CRMG Scrutiny Committee	5 September 2023
Cabinet Meeting	19 September 2023
Council Meeting	4 October 2023

TREASURY MANAGEMENT ANNUAL REPORT 2022/23

Report of the Deputy Chief Executive (Section 151 Officer)

1 INTRODUCTION AND PURPOSE OF REPORT

1.1 The Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management 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).

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

- an annual treasury strategy in advance of the year (Council, 24 February 2022);
- a mid-year treasury update report (Council, 12 January 2023);
- an annual report following the year describing the activity compared to the strategy (this report).

1.3 The Treasury Management Annual Report is a backward look at the 2022/23 financial year. Treasury Management policies and strategies and the economic landscape has moved on since the close of the 2022/23 financial year. Consideration of this report is therefore recommended in conjunction with the Treasury Management Q1 report for 2023/24 elsewhere on this Agenda.

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

1.5 The Council has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Corporate, Resource Management and Governance Scrutiny Committee before they were reported to the full Council. Member training on treasury management issues was undertaken during the year on 22 November 2022 in order to support Members' Scrutiny and Cabinet role.

1.6 During 2022/23, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators are found in the main body of the report. The Deputy Chief Executive (Section 151 Officer) confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the authorised limit) was not breached.

1.7 The financial year 2022/23 saw consumer price inflation rise in many countries. Pandemic-related supply shortages were a major factor. As the global economy recovered from its pandemic-related recession, there was increased demand for products and materials. The conflict in Ukraine also led to higher commodity prices (mainly in the first half of 2022), pushing up inflation around the world. The annual rate of inflation in the UK reached 11.1% in October 2022, a 41-year high, before easing in subsequent months. Increases in the costs of consumer goods, underpinned by strong demand from consumers and supply chain bottlenecks, were the major factors causing rising inflation in 2022.

1.8 This remains a challenging economic backdrop for the Bank of England as it tries to get inflation under control and to keep the economy from stalling into recession. The Bank of England has been raising interest rates throughout 2022/23 to try and get the inflation rate back to its 2% target. High interest rates have led to higher borrowing costs for households, notably on mortgage interest rates. The reaction on financial markets to the mini-Budget of September 2022 led mortgage providers to further increase interest rates on the mortgages they offer. Sustained rises in Bank rate are contributing to a cost-of-living crisis in the UK that is likely to remain throughout 2023 before easing in 2024.

2 TREASURY MANAGEMENT POLICY STATEMENT AND PRACTICES (TMPs)

2.1 The Council's Treasury Code of Practice Statement, Treasury Management Policy Statement and the detailed Treasury Management Practices were last updated and approved by the Council Meeting on 12 January 2023.

2.2 In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued a revised Treasury Management Code and Cross Sectoral Guidance Notes, and a revised Prudential Code. A particular focus of these revised codes was local authority investments which are not treasury type investments, which consequently would be reported to Members annually in a separate Capital Strategy report.

2.3 In December 2021, CIPFA issued a 2021 revision to the 2017 Treasury Management Code, introducing strengthened requirements for skills and training, and for investments that are not specifically for treasury management purposes, and the Prudential Code.

2.4 Another key introduction of the revised Code was a Liability Benchmark. As a minimum, the Council is required to estimate and measure the liability benchmark for the forthcoming financial year and the following two financial years. This covers the full existing debt maturity profile and also shows how minimum revenue provision (MRP) and other cash flows affect the Council's future debt requirement. The Liability Benchmark has been analysed as part of the annual Treasury Management Strategy for 2023/24.

2.6 The Treasury Management Policy Statement was updated to incorporate the necessary changes resulting from the December 2021 revisions (formal adoption for 2023/24 financial year), however work is still ongoing in some areas.

2.7 Some of the changes from the revised CIPFA Treasury Management Code in December 2021 established additional requirements for Environmental, Social and

Governance (ESG) policies and practices to be incorporated into TMP1, setting out the Council's investment considerations in this regard. Members were advised in the Treasury Management Strategy Report for 2022/23 that work was still ongoing in this area, and that incorporating ESG into the Council's investment policy needed further consideration. Officers are working through the requirements to incorporate ESG factors into the Council's Treasury Management Strategy Statements. At the time of writing this is still under consideration.

2.8 The full Treasury Management Practices (TMPs) and Policy Statement will not be reported due to their length and complexity but will be available to view on request once the review is complete.

3 CAPITAL EXPENDITURE AND FINANCING 2022/23

3.1 The Council undertakes capital expenditure on long-term assets. These activities may be financed by either:

- The application of specific capital or revenue resources (capital receipts, capital grants, capital reserves or revenue contributions); and
- Prudential borrowing (in year capital financing requirement).

