TORBAY COUNCIL

Meeting: Audit Committee **Date:** 26th July 2023

Wards affected: All Wards in Torbay

Report Title: Treasury Management Outturn 2022/23 Report

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1. Purpose of Report

1.1 This report is to provide members with an annual report on the treasury management activities undertaken during the year 2022/23, which is compared to the 2022/23 Treasury Management Strategy.

2. Reason for Proposal and its benefits

2.1 Treasury risk management at the Council is conducted within the framework of 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 a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report

3. Recommendation(s) / Proposed Decision

That the Audit Committee recommends to Council :

i) That the Treasury Management decisions made during 2022/23, as detailed in the submitted report be noted; and

ii) That the increases to limits within the Treasury Management Strategy 2023/24 as set out below be approved:

	Strategy 2023/24	**Recommended Change 2023/24**
Limit on principal invested beyond year end (Treasury Management Strategy section 7)	£20M	**£40M**

	Strategy 2023/24		**Recommended Change 2023/24**	
	Counterparty Limit	Sector Limit	**Counterparty Limit**	**Sector Limit**
Strategic Pooled Funds (Treasury Management Strategy Appendix 3, Table 9)	£10M	£20M	**£10M**	**£30M**

Appendices

Appendix 1: Economic Commentary

Background Documents

Treasury Management Strategy 2022/23

Supporting Information

1. Introduction

1.1 In March 2023 the Council 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.

1.2 The Council's treasury management strategy for 2022/23 was approved by Council at a meeting on 3rd March 2022. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Council's treasury management strategy.

2. External Context

2.1 An economic commentary for the year provided by the Council's treasury management advisors, Arlingclose, is provided at Appendix 1 to this report. Bank Rate was raised from 0.75% to 4.25% at regular steps through the year as inflation levels rose sharply and remained persistently high.

3. Local Context

3.1 On 31st March 2023, the Council had net borrowing of £284m 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 (subject to finalisation and audit)

	31.3.23 Actual £m
Total CFR	**428**
Less: *Other debt liabilities	(15)
Borrowing CFR	**413**
External borrowing	385
Internal borrowing	28
Less: Usable reserves	(96)
Less: Working capital and other cash backed balance sheet items	(23)
Net treasury position	**294**

* PFI liabilities that form part of the Council's total debt

3.2 The Council pursued its strategy of keeping borrowing and investments below their underlying levels (i.e. using internal cash resources in place of borrowing), sometimes known as internal borrowing, to reduce risk and interest costs.

3.3 The treasury management position on 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*	389	(4)	385	2.98
Short-term borrowing	0.0	0.0	0.0	0.0
Total borrowing	**389**	**(4)**	**385**	**2.98**
Long-term investments*	(5)	(10)	(15)	4.02
Short-term investments	(107)	32	(75)	3.88
Cash and cash equivalents	(4)	3	(1)	1.49
Total investments	**(116)**	**25**	**(91)**	**3.76**
Net position	**273**	**21**	**294**	**3.13**

*Long term investments include the CCLA Property Fund at market valuation.

4. Borrowing Update

4.1 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.

4.2 The Council has 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.

4.3 At 31st March 2023 the Council held £385.2m of loans, (a decrease of £3.7m to the 31st March 2022 position) 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 3: 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	378.9	(3.7)	375.2	2.941	26.3
Banks (LOBO)	5.0	-	5.0	4.700	56.6
Banks (fixed-term)	5.0	-	5.0	4.395	52.5
Total borrowing	**388.9**	**(3.7)**	**385.2**	**2.983**	**27.8**

4.4 The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

4.5 In keeping with these objectives, no new borrowing was undertaken, while £3.7m of existing loans were allowed to mature without replacement. This strategy enabled the Council to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

4.6 LOBO loans: The Council continues to hold a £5m LOBO (Lender's Option Borrower's Option) loan where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. The lenders option does not become due until 2028.

