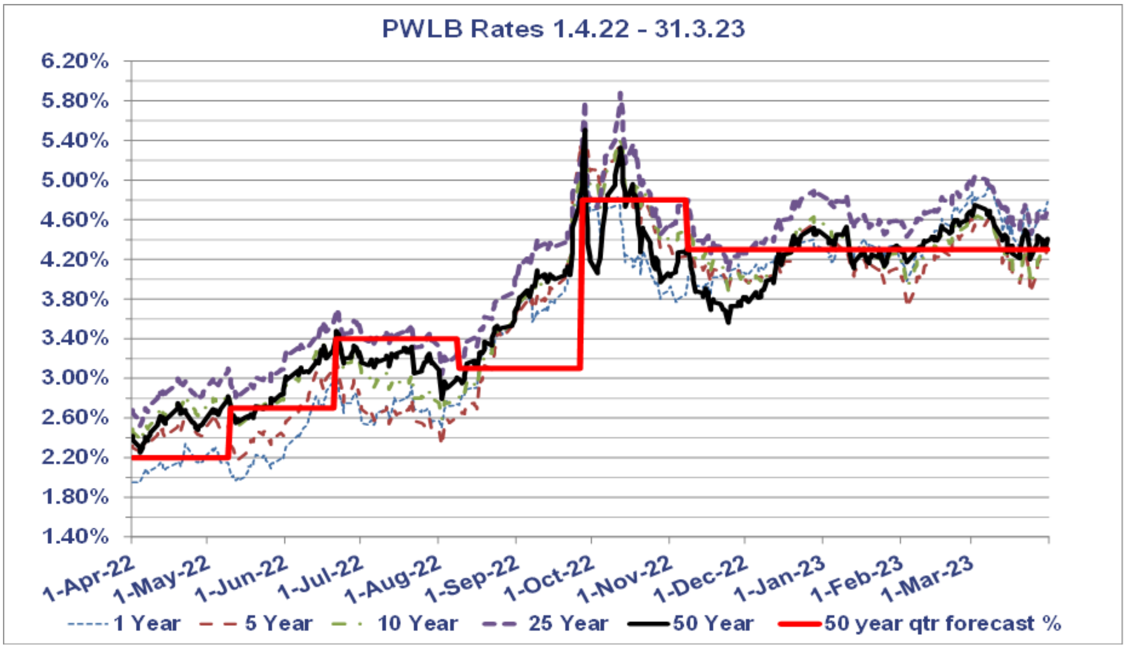
£m	31 March 2022 Actual	31 March 2023 Budget	31 March 2023 Outturn
CFR General Fund	63.9	76.7	67.1

7. Borrowing Rates in 2022/23

PWLB rates are based on gilt (UK Government bonds) yields through H.M.Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields.

Consequently, the rising Bank Rate throughout 2022/23 has seen an increase in PWLB rates on offer for long-term borrowing.

Chart 1: PWLB Rates 1/422 – 31/3/22



8. **Borrowing Outturn for 2022/23**

Borrowing – No new borrowing was taken in 2022/23. The Council's average rate of interest for borrowed sums as at 31 March 2023 was 2.59%.

Rescheduling – No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Repayments – The following PWLB loan repayments were made during the year, as scheduled:

Table 2: PWLB Loan Repayments Made 22/23

Date of Loan	Interest Rate	Duration (Years)	Principal	Balance o/s at 1/4/22	Repaid in Year	Balance o/s at 31/3/23	Type
14/07/97	7.13%	26	£1.0m	£0.04m	£0.04m	nil	Maturity*
24/09/97	6.75%	26	£1.0m	£0.04m	£0.04m	nil	Maturity*
22/10/00	5.13%	23.5	£1.0m	£1.0m	£1.0m	nil	Maturity
14/10/21	2.15%	30	£18.0m	£18.0m	£0.4m	£17.6m	Annuity
10/02/22	2.22%	30	£4.7m	£4.7m	£0.1m	£4.6m	Annuity

* Original loan re-profiled in 1999/2000

9. **Investment Rates in 2022/23**

The Council operates a 'sweep' deposit account with its bank, HSBC, which had paid an underlying interest rate of 0.09% below Bank Rate. This rate was very much in the wake of falling Bank Rate and avoidance of the 'sweep' account falling into negative territory and the bank rewarding its clients for credit balances. More recently, as Bank

Rate has increased, HSBC (and other financial institutions) have revised their offers. At the time of this report, the HSBC ‘sweep’ account currently pays a fixed 1.37% on credit balances, some 3.13% below current Bank Rate 4.50%).

