Appendix A

TREASURY MANAGEMENT STEWARDSHIP REPORT 2022/23

1. Introduction

1.1. The Council has 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 Council to approve treasury management semi-annual and annual reports.

1.2. The Council's treasury management strategy for 2022/23 was approved at a meeting of full Council on 24 February 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.

1.3. The 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 Council's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 24 February 2022.

2. External Context *(provided by Arlingclose Ltd)*

2.1. **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.

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

2.3. Starting the financial year at 5.5%, the annual Consumer Price Index (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. The Retail Price Index (RPI) followed a similar pattern during the year, hitting 14.2% in October. In February RPI measured 13.8%, up from 13.4% in the previous month.

2.4. Support in the form of a cap on what energy suppliers could charge household was announced in the March Budget to run from April until end June 2023. Before the announcement, typical household bills had been due to rise to £3,000 a year from April.

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

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

2.7. Despite household budgets remaining under pressure, consumer confidence rose to -36 in March, following readings of -38 and -45 in the previous two months, and much improved compared to the record-low of -49 in September. Quarterly Gross Domestic Product (GDP) was soft through the year, registering a 0.1% gain in the April-June period, before contracting by (an upwardly revised)
-0.1% in the subsequent quarter. For the October-December period was revised upwards to 0.1% (from 0.0%), illustrating a resilient but weak economic picture. The annual growth rate in Q4 was 0.6%.

2.8. The Bank of England increased the official Bank Rate to 4.25% during the financial year. 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.

2.9. 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.

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

2.11. **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.

2.12. Over the period the five-year UK benchmark gilt yield rose from 1.41% to peak at 4.70% in September 2022 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.

2.13. **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.

2.14. In July 2022, 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 Council to stable from negative and Fitch revised the outlook on HSBC to stable from negative.

2.15. 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.

2.16. 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.

2.17. 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.

2.18. On the back of this, Arlingclose, the Council's advisers, 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.

2.19. As market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Council's counterparty list recommended by Arlingclose remains under constant review.

2.20. 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.

3. Local Context

3.1. On 31 March 2023, the Council had net borrowing of £19.5m 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 Estimate £m
General Fund CFR	39.9
Housing Revenue Account (HRA) CFR	55.3
Total CFR	**95.2**
External borrowing	-62.6
Internal borrowing	-32.6
Total Borrowing	**95.2**

3.2. The Council pursued its strategy of funding its borrowing requirement from internal resources, sometimes known as internal borrowing. This has the effect of reducing interest rate risk and borrowing costs.

3.3. The treasury management position at 31 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	62.6	-2.7	59.8	3.5%
Short-term borrowing	2.2	0.5	2.7	4.2%
Total borrowing	**64.8**	**-2.2**	**62.6**	**3.6%**
Long-term investments	0	0	0	0
Short-term investments	31.0	8.0	39.0	3.5%
Cash and cash equivalents	18.0	-13.9	4.1	3.9%
Total investments	**49.0**	**-5.9**	**43.1**	**3.5%**
Net borrowing	**15.8**	**3.7**	**19.5**	

3.4. As shown above external borrowing decreased by £2.2m after repayment of a £1m loan held with another Council and two PWLB annuity loan repayments totalling £1.2m.

3.5. Investment balances overall reduced by £5.9m from 31 March 2022 due to capital programme delivery, use of reserves and repayment of debt.

3.6. The Council was able to more accurately predict its cashflows allowing more funds to be invested for longer while maintaining cash flow confidence. This resulted in a change in investment portfolio structure with more investments being committed to short term investments in place of cash and cash equivalents as shown in table 2.

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 Council. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield unless these loans are for refinancing purposes.

4.2. The Council currently holds £13.8m in commercial property investments that were purchased prior to the change in the CIPFA Prudential Code. These investments are primarily held for local regeneration and support and not financial return and as such will not fall directly into the above category.

