OPEN REPORT
GOVERNANCE & RESOURCES COMMITTEE

Governance and Resources Committee – 14 September 2023

TREASURY MANAGEMENT OUTTURN REPORT 2022/23

Report of the Director of Resources

Report Author and Contact Details
Karen Henriksen, Director of Resources
01629 761284 or karen.henriksen@derbyshiredales.gov.uk

Rachael Ayre, Principal Accountant
01629 761212 or rachael.ayre@derbyshiredales.gov.uk

Wards Affected
District-wide

Report Summary
This report summarises Treasury Management activities and the out-turn position against Prudential Indicators for 2022/23.

Recommendations

1. That The Treasury Management Out-turn position for 2022/23 be approved.

2. That the Prudential Indicators contained in Appendix 1 be approved.

List of Appendices
Appendix 1 Prudential Indicators

Background Papers
None

Consideration of report by Council or other committee
No

Council Approval Required
No

Exempt from Press or Public
No

Treasury Management Annual Report for 2022/23

1. Introduction

1.1 The Authority has long 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 mid-year and annual reports.

1.2 The Authority's Treasury Management Strategy for 2022/23 was approved at a meeting on 24th March 2022. The Authority has 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.

1.3 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 for 2022/23, complying with CIPFA's requirement, was approved by full Council on 3rd March 2022.

2. External Context

2.1 Economic background: During 2022/23 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.

2.2 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.

2.3 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.

2.4 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.

2.5 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%.

2.6 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.

2.7 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%.

2.8 The Bank of England increased the official Bank Rate to 4.25% during the financial year 2022/23. 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 2023'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.

2.9 After reaching 9.1% in June 2022, annual US inflation slowed for eight consecutive months to 6% in February 2023. 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.

2.10 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. Financial Markets

3.1 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.

3.2 Over 2022/23 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 financial year.

4. Credit Review

4.1 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.

4.2 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.

4.3 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.

4.4 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.

4.5 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.

4.6 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.

4.7 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.

4.8 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.

5. Local Context

5.1 On 31st March 2023, the Authority had net investments of £22.405m 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 Balance £000	**31.3.23 Balance £000**
Borrowing CFR	5,794	5,690
External Borrowing	5,450	5,450
Internal (over) borrowing	**344**	**240**
Usable Reserves	(24,587)	(25,527)
Less: Working Capital	(2,748)	3,122
Net Investments	**(27,335)**	**(22,405)**

5.2 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.

5.3 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 £000	**2022/23 Movement £000**	**31.3.23 Balance £000**	**31.3.23 Rate %**
Total borrowing	**5,450**	**0**	**5,450**	**4.1**
Long-term investments	(1,048)	173	(875)	

Short-term investments	0	(2,000)	(2,000)	
Cash and cash equivalents	(26,287)	6,757	(19,530)	
Total investments	**(27,335)**	**4,930**	**(22,405)**	**4.04**
Net Investments	**(21,885)**	**4,930**	**(16,955)**	

5.4 Borrowing Update

At 31st March 2023, the Authority held £5.45m of loans from the Public works loan board, the same as the previous year, as part of its strategy for funding previous years' capital programmes.

5.5 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.

5.6 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.

5.7 The cost of both long and short-term borrowing rose dramatically over the year, with rates at the end of March around 2% to 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%.

Treasury Investment Activity

5.8 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.

5.9 The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority’s investment balances ranged between £20.6 and £36.8 million due to timing differences between income and expenditure. The investment position is shown in table 3 below.

Table 3: Treasury Investment Position

	31.3.22 Balance £’000	Net Movement £’000	31.3.23 Balance £’000	31.3.23 Income Return %	31.3.23 Weighted Average Maturity days
Banks & Building societies (unsecured)	787	(657)	130		
Central Government	2,000	2,000	4,000		
Local Authorities	0	5,000	5,000		
Money Market Funds	23,500	(11,100)	12,400		
CCLA Property Fund	1,048	(173)	875		
Total investments	**27,335**	**(4,930)**	**22,405**	**4.06%**	***21 days**

*Weighted average days to maturity across the portfolio. Money Market funds and the Councils operational bank accounts are held for immediate access.