3.2 The table below set out the original estimate and actual capital expenditure for 2022/23 and illustrates how this was financed compared to the previous financial year.

	2021/22 Actual £000	**2022/23 Budget £000**	**2022/23 Actual £000**
General Fund			
GF Capital Expenditure	98,547	160,745	127,450
Resourced by:			
Capital grants	52,473	51,305	55,382
Capital receipts	1,251	3,740	4,008
Capital contributions	1,432	1,961	4,166
Revenue contributions	1,667	5,629	7,950
In year Capital Financing Requirement	**41,724**	**98,110**	**55,944**
HRA			
HRA Capital Expenditure	18,819	32,649	17,417
Resourced by:			
Capital grants	1,907	9,745	519
Capital receipts	833	1,958	341
Capital contributions	123	0	72
Revenue contributions	11,968	13,230	13,320
In year Capital Financing Requirement	**3,988**	**7,716**	**3,165**

3.3 The decrease in General Fund prudential borrowing from £98.110m in the budget capital programme for 2022/23 to £55.944m at outturn is largely due to a number of re-phased schemes to later years; most notably £21.962m for Schools Estate Capital Schemes and £19.591m for Regeneration Schemes.

3.4 There was also a significant decrease in the prudential borrowing in the HRA capital programme, largely in relation to New Build schemes, reducing overall from £7.716m in the budget to £3.165m at outturn.

3.5 The capital financing requirement has increased from £824.347m at the start of the year to £862.582mm (illustrated in 4.5 below).

4 BORROWING NEED, PRUDENTIAL AND TREASURY INDICATORS

4.1 The Council's underlying need to borrow for capital expenditure is measured through the Capital Financing Requirement (CFR). This figure is a gauge of the Council's requirement to take on long term borrowing. The CFR is amortised and charged to revenue over a number of years. The in-year CFR represents 2022/23 capital expenditure (see tables above) which has not yet been paid for by revenue or covered by specific capital cash backed resources, such as specific grants.

4.2 Part of the Council's treasury activities is to manage the Council's long-term borrowing requirements. The treasury service organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and long-term cash flow requirements and balance this with short term day to day cash requirements. Long-term borrowing may be sourced through borrowing from external bodies such as the Government, through the Public Works Loan Board (PWLB) or the money markets, or alternatively utilising temporary cash resources from within the Council.

4.3 The General Fund underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets financed through borrowing are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the General Fund borrowing need. There is no statutory requirement for the Council to reduce the HRA CFR.

4.4 The Council's 2022/23 MRP Policy (as required by DLUHC Guidance) was approved as part of the Treasury Management Strategy Report for 2022/23 on 24 February 2022.

4.5 The Council's CFR for the year is shown below and represents a key prudential indicator (this includes leasing schemes on the balance sheet, which increase the Council's borrowing need).

Capital Financing Requirement (CFR):	**31.03.22 Actual £000**	**31.03.23 Budget £000**	**31.03.23 Actual £000**
General Fund (GF)			
Opening balance	647,035	683,406	670,831
Add in year CFR (as above)	41,724	98,110	55,945
Less MRP/voluntary MRP	(17,928)	(25,855)	(19,204)
Closing balance	**670,831**	**755,661**	**707,572**
Housing Revenue Account (HRA)			
Opening balance	150,964	158,110	153,516
Add in year CFR (as above)	3,988	7,716	3,165
Less MRP/voluntary MRP	(1,436)	(1,405)	(1,671)
Closing balance	**153,516**	**164,421**	**155,010**

Note: the CFR opening balances (GF and HRA) for the 2022/23 budget differ to the actual closing balances as at 31 March 2022. This is because budget was calculated on estimates in February 2022, prior to the end of the 2021/22 financial year.

4.6 Actual borrowing activity is monitored through the prudential indicators for borrowing and the CFR and by the authorised limit and operational boundary; these are described below.

4.7 **Gross Borrowing and the CFR**: in order to ensure that actual borrowing levels are prudent over the medium term, the Council's external borrowing must only be for capital purposes. This essentially means that the Council is not borrowing to support revenue expenditure. Gross external borrowing should not therefore, except in the short term, exceed the total of the CFR for 2022/23 plus the estimates of any additional capital financing requirement for the next two financial years. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2022/23. The table below highlights the Council's gross borrowing against the CFR. The Council has complied with this prudential indicator.