5. Other Debt Activity

5.1 After £0.93m repayment of prior years' Private Finance Initiative liabilities, total debt other than borrowing stood at £15.0m on 31st March 2023, taking total debt to £400.2m

6. Treasury Investment Activity

6.1 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 during business.

6.2 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Council's investment balances ranged between £84 million and £131 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	2022/23 Income Return %	2022/23 Weighted Average Maturity days
Banks & building societies (unsecured)	17.2	(11.4)	5.8	1.50	15
Government (incl. local authorities)	77.0	(9.0)	68.0	1.77	223
Money Market Funds	12.6	(4.1)	8.5	2.13	1
Other Pooled Funds:					
- *Cash plus fund*	4.0	-	4.0	2.40	
- *Property fund*	5.5	(0.9)	4.6	4.45	
Total investments	**116.3**	**(25.4)**	**90.9**	**1.91**	

6.3 Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

6.4 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.

6.5 By end March 2023, the rates on DMADF (government) 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 0.5% - 0.6% p.a. in early April and between 4.0% and 4.2% at the end of March.

6.6 The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below.

Table 5: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
31.06.2022	3.56	AA-	27%	83	1.01

31.03.2023	4.67	A+	17%	186	3.65
Similar LAs	**4.84**	**A+**	**60%**	**64**	**3.77**
All LAs	**4.71**	**A+**	**59%**	**12**	**3.66**

6.7 Fixed deposits were made throughout the year at each rise in Bank Rate, predominantly with the DMADF for three to six months duration. A number of slightly longer dated deposits (up to one year) were also transacted with other local authorities.

6.8 Exposure to the Banking sector was limited to ease credit risks and at the end of the year concerns of a banking crisis led Arlingclose to recommend reducing all banking counterparty durational limits to 35 days. The Director of Finance concurred with this advice and the limit remains in place.

6.9 During March 2023 interest rates looked to be peaking and two 2-year deals were taken with local authorities to provide some protection against potentially falling rates. While forecasts have reversed since then these deals remain strategically useful in providing a base return over the longer term.

6.10 Remaining funds were substantially kept liquid to enable the Council’s policy of internal borrowing and in anticipation of future rate rises. At outturn the actual capital spend was well below the original plan contributing to the continuing higher than forecast cash balance.

6.11 **Externally Managed Pooled Funds**: £5m of the Council’s investments are invested in an externally managed strategic pooled property fund 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 an income return of £0.23m (4.45%) and an unrealised capital loss of £0.9m (12.87%).

7. Non-Treasury Investments

7.1 The definition of investments in CIPFA’s revised Treasury Management Code covers all the financial assets of the Authority as well as other non-financial assets which the Council 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) or for commercial purposes (made primarily for financial return).

7.2 The outturn position of the Council’s non-treasury investments will form part of the Statement of Accounts 2022/23 and will be reported with the usual level of detail within the Treasury Management 2023/24 mid-year review.

8. Treasury Performance

8.1 The financial performance of the Council’s treasury management activities in terms of its impact on the revenue budget is shown in table 6 below.

Table 6: Performance

As at 31st March 2023	Budget 2022/23	Outturn 2022/23	Variation
	£M	£M	£M
Investment Income	(0.4)	(2.2)	(1.8)
Interest Paid on Borrowing	12.2	11.5	(0.7)
Net Position (Interest)	**11.8**	**9.3**	**(2.5)**
Minimum Revenue Provision (excl. PFI)	6.9	6.9	(0.0)
Net Position (Other)	**6.9**	**6.9**	**(0.0)**
Net Position Overall	**18.7**	**16.2**	**(2.5)**

9. Compliance

9.1 The Chief Finance Officer reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy. Compliance with specific limits 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	£388.9m	£385.2m	£530m	£620m	Yes
PFI & Finance Leases	£16.0m	£15.0m	£20m	£20m	Yes
Total Debt	**£404.9m**	**£400.2m**	**£550m**	**£640m**	Yes

9.2 **Treasury Management Indicators:** The Council measures and manages its exposures to treasury management risks using the following indicators.