5.10 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.

5.11 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.

5.12 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% and 1.1% p.a. in early April 2022 and between 3.8% and 3.9% at the end of March 2023.

5.13 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 3 above. £1m that is available for longer-term investment is invested in property funds.

5.14 The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 4 below.

Table 4: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	**Credit Rating**	**Bail-in Exposure***	**Weighted Average Maturity (days)**	**Rate of Return %**
31st March 2022	4.55	A+	92%	3	0.58
31st March 2023	4.71	A+	58%	21	4.04
Similar LAs	4.74	A+	63%	56	3.55
All LAs	**4.71**	**A+**	**59%**	**12**	**3.66**

*Bail-in is defined as: Investments that are subject to the risk of a credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent.

Externally Managed Pooled Funds – CCLA Property Fund

5.15 £1m of the Authority's investments is invested in externally managed strategic pooled 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 receipts of £40,784, (3.62% return) in 2022/23.

5.16 The capital value of the property fund has fallen to £875,466. At present a statutory override is in place which in effect means that the valuation loss does not impact upon the budget position of the Authority. The statutory override in in place until 31st March 2025, therefore, the Authority will continue to monitor the position and make appropriate provisions if necessary.

Interest received

5.17 Table 5 below shows interest received in 2022/23 compared to the budget and the previous year.

Table 5 - Interest Received Compared to Budget

Financial Year	Original Budget £	Revised Budget £	Actual £	Revised v Actual Variance £	Average portfolio balance £m
2021/22	37,000	37,000	53,906	7,964	29.0
2022/23	37,000	37,000	610,961	573,961	30.5

As can be seen from the table above, interest accrued and received in 2022/23 was significantly higher than budget and the previous year. The increase in interest rates from 0.75% at the start of the year to 4.75% by the end of the year has generated greater returns along with the further diversification in investments, which involved moving away from banks and money market funds and investing for longer periods with other local authorities and central government.

6. Non-Treasury Investments

6.1 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.

6.2 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).

6.3 The authority held £1.655m of such investments in directly owned property. These investments generated £0.1m of investment income for the Authority after taking account of direct costs, representing a rate of return of 6.17%. This is higher than the return earned on treasury investments but reflects the additional risks to the authority of holding such investments.

7. Compliance

7.1 The Director of Resources 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 6 below.

7.2 Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 6 below.

Table 6: Debt Limits

	2022/23 Maximum £000	31.3.23 Actual £000	2022/23 Operational Boundary £000	2022/23 Authorised Limit £000	Complied? Yes/No
Borrowing	5,450	5,450	8,000	11,000	Yes
Finance Leases	0	0	1,000	1,000	Yes
Total debt	**5,450**	**5,450**	**9,000**	**12,000**	Yes

7.3 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.

7.4 Table 7 below provides details of actual investment limits for 2022/23 against the limits in the Treasury Management Strategy.

Table 7: Investment Limits

	2022/23 Maximum £'000	31.3.23 Actual £'000	2022/23 Limit £'000	Complied? Yes/No
UK Government	18,300	4,000	Unlimited	Yes
Local Authorities & Other Government Entities	5,000	5,000	Unlimited £4m per entity	Yes
Banks (unsecured)	6,817	130	£2m per entity £7m for Council's operational account	Yes
Strategic Pooled Funds	875	875	£4m	Yes
Money Market Funds	23,500	12,400	Unlimited £4m per entity	Yes

8. **Treasury Management Indicators**

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

8.2 **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.

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

8.3 **Liquidity:** The Authority 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 / it can borrow each period without giving prior notice.