There was an average daily total of £13.1m being invested within the HSBC “sweep” deposit account in 2022/23. This represents a fall in the average daily total when compared to 2021/22 (£18.7m) when a large amount of government funding was made available for distribution to business during the pandemic. This is considered a return to more ‘traditional’ levels for the Council’s “sweep” account but also recognition of more activity in market investments for temporary placement of surplus balances given the change in interest rate policy of HSBC (see below).

Investment Outturn for 2022/23

10. **Investment Policy** – the Council’s investment policy is governed by DLUHC investment guidance, which has been implemented in the annual investment strategy approved by Full Council on 23rd February 2022. This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data. This guidance is enhanced by advice from Link Asset Services.

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Investments held by the Council - the Council maintained a daily average balance of £10.7m of internally managed funds during 2022/23.These investments earned an average rate of return of 2.46%. The annual equivalent benchmark return being 2.23%.

There was a total of 15 market investments made during the financial year, totalling £52m. The table below shows the amount deposited, and the rate of return against the market benchmark.

Table 3: Temporary Market Investments 22/23

Counterparties	Date of Investment	Investment Made £m	Return	Benchmark*
Standard Chartered – Sustainable (1 month)	19/4/22	4.0	0.71%	1.39%
Lloyds Bank Corporate Markets (3 months)	17/5/22	4.0	1.13%	1.70%
Standard Chartered – Sustainable (3 months)	19/5/22	4.0	1.21%	1.70%
Lloyds Bank Corporate Markets (3 months)	17/8/22	4.0	2.12%	1.70%
Standard Chartered – Sustainable (2 months)	19/8/22	4.0	1.94%	1.70%
Goldman Sachs (6 months)	8/9/22	2.0	3.22%	2.12%
Goldman Sachs (3 months)	29/9/22	2.0	3.47%	1.70%
Standard Chartered – Sustainable (1 month)	19/10/22	4.0	2.52%	2.41%
Lloyds Bank Corporate Markets (3 months)	17/11/22	4.0	3.62%	2.72%
Standard Chartered – Sustainable (1 month)	18/11/22	4.0	2.90%	2.41%

Standard Chartered – Sustainable (1 month)	19/12/22	4.0	3.25%	2.41%
Standard Chartered – Sustainable (2 months)	19/01/23	4.0	3.80%	2.56%
Lloyds Bank Corporate Markets (3 months)	17/02/23	4.0	4.10%	2.72%
Goldman Sachs (3 months)	22/02/23	2.0	4.025%	2.72%
Goldman Sachs (3 months)	08/03/23	2.0	4.11%	2.72%

- *Benchmark: Qtr Ended SONIA Average returns for Term deposits*

All investments were for less than one year.

The table below shows the maximum amount invested with any of the counterparties at any one time during the period April 2022 to the end of March 2023 against the maximum limits approved in the 2022/23 Treasury Management Strategy.

Table 4: Maximum Investment per Counterparty 22/23

Counterparties	Maximum Limits £m	Highest level of Investment 2022/23 (£m)
HSBC	50.0	22.3
Standard Chartered Sustainable	4.0	4.0
Goldman Sachs	4.0	2.0
Santander UK plc	4.0	4.0
Lloyds Bank Corporate Markets	4.0	4.0
Burnley College	4.0	2.0

Interest payable on External Borrowing / Interest Receivable on Investments

11. The total PWLB interest payable on external borrowing for 2022/23 was £1,584,354.06 compared to the revised annual budget of £1,841,185, most notably as a result of slippage on the 2022/23 Capital Investment Programme and deferred borrowing.

The total interest receivable on temporary investments in 2022/23 amounted to £658k compared to the revised annual budget of £210k (excluding dividend income). The increase in interest income received was due to a continued rise in the underlying bank rate throughout the year, which was reflected in the rates on offer from the markets for the Council's deposits.

Property Fund Investments, & dividends received

12. The Council continues to invest £2m in property funds with CCLA and Hermes. Dividends receivable amounted to £68,502 compared to an approved annual budget of £60,000.

The aim of the Property Fund investments is to provide high levels of income and long-term capital appreciation. As at 31 March 2023, valuations of both property funds were below the initial levels of investment (CCLA £0.883m, Hermes £0.897m respectively) owing to challenging and volatile economic conditions throughout the year impacting the (commercial) property market.

FINANCIAL IMPLICATIONS AND BUDGET PROVISION

13. None arising as a direct result of this report.

POLICY IMPLICATIONS

14. All transactions are in accordance with the Council’s approved Treasury Policy Statement

DETAILS OF CONSULTATION

15. None

BACKGROUND PAPERS

16. None.

FURTHER INFORMATION PLEASE CONTACT:	**Craig Finn** **Principal Accountant**