5. Borrowing Strategy and Activity

5.1. As outlined in the treasury strategy, the Council'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 Council's long-term plans change being a secondary objective. The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

5.2. 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 the '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 31 March 2023, 20 years at 4.70% and 30 years at 4.66%.

5.3. A new HRA PWLB rate of gilts plus 0.4% (0.4% below the currently available certainty rate) was announced on 15 March 2023. This will be available from June 2023, initially for a period of one year.

5.4. Alongside the discounted HRA borrowing rate interest rates have increased to a level in which discounts may be available from the PWLB for the repayment of debt. This is because it becomes beneficial for the PWLB to relend the funds at higher interest rates than those held in the old-dated loans. As a result of these two factors the Council is actively investigating the possibility of restructuring its borrowing in 2023/24 to see if savings can be created. This may be particularly effective if the requirement to borrow continues to slip as has been the case for the previous two years, this is likely to be the case as many of the

Council's cashflow and borrowing forecasts are done on a conservative basis.

5.5. At 31 March 2023, the Council held £62.6m of loans, a decrease of £2.2m from the 31 March 2022, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 31 March 2023 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	56.3	-1.2	55.1	3.4%	15.8
Banks (LOBO)	3.5	0.0	3.5	4.8%	31.9
Banks (fixed-term)	3.9	0.0	3.9	4.7%	30.9
Local authorities (long-term)	0.0	0.0	0.0	0.0%	0.0
Local authorities (short-term)	1.0	-1.0	0.0	0.0%	0.0
Total borrowing	**64.8**	**-2.2**	**62.6**	**3.6%**	**17.6**

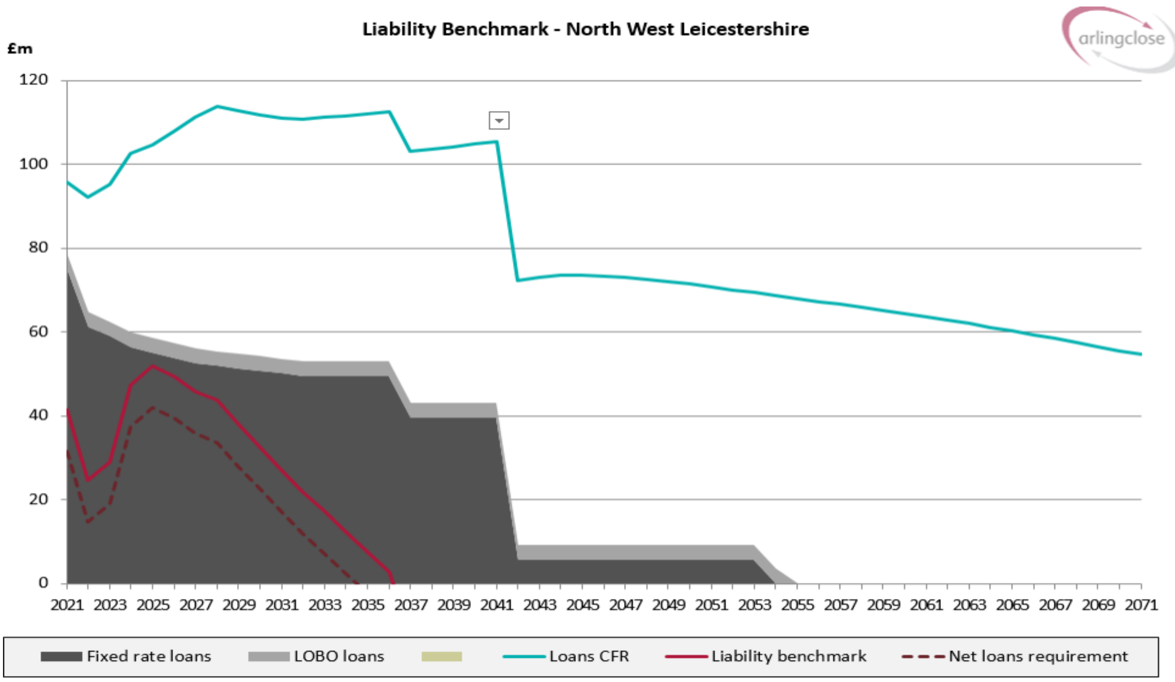
5.6. In keeping with these objectives, no new borrowing was undertaken, while £2.2m of existing loans were allowed to mature without replacement. This strategy enabled the Council to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

5.7. There remains an argument for diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields + 0.80%. The Council will evaluate and pursue these lower cost solutions and opportunities with its advisor Arlingclose.

