Review of Treasury Management Activity 2022/23

Introduction

The council's treasury management activity is underpinned by the Chartered Institute of Public Finance and Accountancy's Codes of Practice on Treasury Management ("the Code") and the related Prudential Code. These were last updated in 2021. The council is required to produce Prudential Indicators and a Treasury Management Strategy Statement on the financing and investment activity annually which was approved by Full Council on 9 February 2023. As a consequence of changes to the Prudential Code, the county council no longer had a non-treasury management investment portfolio in 2022/23.

Investment and borrowing decisions are taken based upon long-term borrowing requirements, the estimated level of reserves and actual and estimated cash-flow. They are also taken in the context of the current and forecast economic conditions. Consideration is also given to risks and compliance with Prudential Indicators. Therefore, this report provides commentary on the following factors for 2022/23:

- Economic environment
- Borrowing activity
- Investment activity
- Performance against the Prudential Indicators

Economic environment during 2022/23

The key economic features of the year were increasing inflation and the subsequent rise in interest rates as central banks globally tried to bring inflation under control. Global inflation continued to be above central bank targets largely as a consequence of the war in Ukraine. In the UK economic outlook remained relatively weak with forecasts indicating there was a chance of a mild recession.

Starting the financial year at 5.5%, the annual Consumer Prices Index (CPI) measure of UK inflation rose strongly to 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 to 10.4% before falling back a little to 10.1% in March. However, the expectation was that the rate of inflation would fall, potentially quite sharply, over the next few months as the impact of the large increases in energy costs fell out of the calculation.

In response to the high inflation The Bank of England increased the official Bank Rate several times during the year. At March 2022 the Bank Rate stood at 0.75%. The Monetary Policy Committee (MPC) increased the rate at its every meeting in the financial year. Increases of 0.5% in December and February and then 0.25% in March saw the rate rising to 4.25%.

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.

This continuing uncertainty has seen gilt yields increase. The costs of authorities borrowing from the Public Loans Work Board (PWLB) are related to the bond yields and therefore the cost of borrowing has increased. For example, a 10-year PWLB fixed rate loan taken on the 1 April 2022 had an interest rate of 1.61%. An equivalent loan taken on 31 March 2023 was 3.49%.

The picture seen in the UK was similar in many of the world economies. Europe and America have seen increases in 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.

Treasury Management Portfolio 2022/23

In summary, the holdings at 31 March 2023 are shown as follows compared to the balances at the end of the previous year:

	31/3/2023	**31/3/2022***
	£m	£m
Long term borrowing	879.6	884.6
Short term borrowing	296.7	318.8
Total borrowing	**1,176.3**	**1,203.4**
Long term investments	700.1	660.4
Short term investments	180.0	224.7
Total investments	**880.1**	**885.1**
Net borrowing position	**296.2**	**318.3**

*For comparative purposes the 2021/22 position has been restated to include Non treasury management investments which were shown separately in the 2021/22 report.

Borrowing Activity 2022/23

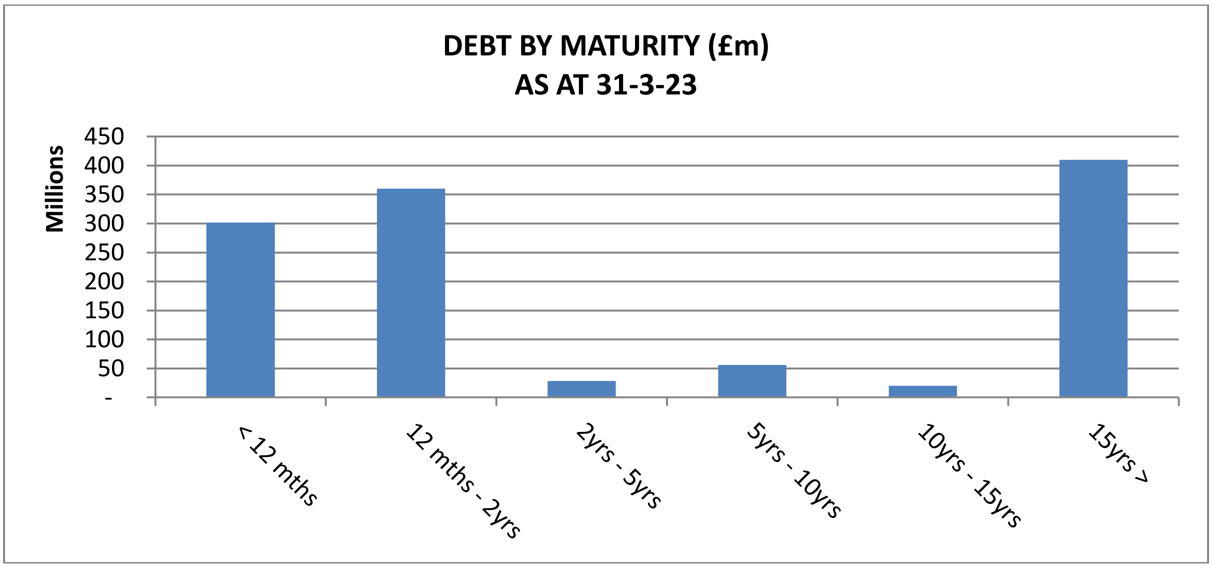
The Code requires that the council, in the medium term, only borrows for capital purposes (with the underlying need to borrow for capital purposes being measured by the Capital Financing Requirement). Total borrowing in the year was managed within the operational and authorised borrowing limits as approved in the Treasury Management Strategy which reflects the underlying need to borrow for capital purposes.