Gross Borrowing and the CFR	**31.03.22 Actual £000**	**31.03.23 Original £000**	**31.03.23 Actual £000**
Gross borrowing	614,443	748,969	703,353
Other long-term liabilities	13,700	13,700	13,700
Total Gross External Debt	**628,143**	**762,669**	**717,053**
CFR	824,347	920,082	862,582

Note: The actual gross external debt as at 31 March 2023 above differs from the total debt figures in the table in 5.2 below as this includes the finance lease for Stockport Exchange Central Multi-Storey Car Park under 'other long-term liabilities'.

4.8 **The authorised limit**: the authorised limit is the 'affordable borrowing limit' required by Section 3 of the Local Government Act 2003; the Council does not have the power to borrow above this level. The table below demonstrates that during 2022/23 the Council has maintained gross borrowing within its authorised limit.

4.9 **The operational boundary**: the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached. The table below demonstrates that during 2022/23 the Council has maintained gross borrowing within its operational boundary.

4.10 **Actual financing costs as a proportion of net revenue stream**: this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2021/22 £000	**2022/23 £000**
Authorised Limit	910,500	910,500
Maximum gross borrowing position during the year	678,647	717,053
Operational Boundary	890,500	890,500
Average gross borrowing position during the year	655,973	669,431
Financing costs as a proportion of net revenue stream: General Fund	9.09%	7.90%
Financing costs as a proportion of net revenue stream: HRA	10.97%	10.58%

4.11 The 2022/23 budget financing costs as a proportion of net revenue stream were:

- General Fund 8.33%
- HRA 10.82%

5 **TREASURY POSITION AS AT 31 MARCH 2023**

5.1 The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices.

5.2 At the beginning and the end of 2022/23 the Council's treasury position was as follows:

Treasury Position	Financial Year 2021/22 (2 Pools)				**Financial Year 2022/23 (2 Pools)**			
	General Fund		HRA		**General Fund**		**HRA**	
	£000	%	£000	%	**£000**	**%**	**£000**	**%**
	as at 31.03.22		as at 31.03.22		**as at 31.03.23**		**as at 31.03.23**	
Fixed Rate Funding:								
PWLB	330,975	3.14%	75,494	4.76%	**330,975**	**3.14%**	**75,494**	**4.76%**
Market (LOBO)	10,942	4.26%	6,558	4.26%	**10,942**	**4.26%**	**6,558**	**4.26%**
Market (converted LOBOs)	37,517	3.89%	22,483	3.89%	**37,517**	**3.89%**	**22,483**	**3.89%**
Market (other long-term loans)	40,000	2.33%	0	0%	**40,000**	**2.33%**	**0**	**0%**
Market (short-term)	85,050	0.07%	0	0%	**125,000**	**2.55%**	**0**	**0%**
Market (short-term fixed, variable rate)	0	0%	0	0%	**20,000**	**4.30%**	**0**	**0%**
Market (short-term variable)	0	0%	0	0%	**30,000**	**4.25%**	**0**	**0%**
Salix loans	5,455	0%	0	0%	**4,365**	**0%**	**0**	**0%**
Sub-total	509,889		104,535		**598,799**		**104,435**	
Variable Rate Funding:								
Market (short-term)	19	0.75%	0	0%	**20**	**4.25%**	**0**	**0%**
Sub-total	19		0	0%	**20**		**0**	
Total Debt	509,908	2.61%	104,535	4.54%	**598,819**	**3.10%**	**104,535**	**4.54%**
Total Investments	35,050	0.76%	0	0%	**66,150**	**4.35%**	**0**	**0%**
Net Debt	474,858		104,535		**532,669**		**104,535**	

5.3 Long-term borrowing remains unchanged between years as the Council has avoided taking more expensive long-term loans during 2022/23. Overall the General Fund loan rate has marginally increased between periods, from 2.61% at 31 March 2022 to 3.10% as at 31 March 2023. This reflects the increase in short-term borrowing from £85.069m to £175,020m, which is at levels close to Bank rate. Bank rate has been on a rising trend throughout 2022/23 starting the year at 0.75% and ending at 4.25%. Overall net borrowing has risen by £57.811m between years.