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating/credit score of its investment portfolio. The credit score is calculated by applying a value to each investment (AAA=1, AA+=2, …. A=6 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 (score)	A+ (5)	A (6)	Yes

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

	31.3.23 Actual	2022/23 Target	Complied?
Total cash available within one month	£19M	£10M	Yes

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in 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	(£241,000)	£300,000	Yes
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	£241,000	£300,000	Yes

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

	31.3.23 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	1%	40%	0%	Yes
12 months - within 24 months	2%	40%	0%	Yes
24 months and within 5 years	3%	30%	0%	Yes
5 years and within 10 years	12%	40%	0%	Yes
10 years and within 20 years	15%	50%	0%	Yes
20 years and within 30 years	10%	60%	0%	Yes
30 years and within 40 years	36%	50%	0%	Yes
40 years and over	21%	50%	0%	Yes

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	£15m	£10m	£5m
Limit on principal invested beyond year end	£20m	£20m	£20m
Complied?	Yes	Yes	Yes

10. Other

10.1 **IFRS 9**: 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.

10.2 **Change to approved investment limits 2023/24**: Changes in the interest rate environment and outlook have prompted an increase in longer dated deposits. The Director of Finance, in consultation with Arlingclose, also sees value in increasing the Council's exposure to longer term strategic investments. The limits set by the Treasury Management Strategy 2023/24 will not facilitate these measures and the following changes to the Strategy limits are recommended:

	Strategy 2023/24	Recommended Change 2023/24
Limit on principal invested beyond year end (Treasury Management Strategy section 7)	£20M	**£40M**

	Strategy 2023/24		Recommended Change 2023/24	
	Counterparty Limit	Sector Limit	**Counterparty Limit**	**Sector Limit**
Strategic Pooled Funds (Treasury Management Strategy Appendix 3, Table 9)	£10M	£20M	**£10M**	**£30M**

Appendix 1

<u>Economic Commentary</u> <u>(provided by Arlingclose, April 2023)</u>

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

Central Bank rhetoric and actions remained consistent with combatting inflation. The Bank of England, US Federal Reserve, and European Central Bank all increased interest rates over the period, even in the face of potential economic slowdowns in those regions.

Starting the financial year at 5.5%, the annual CPI measure of UK inflation rose strongly to hit 10.1% in July and then 11.1% in October. Inflation remained high in subsequent months but appeared to be past the peak, before unexpectedly rising again in February. Annual headline CPI registered 10.4% in February, up from 10.1% in January, with the largest upward contributions coming from food and housing. RPI followed a similar pattern during the year, hitting 14.2% in October. In February RPI measured 13.8%, up from 13.4% in the previous month.

Following the decision by the UK government under Rishi Sunak and Jeremy Hunt to reverse some of the support to household energy bills announced under Liz Truss, further support in the form of a cap on what energy suppliers could charge 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.

The labour market remained tight albeit with some ongoing evidence of potential loosening at the end of the period. The unemployment rate 3mth/year eased from 3.8% April-June to 3.6% in the following quarter, before picking up again to 3.7% between October-December. The most recent information for the period December-February showed an unemployment rate of 3.7%.

The inactivity rate was 21.3% in the December-February quarter, slightly down from the 21.4% in the first quarter of the financial year. Nominal earnings were robust throughout the year, with earnings growth in December-February at as 5.7% for both total pay (including bonuses) and 6.5% for regular pay. Once adjusted for inflation, however, both measures were negative for that period and have been so throughout most of the year.

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%.

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

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

From the record-high of 10.6% in October, Eurozone CPI inflation fell steadily to 6.9% in March 2023. Energy prices fell, but upward pressure came from food, alcohol, and tobacco. The European Central Bank continued increasing interest rates over the period, pushing rates up by 0.50% in March, taking the deposit facility rate to 3.0% and the main refinancing rate to 3.5%.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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 of caution is merited with certain authorities.