	31.3.23 Actual	2022/23 Target	Complied?
Total cash available within 3 months	£19.5m	£30m	**No**
Total sum borrowed in past 3 months without prior notice	0	0	Yes

8.4 When the indicator for liquidity was set in March 2022, returns were low and resources within the Finance team were scarce, therefore a decision was made to prioritise liquidity and therefore short-term financial instruments such as money markets were utilised. This resulted in a target of £30m being set. The Authority changed its approach to this strategy in the final quarter of 2022/23 amid the banking crisis and to earn better returns on investments available for longer terms exceeding 3 months. By this time, it was possible to devote more resources to actively manage the Authority's investments. This change of strategy meant that it was no longer appropriate to maintain cash (available for 3 months) at such high levels and the liquidity target for 2023/24 was set at £7m in the Treasury Management Strategy for 2023/24.

Officer comment: While the liquidity target for short term cash availability in 2022/23 was not complied with, there was no problem with cash availability during the year. In reality, the change of strategy resulted in higher levels of investment income with no reduction in security and no problems with liquidity.

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

Interest rate risk indicator	31.3.23 Actual	2022/23 Limit	Complied?
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	(£111,277)	(£290,000)	Yes
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	£111,277	£290,000	Yes

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

8.6 **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	0	35%	0%	Yes
12 months and within 24 months	0	50%	0%	Yes
24 months and within 5 years	0	65%	0%	Yes
5 years and within 10 years	0	80%	0%	Yes
10 years and above	100%	100%	0%	Yes

8.7 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.

8.8 **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	£1m	£1m	£1m
Limit on principal invested beyond year end	£5m	£5m	£5m
Complied?	Yes	Yes	Yes

9. Financial and Resource Implications

9.1 Interest arising from Treasury investments in 2022/23 was £610,961. The budget for the year was set at £37,000, which means that the Authority received £573,961 more interest than expected in 2022/23. This additional income was reported to Council in July in the report on the Provisional Revenue Outturn for 2022/23; it has been transferred to the General Reserve as part of the overall surplus for 2022/23.

9.2 There are no financial risks arising from the recommendations in this report.

10. Legal Advice and Implications

10.1 This report summarises Treasury Management activities and the out-turn position against Prudential Indicators for 2022/23.

10.2 The report complies with best practice and government guidance on the preparation of the treasury management outturn report, which aims in part, to mitigate financial risk to the Council.

10.3 The recommended decision making connected to this report are that the Treasury Management Out-turn position for 2022/23 and Prudential Indicators contained in Appendix 1 be approved the legal risk of the report recommended decision making has been assessed as low.

11. Equalities Implications

11.1 There are no direct equalities issues arising from this report.

12. Climate Change Implications

12.1 No detailed climate change impact assessment is required when reporting outcomes, as this report does. However, it is noted that during 2022/23 the Council held several investments of significant value (see table 3). The potential climate change impacts of investments are complex, and the Council would need external expertise to understand fully the impacts of any investments.

12.2 CIPFA's Treasury Management Code of Practice (2021) acknowledges that the development of policy and practices relating to Environmental, Social and Governance (ESG) investment considerations is a developing area and it is not implied that the organisation's ESG policy will currently include ESG scoring or other real-time ESG criteria at individual investment level

12.3 The Code goes on to say that Environmental, social and governance (ESG) issues are increasingly significant for investors and investment managers. This is better developed in equity and bond markets than for short-term cash deposits, and there is a diversity of market approaches to ESG classification and analysis. This means that a consistent and developed approach to ESG for public service organisations is currently difficult.

12.4 There are, however, no universally agreed and accepted definitions or metrics for environmental, social and governance issues. Officers have explored the options available in terms of engaging a partner to assist the Council in conducting due diligence on current investments and considering and selecting funds with one or more specific themes such as climate change and transition, clean/renewable energy, sustainability, impact investing. This work would attract a fee – further details can be provided if required.

13. Risk Management

13.1 Financial and legal risks have been assessed above. Other significant risks are set out in the report.

Report Authorisation

Approvals obtained from Statutory Officers:-

	Named Officer	**Date**
Chief Executive	Paul Wilson	24/08/2023
Director of Resources/ S.151 Officer (or Financial Services Manager)	Karen Henriksen	24/08/2023
Monitoring Officer (or Legal Services Manager)	James McLaughlin	24/08/2023