5.4 The maturity structure of the debt portfolio was as follows:

Maturity structure of fixed rate borrowing	**31.03.22 Actual**	**2022/23 Original (Max %)**	**31.03.23 Actual**
Under 12 months	12.0%	45%	26.2%
12 months and within 24 months	1.8%	45%	1.4%
24 months and within 5 years	1.7%	45%	0.3%
5 years and within 10 years	3.5%	45%	5.1%
10 years and above	68.6%	100%	66.9%
	100%		100%

5.5 The maturity structure of the investment portfolio was as follows:

Investment Portfolio	31.03.22 Actual £000	2022/23 Original (Max Limit) £000	31.03.23 Actual £000
Less than 365 days	35,050	No limit	66,150
Over 365 days	0	80,000	0
Total	**35,050**		**66,150**

5.6 The exposure to fixed and variable rates was as follows:

Interest Rate Exposure	31.03.22 Actual %	2022/23 Original (Max Limit) %	31.03.23 Actual %
Fixed Rate:			
Gross borrowing (Principal)	100%	100%	93%
Variable Rate:			
Gross borrowing (Principal)	0%	40%	7%

5.7 The table above illustrates the maximum limits that have been set (in percentage terms) for the Council's total borrowing that can be at either fixed or variable interest rates; it then compares these limits to the actual borrowing at fixed and variable rates at the year end.

5.8 The percentage for fixed rate borrowing is set at 100% of the Council's loans portfolio, because at certain times in the financial year it would be possible for the Council not to have any temporary borrowing at variable rates.

5.9 The maximum limit for variable rate loans is set much lower as it would not be desirable for the Council to have too much of its loan portfolio at variable rates, potentially exposing it to an unacceptable levels of interest rate refinancing risk if rates should suddenly rise.

6 THE STRATEGY FOR 2022/23

6.1 The expectation for interest rates within the initial Treasury Management Strategy for 2022/23 anticipated that Bank Rate would rise four times during the forecast period; one in June 2022 to 0.50%, quarter 1 of 2023 to 0.75%, quarter 1 of 2024 to 1.00% and, finally, one in quarter 1 of 2025 to 1.25%. At the time it was not expected that Bank Rate would go up fast after the initial rate rise in December 2021 as it was thought the supply potential of the economy was not likely to have taken a major hit during the pandemic and should therefore be able to cope well with meeting demand after supply shortages subside over the coming year, without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the spike up to around 6% (anticipated at the time).

6.2 Since the start of 2021, there has been a lot of volatility in gilt yields, and hence PWLB rates. It was therefore anticipated that there would be steady, but slow, rises in both Bank Rate and gilt yields during the forecast period to March 2025, though there was unpredictable volatility assumed during this forecast period.

6.3 Based on these assumptions, the Council would aim to maintain an appropriate balance between internal and external borrowing during 2022/23.

6.4 The Council would make use of temporary borrowing from the money markets/other local authorities throughout 2022/23 to supplement cashflow fluctuations.

6.5 Target new long-term borrowing rates to be considered in 2022/23 from the PWLB in the initial Treasury Strategy for 2022/23 are detailed in the table below (representing the lowest forecast rate in each period for each quarter).

Term	Q1	Q2	Q3	Q4
5 year	1.50%	1.50%	1.60%	1.60%
10 year	1.70%	1.80%	1.80%	1.90%
25 year	1.90%	2.00%	2.10%	2.10%
50 year	1.70%	1.80%	1.90%	1.90%

6.6 Investment returns were likely to rise steadily in line with Bank Rate throughout 2022/23. The budgeted return of 0.50% for 2022/23 assumed an average investment duration of up to three months. This represents the Council's typical investment duration which is predominantly at the short end of the curve and fairly liquid to cater for cashflow needs.

6.7 In this scenario, the treasury strategy was that the Council maintain an under-borrowed position, meaning that capital borrowing need (the Capital Financing Requirement), would not be fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow was used as a temporary measure. The policy would be kept under review in light of changes in the outlook for interest rates and other market developments that may impact the central strategy. Interest rate forecasts expected only gradual rises in medium and longer-term fixed borrowing rates during 2022/23. Internal, variable, or short-term rates, were expected to be the cheaper form of borrowing throughout 2022/23 which supported this strategy.

6.8 Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Deputy Chief Executive (Section 151 Officer), therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks:

- If it had been felt that there was a significant risk of a sharp FALL in long- and short-term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

- If it had been felt that there was a significant risk of a much sharper RISE in long- and short-term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

6.9 What actually transpired during 2022/23 is explained in the following paragraphs of the report.

- By the later stages of the financial year forecasts were for a much faster pace of increase in Bank Rate.

- Gilt yields and, therefore, PWLB rates, were highly volatile.

- Financial markets built in most of the expected increases in Bank Rate into shorter-dated gilt yields, whilst heightened inflation concerns impacted the medium to long parts of the maturity curve. Consequently, the yield curve flattened out considerably.

- LIBOR and LIBID rates ceased at the end of 2021.

