REDDITCH BOROUGH COUNCIL

Executive 25th July 2023

Draft Treasury Management Outturn Report 2022/23

Relevant Portfolio Holder		Councillor Luke Court, Finance and Enabling Portfolio Holder
Portfolio Holder Consulted		Yes
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Wards Affected		N/A
Ward Councillor(s) consulted		N/A
Relevant Strategic Purpose(s)		All
Non-Key Decision		
If you have any questions about this report, please contact the report author in advance of the meeting.		

1. **SUMMARY**

This report for 2022/23 presents the draft outturn position on the Council's Capital and Treasury Management Strategies, including all prudential indicators. There is the requirement for progress to reported through Executive to Council.

2. **RECOMMENDATIONS**

Executive are asked to Recommend to Council that:

- **Council note the Treasury Outturn position for 2022/23.**

3. **KEY ISSUES**

Introduction

3.1 In June 2022 the Authority 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 semi-annual and annual reports.

3.2 The Authority's treasury management strategy for 2022/23 was approved at a meeting on 27th June 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.

3.3 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, complying with CIPFA's requirement, was approved by full Council on 27th June 2022.

External Context

3.4 **Economic background:** The war in Ukraine continued to keep global inflation above central bank targets and the UK economic outlook remained relatively weak with the chance of a mild recession. The economic backdrop during the January to March period continued to be characterised by high energy and commodity prices, high inflation, and the associated impact on household budgets and spending.

3.5 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.

3.6 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.

3.7 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.

3.8 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%.

3.9 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.

3.10 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%.

3.11 The Bank of England increased the official Bank Rate to 4.25% during the financial year. From 0.75% in March 2022, the Monetary Policy Committee (MPC) pushed through rises at every subsequent meeting over the period, with recent hikes of 50bps in December and February and then 25bps in March, taking Bank Rate to 4.25%. March's rise was voted by a majority of 7-2, with two MPC members preferring to maintain Bank Rate at 4.0%. The Committee noted that inflationary pressures remain elevated with growth stronger than was expected in the February Monetary Policy Report. The February vote was also 7-2 in favour of a hike, and again with two members preferring to keep Bank Rate on hold.

3.12 After reaching 9.1% in June, annual US inflation slowed for eight consecutive months to 6% in February. The Federal Reserve continued raising interest rates over the period with consecutive increases at each Federal Open Market Committee meetings, taking policy rates to a range of 4.75%- 5.00% at the March meeting.

3.13 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%.

3.14 **Financial markets:** 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.

3.15 Over the period 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 period.

3.16 **Credit review:** 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.

3.17 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.

3.18 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.

3.19 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.

3.20 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.

3.21 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.

3.22 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.

3.23 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.

Local Context

3.24 On 31st March 2023, the Authority had net borrowing of £93.3m 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

	31.3.23 Actual £m
Draft total CFR	**149.2**
Less:	
External borrowing	(103.9)
Internal borrowing	45.3
Less: Draft Usable reserves/working capital	(48.0)
Net Borrowing	**93.3**

*** Figures are draft as still to close 20/21 and 21/22 Statements of accounts which impact opening 2022/23 opening balances**

3.25 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.

3.26 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 £m	Movement £m	31.3.23 Balance £m	31.3.23 Rate %
Long-term borrowing	103.9	0	103.9	3.42%
Short-term borrowing	0	0	0	0
Total borrowing	**103.9**	**0**	**103.9**	
Long-term investments	0	0	0	0
Short-term investments	34.0	(23.4)	10.6	4.52%
Cash and cash equivalents	0	0	0	0
Total investments	**34.0**	**(23.4)**	**10.6**	
Net Borrowing	**69.9**	**(23.4)**	**93.3**	

Borrowing Update

3.27 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.

3.28 The Authority has is reviewed its capital programme in light of changes to the CIPFA Prudential Code and PWLB lending arrangements to ensure that borrowing to invest primarily for commercial return is no longer undertaken.

Borrowing Strategy and Activity

3.29 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.