5.8. Lender's Option Borrower's Options (LOBO) loans: The Council continues to hold £3.5m of LOBO loans 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 bank did not exercise its option during the year.

5.9. In 2022, a review of the Council's minimum revenue provision (MRP) policy was undertaken alongside the Council's treasury advisors Arlingclose. As a result, the Council has moved to the annuity method of charging MRP to create a smoother cost profile for MRP across the lifetime of repayment, this is anticipated to create a saving of £2.7m over the next ten years. Additionally, no further capital programmes will be funded by borrowing. Finally, there is a plan to review the HRA MRP policy going forward.

5.10. The liability benchmark graph is shown below. This shows the Council's overall forecasted borrowing requirement and anticipated underlying need to borrow. The solid red line shows the Council's external borrowing requirement, and the solid grey shading shows the current external borrowing position. Internal borrowing is represented by the gap between the grey shading and the blue line. Due to the 2021/22 accounts not having yet been completed yet this graph is based on the 20/21 accounts as a starting point and is subject to some change as a result. The graph shows that based on current projections the Council will not have a requirement to borrow externally as internal and existing external borrowing is sufficient. The graph does show that over the next few years the need to borrow is set to increase significantly before dropping again in later years.



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 20 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.

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 £43.3m and £70.6m 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)	3.0	-1.0	2.0	3.7%	94.5
Government (incl. local authorities)	29.0	8.0	37.0	3.4%	85.6
Money Market Funds	17.0	-12.9	4.1	3.9%	1.0
Total investments	**49.0**	**-5.9**	**43.1**	**3.5%**	**78.0**

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 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 0.6% - 0.7% per annum in early April 2022 and between 3.8% and 3.9% at the end of March 2023.

6.6. Investment objectives were achieved by increasing exposure to short dated, low risk deposits with Government and decreasing exposure to both banks and Money Market Funds. This encouraged longer dated deposits with higher returns alongside increased security of funds.

6.7. 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 %**
31.03.2022	4.00	AA-	41%	71	0.39%
31.03.2023	4.07	AA-	14%	78	3.49%
Similar Las	4.74	A+	63%	56	0.73%
All Las	4.71	A+	59%	12	1.59%

6.8. The Council had budgeted £9,000 in interest income from investments after deductions in 2022/23. Actual income received in 2022/23 was £1.1m. This represents an average return on balances through the year of 2%.

6.9. Of the £1.1m received, an estimated £137,000 will be deducted for S106 balances and other minor deductions. The remaining £983,000 will be apportioned between the General Fund and HRA.

6.10. The allocations to the General Fund and HRA are based on the notional investment balances of both funds throughout the year. The percentage of which will be applied to the overall interest received after deductions. This approach leads to the balances being split £623,000 to the General Fund and £360,000 to the HRA. Please note these figures are subject to change due to the final notional balance figures not yet being finalised. This will be confirmed with the completion of the year end accounts.

6.11. The budgeted interest received for 2022/23 in comparison to actuals is significantly different. This is largely due to the dramatic increase in interest rates by the Bank of England in response to the exceptional economic scenario detailed in section 2. These increased interest rates have boosted the interest return for the Council from 0.4% on 31 March 2022 to 3.5% on 31 March 2023 resulting in the overall increase in investment return. Additionally, Investment balances have been higher than expected due to a number of factors including delayed repayment of grants to central government, slippage in capital programmes and higher income than anticipated from sources such as business rates, rents and council tax.