7 THE ECONOMY AND INTEREST RATES

7.1 **UK.** 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, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022/23.

7.2 Market commentators' misplaced optimism around inflation has been the root cause of the trajectory in the bond markets with, for example, UK, EZ and US 10-year yields all rising by over 200bps in 2022. The table below provides a snapshot of the conundrum facing central banks; inflation is elevated but labour markets are extra-ordinarily tight, making it an issue of fine judgment as to how far monetary policy needs to tighten.

	UK	Eurozone	USA
Bank Rate	4.25%	3%	4.75%-5%
GDP	0.1%q/q Q4 (4.1% y/y)	+0.1%q/q Q4 (1.9%y/y)	2.6% Q4 Annualised
Inflation	10.4%y/y (Feb)	6.9%y/y (Mar)	6.0%y/y (Feb)
Unemployment	3.7% (Jan)	6.6% (Feb)	3.6% (Feb)

7.3 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 HM 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.

7.4 Nevertheless, CPI inflation picked up to what should be a peak reading of 11.1% in October 2022, 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% and finished the financial year at 10.1% in March.

7.5 The UK unemployment rate fell through 2022 to a 48-year low of 3.6%, and this was 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 22 February 2022.

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

7.7 In the interim, following a Conservative Party leadership contest, Liz Truss became Prime Minister in September 2022. The markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng, and they were subsequently replaced after seven weeks by Prime Minister Rishi Sunak and Chancellor Jeremy Hunt. Their Autumn Statement of the 17 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 Truss's leadership, although they remain elevated in line with developed economies generally.

7.8 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.

7.9 Capital Economics, expect real GDP to contract by around 0.2% q/q in Q1 and forecast a recession this year involving a 1.0% peak-to-trough fall in real GDP.

7.10 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.

7.11 As for equity markets, the FTSE 100 started 2023 strongly, rising to a record high of 8,014 on 20 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 20 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.

7.12 **USA.** The flurry of comments from Fed officials over recent months suggest there is still an underlying hawkish theme to their outlook for interest rates. Markets are pricing in a further interest rate increases of 25-50bps, on top of the current interest rate range of 4.75%-5%.

In addition, the Fed is expected to continue to run down its balance sheet once the on-going concerns about some elements of niche banking provision are in the rear-view mirror.

As for inflation, it is currently at around 6% but with the economy expected to weaken during 2023, and wage data already falling back, there is the prospect that should the economy slide into a recession of any kind there will be scope for rates to be cut at the backend of 2023 or shortly after.

7.13 **EU.** Although the Euro-zone inflation rate has fallen below 7%, the ECB will still be mindful that it has further work to do to dampen inflation expectations and it seems destined to raise rates to 4% in order to do so. Like the UK, growth has remained more robust than anticipated but a recession in 2023 is still seen as likely by most commentators.

8 BORROWING RATES IN 2022/23

8.1 PWLB certainty borrowing rates: the table for PWLB maturity rates below shows, for a selection of maturity periods, the range (high and low points) in rates, the average rates and individual rates at the start and the end of the financial year.

8.2 PWLB rates are based on gilt (UK Government bonds) yields through HM 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. Inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation and the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. Indeed, in recent years many bond yields up to 10 years in the Eurozone turned negative on expectations that the EU would struggle to get growth rates and inflation up from low levels. In addition, there has, at times, been an inversion of bond yields in the US whereby 10-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession.

8.3 However, since early 2022, yields have risen dramatically in all the major developed economies, first as economies opened post-Covid; then because of the inflationary impact of the war in Ukraine in respect of the supply side of many goods. In particular, rising cost pressures emanating from shortages of energy and some food categories have been central to inflation rising rapidly. Furthermore, at present the FOMC, ECB and Bank of England are all being challenged by persistent inflation that is exacerbated by very tight labour markets and high wage increases relative to what central banks believe to be sustainable. Gilt yields have

been on a continual rise since the start of 2021, peaking in the autumn of 2022. Currently, yields are broadly range bound between 3% and 4.25%.

8.4 At the close of the day on 31 March 2023, all gilt yields from 1 to 50 years were between 3.64% and 4.18%, with the 1 year being the highest and 6-7.5 years being the lowest yield.

8.5 Regarding PWLB borrowing rates, the various margins attributed to their pricing are as follows: -

PWLB Standard Rate: gilt plus 100 basis points (G+100bps)
PWLB Certainty Rate: gilt plus 80 basis points (G+80bps)
Local Infrastructure Rate: gilt plus 60bps (G+60bps)

8.6 There is likely to be a fall in gilt yields and PWLB rates across the whole curve over the next one to two years as Bank Rate first rises to dampen inflationary pressures and a tight labour market, and is then cut as the economy slows, unemployment rises, and inflation (on the Consumer Price Index measure) moves closer to the Bank of England’s 2% target.