The year saw a fall of £27m in the total borrowing held. This was a planned reduction as reported to this committee on 25 July 2022 as the borrowing held at 31 March 2022 was greater than required due to the council having taken advantage of market conditions to borrow in advance of need to secure lower borrowing rates. It was therefore anticipated that borrowing would fall by 31 March 2023, reflected in the following table.

	Debt 31/03/2022	Borrowing	Repayments	Debt 31/03/2023	
	£m	£m	£m	£m	%
Fixed Rate Funding					
Public Works Loan Board	284.6	0.0	-5.0	279.6	24
Bond	250.0	0.0	0.0	250.0	21
Market Borrowing	247.0	409.6	-439.6	217.0	18
Total Fixed Rate Funding	**781.6**	**409.6**	**-444.6**	**746.6**	
Variable Rate Funding					
Bond	350.0	0.0	0.0	350.0	30
Shared Investment Scheme	71.8	626.2	-618.3	79.7	7
Total Variable Rate Funding	**421.8**	**626.2**	**-618.3**	**429.7**	
Total Loan Debt	**1,203.4**	**1,035.8**	**-1,062.9**	**1,176.3**	**100**

Despite the moves towards longer term borrowing in previous years the short-term debt is still significant with some £302m of debt at 31 March 2023 due to mature within 12 months.

The two bonds issued by the council form approximately half of the total council borrowing.



Overall, the average rate of interest paid in 2022/23 on borrowing by the council was 2.93% per annum compared with an average rate of 1.97% in 2021/22.

The council did not enter into any new other long term liability arrangements in the year.

The outstanding Private Finance Initiative liability at 31 March 2023 was £126m.

Investment Activity

The council invests its reserves and other cash balances. The total value of investments held (excluding fair value adjustment), at 31 March 2023 for treasury management purposes was £880.1m. This is £5m lower than at 31 March 2022. The table below shows the investment holdings and the movements during the year:

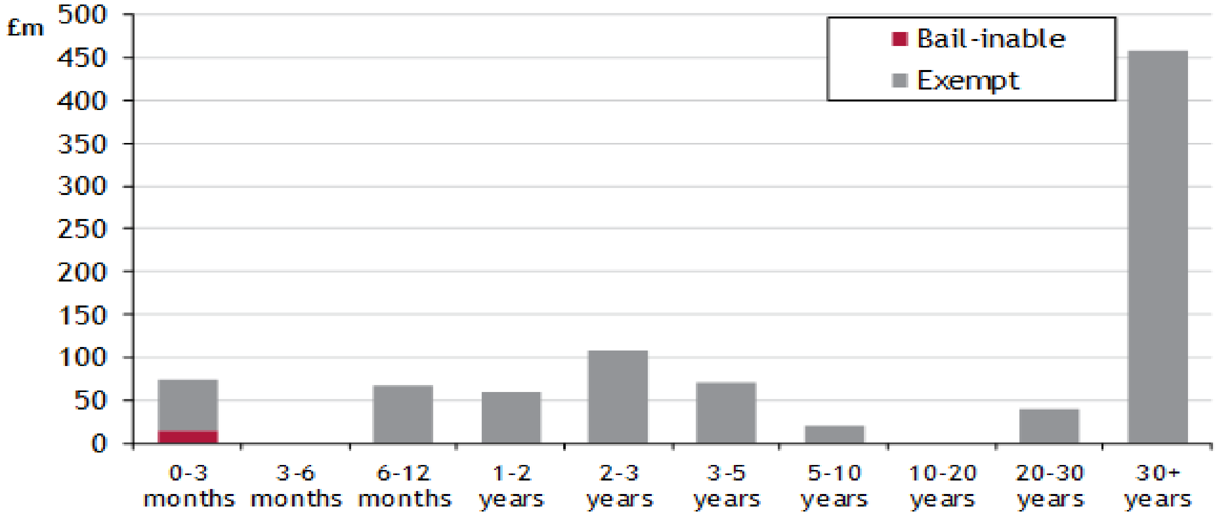
Maturity Range	**Position* at 31/3/2022 £m**	**Movement £m**	**Position at 31/3/2023 £m**
Call accounts and under 1 year	71.0	-16.3	54.7
Local Authority deposit 1-2 years	0.0	10.0	10.0
Local authority deposits 2-3 years	10.0	-10.0	0.0
Local authority bonds	34.5	-2.9	31.6
UK Government and supranational bonds	769.6	14.2	783.8
Total	**885.1**	**-5.0**	**880.1**