7. Non-Treasury Investments

7.1. The definition of investments in CIPFA's revised 2021 Treasury Management Code covers all the financial assets of the Council 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) and or for commercial purposes (made primarily for financial return).

7.2. 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.

7.3. On 31 March 2023, the Council held £13.8m of directly owned property investments which although are primarily held for local regeneration and development do also provide financial return as a secondary function.

7.4. A full list of the Council's non-treasury investments is available in the Council's investment strategy found here.

7.5. These investments are budgeted to generate £195,889 of investment income for the Council after taking account of direct costs, representing a rate of return of 3.91%.

8. Treasury Performance

8.1. The Council 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.

8.2. Since the beginning of the reporting period the Council has paid £2.2m in interest. The overall interest rate for the financial year 2022/23 is 3.4%. For comparison purposes current one year borrowing through the PWLB upon writing this report is 5.0%.

8.3. No new borrowing was undertaken in the 2022/23 financial year in line with expectations.

8.4. The Council's interest return percentage on 31 December 2022 (the last available benchmarking data) was 3.0%. In comparison with other local authorities this was significantly better than the 1.4% average. A further comparison is the Daily Sterling Overnight Index Average (SONIA) which on December 31 2022, was 3.4%.

9. Compliance

9.1. The S151 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 investment limits is demonstrated in table 7 below.

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

Table 6: Debt Limits

	2022/23 Maximum	31.3.23 Actual	2022/23 Operational Boundary	2022/23 Authorised Limit	Complied?
Borrowing	64.9m	62.6m	72.9m	82.9m	Yes

9.3. Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

Table 7: Investment Limits

	2022/23 Maximum	31.3.23 Actual	2022/23 Limit	Complied? Yes
Any single organisation, except the UK Government	£5m	£5m	£5m	Yes
Any group of organisations under the same ownership	£5m	£5m	£5m	Yes
Any group of pooled funds under the same management	£5m	£5m	£12.5m	Yes
Negotiable instruments held in a broker's nominee account	£5m	£5m	£12.5m	Yes
Registered providers and registered social landlords	£0m	£0m	12.5m	Yes
Unsecured investments with building societies	£0m	£0m	£5m	Yes
Money Market Funds	£23m	£4.1m	Unlimited	Yes
Real Estate Investment Trusts	£0m	£0m	£12.5m	Yes

10. Treasury Management Indicators

10.1. The Council measures and manages its exposures to treasury management risks using the following indicators.

10.2. **Security:** The Council 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.

	31.12.23 Actual	2022/23 Target	Complied?
Portfolio average credit score	AA-	A-	Yes

10.3. **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 three-month period.

	31.3.22 Actual	2022/23 Lower Limit	Complied?
Total cash available within 3 months	£36.1m	£2.5m	Yes

10.4. **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 interest rates 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	-327,459	-200,000	No
Upper limit on one-year revenue impact of a 1% fall in interest rates	327,459	200,000	No

10.5 The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at current rates. Although the indicator has not been complied with this is not a compliance failure as it reflects the fact that all of the Council's investments are due to mature this year. Longer investments would reduce the interest rate risk but would expose the Council to higher liquidity risk. This indicator has been updated for 23/24 to have an increased limit to make it more relevant for interest rate risk for the Council.

10.6 **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:

	31.03.23 Actual £m	31.03.23 Actual %	Upper Limit	Lower Limit	Complied?
Under 12 months	2.74	4%	30%	0%	Yes
12 months and within 24 months	1.27	2%	30%	0%	Yes
24 months and within 5 years	3.20	5%	30%	0%	Yes
5 years and within 10 years	2.46	4%	30%	0%	Yes
10 years and above	52.98	85%	90%	0%	Yes

10.7 Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

10.8 **Principal Sums Invested for Periods Longer than a year:** The purpose of this indicator is to control the Council'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	0	0	0
Limit on principal invested beyond year end	£10m	£10m	£10m
Complied?	Yes	Yes	Yes