8.7 As a general rule, short-dated gilt yields will reflect expected movements in Bank Rate, whilst medium to long-dated yields are driven primarily by the inflation outlook.

8.8 The Bank of England is also embarking on a process of Quantitative Tightening, but the scale and pace of this has already been affected by the Truss/Kwarteng “fiscal experiment” in the autumn of 2022 and more recently by the financial market unease with some US (e.g., Silicon Valley Bank) and European banks (e.g., Credit Suisse). The gradual reduction of the Bank’s original £895bn stock of gilt and corporate bonds will be sold back into the market over several years. The impact this policy will have on the market pricing of gilts, while issuance is markedly increasing, is an unknown at the time of writing.

8.9 As a result of the explanations above, during the financial year, the 50-year PWLB target (Certainty) rate for new long-term borrowing changed considerably. For Q1 it was based on initial estimates for PWLB rates for 2022/23 detailed in the Treasury Management Strategy report and rose considerably throughout the financial year as borrowing rates became more and more expensive.

8.10 The table below illustrates the significant spread in rates that actually occurred throughout 2022/23 for periods from 1 year to 50 years, with 50-year PWLB rates hitting 2.49% as early as March 2022.

PWLB CERTAINTY RATES IN 2022/23					
	1 Year	**5 Year**	**10 Year**	**25 Year**	**50 Year**
Low	1.95%	2.18%	2.36%	2.52%	2.25%
Date	01.04.22	13.05.22	04.04.22	04.04.22	04.04.22
High	5.11%	5.44%	5.45%	5.88%	5.51%
Date	28.09.22	28.09.22	12.10.22	12.10.22	28.09.22
Average	3.57%	3.62%	3.76%	4.07%	3.74%
Spread	3.16%	3.26%	3.09%	3.36%	3.26%

9 BORROWING PORTFOLIO OUTTURN FOR 2022/23

9.1 Borrowing is undertaken to fund net unfinanced capital expenditure and naturally maturing debt and also to maintain cashflow liquidity requirements. Throughout 2022/23, the Council maintained an under-borrowed position. Internal borrowing is a treasury management practice whereby the Council delays the need to borrow externally by temporarily using cash it holds for other purposes, such as reserves. The Council's internal borrowing is a cumulative measure of the potential liabilities from this form of financing at any point in time.

9.2 The Council's opening capital financing requirement (CFR) for 2022/23 was £824.347m rising to £862.582m by 31 March 2023. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The table in 4.7 above shows the Council's significantly internally borrowed position (the CFR compared to total gross external debt).

9.3 Whilst the Council continued to run with internal borrowing positions during 2022/23, it was also aware of its reliance on internal cash reserves and the availability of short-term loans from other councils.

9.4 The Borrowing Strategy followed in 2022/23 has been to fund net unfinanced capital expenditure and naturally maturing debt by taking shorter-term loans from the market (other councils) and to draw back liquid investments to meet cashflow requirements as all borrowing became much more expensive during the year. Years of maintaining an internal borrowing policy has also given rise to the need for more significant temporary borrowing.

9.5 Interest rate forecasts were initially suggesting only gradual rises in short, medium and longer-term fixed borrowing rates during 2022/23 but by August it had become clear that inflation was moving up towards 40-year highs, and the Bank of England engaged in monetary policy tightening at every Monetary Policy Committee meeting during 2022, and into 2023, either by increasing Bank Rate by 0.25% or 0.5% each time. Currently the CPI measure of inflation is still above 10% in the UK but is expected to fall back towards 4% by year end. Nonetheless, there remain significant risks to that central forecast.

9.6 The Council continually assesses how much borrowing may be needed in the short to medium term, taking into account cashflows, level of investments or use of short-term borrowing, use of reserves, and spend on the Capital Programme. The availability of each type of borrowing is also a key consideration and has given rise more recently to questions over the risk and sustainability of maintaining a higher level of temporary borrowing.

9.7 The Council avoided taking any long-term financing in the 2022/23 financial year. Both short-term and long-term interest rates had been rising and were expected to remain relatively high over the next couple of years. As such the Council sought to take only short-term borrowing where possible and to avoid fixing higher priced long-term loans until rates start to fall back. Although short-term loans also became much more expensive throughout 2022/23, the Council favoured keeping high cost borrowing as short lived as possible. This policy of taking more temporary

borrowing and the avoidance of long-term debt is illustrated in the maturity structure of debt indicator in 5.4 above which shows the increase in loans due within 1 year.