3.30 The cost of both long and short-term borrowing rose dramatically over the year, with rates at the end of March around 2% - 4% higher than those at the beginning of April. Rate rises have been driven primarily by inflation and the need for central banks to control this by raising interest rates. Particularly dramatic rises were seen in September after Liz Truss' 'mini-budget' included unfunded tax cuts and additional borrowing to fund consumer energy price subsidies: over a twenty-four-hour period some PWLB rates increased to 6%. Rates have now fallen from September peaks but remain volatile and well above recent historical norms. The PWLB 10 year maturity certainty rate stood at 4.33% at 31st March 2023, 20 years at 4.70% and 30 years at 4.66%.

3.31 A new HRA PWLB rate of gilt yield plus 0.4% (0.4% below the currently available certainty rate) was announced on 15th March 2023. This discounted rate is to support local authorities borrowing for Housing Revenue Accounts and the delivery of social housing and is expected to be available from June 2023, initially for a period of one year.

3.32 At 31st March 2023 the Authority held £103.9m of loans, the same as at the 31st March 2022, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 31st March are summarised in Table 3 below.

Table 3A: Borrowing Position

	31.3.22 Balance £m	**Net Movement £m**	**31.3.23 Balance £m**	**31.3.23 Weighted Average Rate %**	**31.3.23 Weighted Average Maturity (years)**
Public Works Loan Board	98.9	0	98.9	3.35%	12.2
Banks (LOBO)	0	0	0	0	0
Banks (fixed-term)	5.0	0	5.0	4.71%	9
Local authorities (long-term)	0	0	0	0	0
Local authorities (short-term)	0	0	0	0	0
Total borrowing	**103.9**	**0**	**103.9**	**3.42%**	**12**

Table 3B: Long-dated Loans borrowed

	Amount £m	**Rate %**	**Period (Years)**
PWLB Maturity Loan 1	15.0	3.01	15
PWLB Maturity Loan 2	25.0	3.30	20
PWLB Maturity Loan 3	40.0	3.44	25
PWLB Maturity Loan 4	18.9	3.50	30
Commercial Loan 1	5.0	4.71	25
Total borrowing	**103.9**		

3.33 The Authority's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short- and long-term borrowing was maintained.

Treasury Investment Activity

3.34 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.

3.35 The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances ranged between £34 million and £10.6 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.22 Balance £m	Net Movement £m	31.3.23 Balance £m	31.3.23 Income Return %	31.3.23 Weighted Average Maturity days
Banks & building societies (unsecured)	0	0	0	0	0
Covered bonds (secured)	0	0	0	0	0
Government (incl. local authorities)	26.0	(20.3)	5.7	4.52	30.7
Corporate bonds and loans	0	0	0	0	0
Money Market Funds	8.0	(3.1)	4.9	3.99	29.7
Other Pooled Funds Real Estate Investment Trusts	0	0	0	0	0
Total investments	**34.0**	**(23.4)**	**10.6**		

3.36 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.

3.37 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.

3.38 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 0.61% p.a. in early April and 3.99% at the end of March.

3.39 **Externally Managed Pooled Funds**: The Authority currently does not invest in any of these vehicles.

3.40 The change in the Authority's funds' capital values and income earned over the 12-month period is shown in Table 4.

3.41 Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's medium- to long-term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns should exceed cash interest rates.

3.42 The Authority had budgeted £1,296,000 income from these investments in 2022/23. Income received was £1,121,000, whist a further £10,000 has been declared and is due to be paid by April/May.

3.43 The DLUHC published a consultation on the IFRS 9 pooled investment fund statutory override for English authorities for fair value gains and losses on pooled investment funds which was due to expire with effect from 2023/24. The options under evaluation were to allow the override to lapse, to extend it, or to make it permanent. The override will be extended for two years and therefore remain in place for the 2023/24 and 2024/25 financial years. Under the Regulations, gains and losses resulting from unrealised fair value movements relating to treasury pooled investment funds, that otherwise must be recognised in profit or loss under IFRS 9, are not charges to the revenue account, and must be taken into an unusable reserve account.

Non-Treasury Investments

3.44 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. 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).

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

3.46 The Authority also held £0.9m of such investments in

- Office complex in Oak Tree Park in 2019 held for regenerative purposes but with a commercial return – total value of investment is £0.9m.