* In line with the new Prudential Code and the approved treasury management strategy for 2022/23 the council made no 'non-treasury' management investments in 2022/23 and the existing non-treasury management investments were managed within the treasury management limits. Therefore, the table reflects the adjusted position for 2021/22 including the reclassification for comparative purposes.

In undertaking investments consideration is given to the risk and liquidity within the portfolio which are affected by the maturity of the investment, asset type, country invested in and the credit rating. The position of the investment portfolio on these areas at the end of the year were as follows.

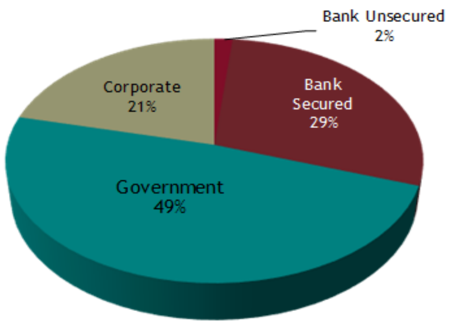
Investments by Maturity

The following graph shows the maturity dates of assets along with the exposure to bail-in in the event of a bank default (i.e. the risk that the investment may be lost, or the principal repaid significantly reduced). As can be seen the exposure to bail in is relatively low and arises mainly in the short term with the use of call accounts. The very long-term investments are principally investment in the UK government via gilts. Therefore, the credit risk is considered low. The assets are saleable and do not need to be held to maturity, however market prices fluctuate and this market risk requires management.

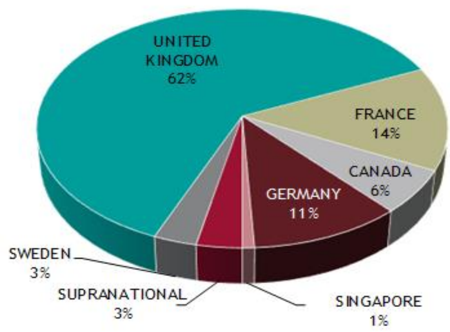


Security

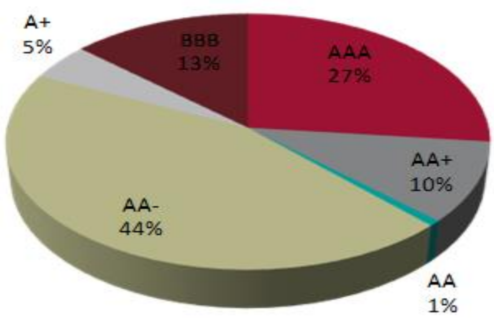
Total investments analysed by asset type



Total Investments analysed by Country



Total Investments analysed by credit rating



Security of capital remained the council's main investment objective. This was maintained by following the council's Counterparty Policy, as set out in its Treasury Management Strategy Statement for 2022/23. This defined 'high credit quality' organisations as those having a minimum long-term credit rating of A+. In practice the average credit rating in 2022/23 was higher at AA, with the lowest rating being BBB which relates to the holding of bonds issued by the energy company EDF which is largely owned by the French government.

Investments with banks were held in call accounts only, with other short-term deposits restricted to deposits with other local authorities.

Liquidity Management

The council maintained a minimum level of primary liquidity through the use of Call Accounts. The council also has bond portfolios which are available for sale, at current market prices, if needed as 'secondary' liquidity.

The council undertakes cash flow forecasting daily to determine the maximum period for which funds may prudently be committed.

Yield

The rates of return on the council's investments reflect prevailing market conditions and the council's objective of optimising returns commensurate with the principles of security and liquidity.