9.8 Opportunities to take long-term loans from alternative market participants were absent during 2022/23, unless the Council had considered bond issuance.

9.9 The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

9.10 The Council did not engage in any debt-rescheduling during 2022/23 as the average 1% differential between PWLB new borrowing rates and premature repayment rates, made re-scheduling unviable.

9.11 The Council's overall weighted average borrowing rate for 2022/23 was 3.10% rising from 2.61% for the previous financial year. This change reflects the increase in Bank Rate and level of short-term borrowing.

10 INVESTMENT RATES IN 2022/23

10.1 The Council seeks to compare income returns with SONIA rates as an interest rate benchmark. In sterling markets, the SONIA (Sterling Overnight Index Average) is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors.

10.3 The table below backward-looking Sterling overnight index (SONIA) rates for 2022/23. The rates decrease for the longer-duration as they are reflective of the lower market rates and Bank rate at the start of 2022/23.

		INVESTMENT RATES IN 2022/23					
	Bank Rate	**SONIA**	**7 Day**	**1 Month**	**3 Month**	**6 Month**	**1 Year**
High	4.25%	4.18%	4.18%	4.00%	3.78%	3.27%	2.25%
High Date	23.03.23	31.03.23	31.03.23	31.03.23	31.03.23	31.03.23	31.03.23
Low	0.75%	0.69%	0.69%	0.57%	0.39%	0.23%	0.14%
Low Date	01.04.22	28.04.22	29.04.22	01.04.22	01.04.22	01.04.22	01.04.22
Average	**2.30%**	**2.24%**	**2.20%**	**2.09%**	**1.81%**	**1.42%**	**0.90%**
Spread	3.50%	3.49%	3.49%	3.43%	3.39%	3.04%	2.11%

11 INVESTMENT PORTFOLIO OUTTURN FOR 2022/23

11.1 The Council's cash balances comprise of revenue and capital resources and cash flow monies.

11.2 Investment Policy: The Council's investment policy is governed by DLUHC guidance, which was implemented in the annual investment strategy approved by the Council on 24 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 such as rating outlooks, credit default swaps, bank share prices etc.

11.3 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.

11.4 Starting April 2022 at 0.75%, Bank Rate 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.

11.5 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'[1] 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.

11.6 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.

11.7 Nonetheless, while the Council has taken a 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 of 2008/09. 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.

11.8 For its cash flow generated balances, the Council utilised its business reserve instant access and notice accounts, Money Market Funds and short-dated deposits, (overnight to 100 days), in order to benefit from the compounding of interest. Counterparty quality and suitable limits remain primary factors when making investment decisions.

11.9 Markets were pricing in several rate increases throughout much of the year so investment returns were generally elevated. When rates are expected to rise, an investor will generally look to keep rolling maturities on a short-term basis, the idea is that you continue to roll up ever increasing yields to generate a steadily improving return and one where 'lag' i.e., how long it takes your portfolio's return to catch up with the higher rates on offer, is limited as much as possible. The Council however had little opportunity to take real advantage of increased yields on offer. Overall the Council is always in a borrowing position and does not have 'core cash' to invest over longer time horizons. Investments are generated out of cashflows and used predominantly to supplement cashflow shortages. Although chasing investment returns could be tempting the flip side of that is fixing investments, rather than using to support cashflow shortages, will only lead to an increased need for more temporary borrowing, also at high rates.

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[1] Laddering is an investment technique where the investors makes a number of investments with differing maturity dates. By staggering maturity dates, investors avoid getting locked into a single interest rate. A ladder helps smooth out the effect of fluctuations in interest rates, particularly useful in a rising interest rate environment.

11.10 The Council's average investment balances for each quarter are detailed in the table below. Balances were maintained at a level to support cash flow fluctuations throughout 2022/23.

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

11.12 Detailed below is the result of the investment strategy undertaken by the Council.

Council Performance 2022/23			
Combined Investments	**Average Balance Invested**	**Return**	**Average Duration (days)**
Q1	£49.242m	1.06%	65.65
Q2	£59.136m	1.70%	60.01
Q3	£49.838m	2.48%	27.61
Q4	£44.950m	3.92%	61.35
Average 2022/23	£50.371m	2.22%	53.89

11.13 **Investments held by the Council:**

During 2022/23 the Council's combined investments (long and short-term), maintained an average balance of £50.371m (£51.949m 2021/22) of internally managed funds, for an average period of 53.89 days (62.27 2021/22).