3.47 The Authority held £0m of investments made for commercial purposes.

3.48 Fully let these investments will generate £76k of investment income for the Authority.

Treasury Performance

3.49 The Authority measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 6 below.

Table 6: Performance

	Actual £m	Budget £m	Over/ Under £m	Actual %
PWLB Debt – HRA	**98.9**			
Bank Loan – HRA	**5.0**			
Total borrowing	**103.9**			
PFI and Finance leases	0			
Total debt	**103.0**	**130.5**	**(27.5)**	**78.9%**
Other Local Authorities	5.7			
Money Market Funds	4.9			
Total treasury investments	**10.6**	**12.4**	**(1.8)**	**85.5%**

Compliance

3.50 The Interim Director of Finance 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 apart from the movement up of the Councils operational limit for its bank which increased to £2m. Compliance with specific investment limits is demonstrated in table 7 below.

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

Table 7: Debt Limits

	2022/23 Maximum	**31.3.23 Actual**	**2022/23 Operational Boundary**	**2022/23 Authorised Limit**	**Complied?** Yes/No
Borrowing	103.9	103.9	165.0	175.0	Yes
PFI and Finance Leases	0	0	1.5	1.5	Yes
Total debt	**103.9**	**103.9**	**166.5**	**176.5**	Yes

3.52 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.

Table 8: Investment Limits

	2022/23 Maximum	**31.3.23 Actual**	**2022/23 Limit**	**Complied?** Yes/No
Any single organisation, except the UK Government	£3.8m	£3.8m	£5m each	Yes
Any group of organisations under the same ownership	0	0	unlimited	Yes
Any group of pooled funds under the same management	0	0	£5m per group	Yes
Negotiable instruments held in a broker's nominee account	0	0	£5m per manager	Yes
Limit per non-UK country	0	0	£5m per country	Yes
Registered providers and registered social landlords	0	0	£2.5m in total	Yes
Unsecured investments with building societies	0	0	£2.5m in total	Yes
Loans to unrated corporates	0	0	£1m in total	Yes

Money Market Funds	£11m	£4.9m	£20m in total	Yes
Real Estate Investment Trusts	0	0	£2.5m in total	Yes

Treasury Management Indicators

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

3.54 **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	AAA	A	Yes

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

	31.3.23 Actual	**2022/23 Target**	**Complied?**
Total cash available within [3] months	£4.9m	£2.5m	Yes
Total sum borrowed in past [3] months without prior notice	0	0	Yes

3.56 **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 interest was:

Interest rate risk indicator	31.3.23 Actual	2022/23 Limit	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	0	500,000	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	0	500,000	Yes

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

3.58 **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%	50%	0%	Yes
12 months and within 24 months	0%	50%	0%	Yes
24 months and within 5 years	14.4%	50%	0%	Yes
5 years and within 10 years	28.9%	50%	0%	Yes
10 years and above	56.7%	100%	0%	Yes

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.

3.59 **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	£5.7m	0	0
Limit on principal invested beyond year end	£1.5m	£1.0m	£0.5m
Complied?	No	Yes	Yes

4. Legal Implications

4.1 No Legal implications have been identified.

5. Strategic Purpose Implications

Relevant Strategic Purpose

5.1 The Strategic purposes are included in the Council's corporate plan and guides the Council's approach to budget making ensuring we focus on the issues and what are most important for the borough and our communities. Our Financial monitoring and strategies are integrated within all of our Strategic Purposes.

Climate Change Implications

5.2 The green thread runs through the Council plan. Procurements by their nature have potential financial implications and these in term can have implications on climate change. These will be addressed and reviewed through individual reports when relevant by climate change officers will ensure the correct procedures have been followed to ensure any impacts on climate change are fully understood.

6. Other Implications

Customer / Equalities and Diversity Implications

6.1 None as a direct result of this report.

Operational Implications

6.2 None as a direct result of this report, service requirements which form the Capital Programme are the base data for this report.

7. RISK MANAGEMENT

7.1 The financial monitoring is included in the corporate risk register for the authority.

8. APPENDENCES

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