Overall, the treasury management investment portfolios returned an average rate of 3.49% in 2022/23 which can be attributed to the categories as follows:

Maturity Range	**Average Balance £m**	**Average Rate**
Call account and under 1 year	87.3	2.15%
Bank and local authority deposits 3-5 years	10.0	2.95%
Local authority bonds	31.9	3.18%
UK government and other bonds	856.8	3.65%
Total	**986.0**	**3.49%**

Impact of Treasury Management activity on the council's revenue budget

In total there was a net underspend against budget of £7.4m as shown in the following table.

	22/23 Budget	31 March 2023	Variance
	£m	**£m**	**£m**
Minimum Revenue Provision	23.9	27.1	3.2
Interest Paid	25.2	38.0	12.8
Interest Received/surplus on sale	(18.9)	(42.3)	(23.4)
Total	**30.2**	**22.8**	**(7.4)**

Income received in the year was £23.4m higher than budgeted. This was largely due to the gains of £14.2m realised on the buy-out of a £40m shorts position. The shorts position arose as in 2019/20 the council entered into a forward contract agreement in which it agreed to purchase £90 million of UK government bonds at a future time for a sale price of £150.2 million, to mitigate market risk relating to local authority loans made to other local authorities.

The increase in the bank base rate also contributed to the income received for variable investments and the fair value gains on the remaining hedge position.

The amount of interest paid was more than budget due to the increases in the bank base rate affecting variable rate debt costs.

Treasury Management and Prudential Indicators 2022/23

The Local Government Act 2003 and supporting regulations require the council to have regard to the Prudential Code and to set prudential indicators to ensure the council's capital investment plans are affordable, prudent and sustainable**.** A comparison of the actual position at 31 March 2023 compared to the 2022/23 indicators set in the Treasury Management Strategy is as follows. All activity in the year complied with the Prudential Indicators and Treasury Management Strategy Statement for the year.

Prudential Indicators

Authorised limit for external debt The authorised limit is a prudent estimate of debt which reflects the council's capital expenditure plans and allows sufficient headroom for unusual cash movements.	**2022/23**	**Actual**
	£m	**£m**
Borrowing	1,700	1,176
Other long term liabilities (PFI schemes)	400	126
TOTAL	**2,100**	**1,302**

Operational boundary for external debt The operational boundary is a prudent estimate of debt but has no provision for unusual cash movements. It represents the estimated maximum external debt arising as a consequence of the council's current plans.	2022/23	Actual
	£m	**£m**
Borrowing	1,400	1,176
Other long term liabilities (PFI schemes)	160	126
TOTAL	**1,560**	**1,302**

Loans Capital Financing Requirement to Gross debt For the purposes of managing activity the CFR and gross debt comparison exclude the PFI schemes.	**2022/23**	**Actual/ Estimate 31/3/23**
	£m	**£m**
Capital Financing Requirement	1,080	1,023
Estimated gross debt	1,157	1,176
Debt to Capital Financing Requirements	107%	115%

The Capital Financing requirement is the underlying need to borrow for capital purposes. This is the cumulative effect of past borrowing decisions and future plans. This is not the same as the actual borrowing requirement on any one day, as day to day borrowing requirements incorporate the effect of cash flow movements relating to both capital and revenue expenditure and income. The financing of the 2022/23 capital expenditure has not yet been finalised therefore the Capital Financing Requirement is based on an estimated use of borrowing and is subject to change.

Gross debt includes borrowing for premiums, long term debtors and transferred debt. Under the Prudential Code when comparing debt to the Capital Financing Requirement these should be removed from the gross debt. The non-adjusted gross debt is above the Capital Financing Requirement by £153m but once the adjustments are made the borrowing is £76m above Capital Financing Requirement. This largely reflects the on-going impact of advance borrowing and the capital expenditure funded from borrowing being estimated to be higher than initial forecasts. The amount above the Capital Financing Requirement will be eliminated as debt matures.

Treasury Management Indicators

Interest rate exposure	**Upper Limit**	**Actual**

Measures the council's exposure to the risk of interest rate movements. The one-year impact indicator calculates the theoretical impact on the revenue account of an immediate 1% rise in all interest rates over the course of one financial year.		
	£m	**£m**
1 year impact of a 1% rise	50.0	0.3

Maturity structure of debt Limits on the maturity structure of debt helps control refinancing risk.	**Upper Limit %**	**Actual %**
Under 12 months	75	26
12 months and within 2 years	75	31
2 years and within 5 years	75	2
5 years and within 10 years	75	5
10 years and above	75	36

Minimum Average Credit Rating To control credit risk the council requires a very high credit rating from its treasury counterparties.	**Benchmark**	**Actual**
Average counterparty credit rating	A	AA