The internally managed funds earned an average rate of return of 2.22%.

11.14 No institutions in which investments were made had any difficulty in repaying investments and interest in full during the year.

12 PERFORMANCE MEASUREMENT

12.1 One of the key requirements in the Treasury Management Code is the formal introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide. The Council's performance indicators are set in the Treasury Management Policy Statement and Annual Treasury Management Strategy.

12.2 This service has set the following performance indicators:

- Debt (borrowing): average rate movement year on year (illustrated in table in paragraph 5.2).

- Investments: internal returns above the average 2-month SONIA rate (comparable to average portfolio duration (53.89 days) (paragraphs 10.3 and 11.13).

13 OTHER CONSIDERATIONS

13.1 FINANCIAL AND RISK ASSESSMENT CONSIDERATIONS

13.1.1 The financial implications are covered in the body of the report.

13.1.2 There are no further financial and risk considerations arising from the report. This report is produced as a finance report and discusses in detail risk mitigation processes which are at the heart of Treasury Management Policy. Treasury Management Risk Management is the practice of planning for unexpected expenditures. It is primarily about mitigating and avoiding the impact of the changing financial environment on the Council's cash flow objectives.

13.1.3 It is confirmed that the Deputy Section 151 Officer has signed off the financial implications detailed within the report.

13.2 LEGAL CONSIDERATIONS

13.2.1 There are no Legal and Governance implications to consider as a result of the report and recommendations.

13.2.2 The Council will ensure that all its treasury management activities comply with its statutory powers and regulatory requirements. In framing its credit and counterparty policy under Treasury Management Practice (TMP1) *Counterparty credit risk management*, it will ensure that there is evidence of counterparties' powers, authority and compliance in respect of the transactions they may effect with the Council, particularly with regard to duty of care and fees charged.

13.2.3 The Council recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as it is reasonably able to do so, will seek to manage the risk of these impacting adversely on the Council.

13.3 HUMAN RESOURCES IMPACT

13.3.1 There is no impact to the workforce or the workforce of partner organisations as a result of the report and recommendations.

13.3.2 The Council recognises the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills.

13.3.3 The Council will also ensure that Members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and those responsibilities.

13.3.4 The present arrangements, including a knowledge and skills schedule, are detailed in the relevant Treasury Management Practice (TMP). This *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes* (the TM Code) revision for 2021 introduced strengthened requirements for skills and training.

13.4 EQUALITIES IMPACT

13.4.1 A full Equalities Impact Assessment was undertaken with the initial Treasury Management Strategy Report for 2022/23 that went to Council on 24 February 2022. This is a backward-looking performance report on that Strategy.

13.5 ENVIRONMENTAL IMPACT

13.5.1 Part of the revisions to the Treasury Management Code in December 2021 detailed in Section 2 of the report, that will be incorporated into the Council's Treasury Management Policy Statement and Treasury Management Practices (TMPs), will provide further clarification of the way the Council is looking to incorporate environmental considerations in the Council's Investment Strategy.

13.5.2 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.

13.5.2 This means that a consistent and developed approach to ESG for the Council in its treasury management dealings will be challenging. The Council will consider its credit and counterparty policies in light of ESG information and develop ESG investment policies and treasury management practices consistent with the Council's own relevant policies where possible, for example, climate change policies. It is not expected that the Council's ESG policy will include ESG scoring or other real-time ESG criteria at individual investment level.

14 CONCLUSIONS AND RECOMMENDATIONS

14.1 It is hoped that the report has provided Members with a clear understanding of the Council's capital activity during the year and the impact of this activity on the Council's underlying indebtedness, (the Capital Financing Requirement). The actual Prudential and Treasury indicators; overall Treasury Position identifying how the Council has borrowed in relation to this indebtedness and the impact on investment balances. The report should also have given an insight into interest rate movements throughout 2022/23 and detailed debt and investment activity.

14.2 The Council's treasury management function has been successful in 2022/23; investment performance has achieved an annual return of 2.22% and debt costs have been minimised at an overall rate of 3.10%

14.2 During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

14.3 The Council has had as its first priority the security of invested funds and its policy to place appropriate parameters (in terms of credit quality), to organisations with whom it invests. This has safeguarded the Council's investments during 2022/23.

14.4 The Council Meeting is recommended to:

- Approve the actual 2022/23 prudential and treasury indicators in this report;
- Note the Annual Treasury Management Report for 2022/23.

BACKGROUND PAPERS

There are none.

Anyone wishing to inspect the above background papers or requiring further information should contact Lorna Soufian

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