APPENDIX A

ANNUAL TREASURY REPORT 2022/23

1. Background

1.1 This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2022/23. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

1.2 Treasury management is defined as: 'The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.'

1.3 Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management strategy.

2.0 Economic Background

2.1 **UK. Economy.** Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022/23.

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

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

2.3 Q2 of 2022 saw UK GDP deliver growth of +0.1% q/q, but this was quickly reversed in the third quarter, albeit some of the fall in GDP can be placed at the foot of the extra Bank Holiday in the wake of the Queen's passing. Q4 GDP was positive at 0.1% q/q. Most recently, January saw a 0.3% m/m increase in GDP as the number of strikes reduced compared to December. In addition, the resilience in activity at the end of 2022 was, in part, due to a 1.3% q/q rise in real household disposable incomes. A big part of that reflected the £5.7bn payments received by households from the government under the Energy Bills Support Scheme.

2.4 Nevertheless, CPI inflation picked up to what should be a peak reading of 11.1% in October, although hopes for significant falls from this level will very much rest on the movements in the gas and electricity markets, as well as the supply-side factors impacting food prices. On balance, most commentators expect the CPI measure of inflation to drop back towards 4% by the end of 2023. As of February 2023, CPI was 10.4%.

2.5 The UK unemployment rate fell through 2022 to a 48-year low of 3.6%, and this despite a net migration increase of c500k. The fact remains, however, that with many economic participants registered as long-term sick, the UK labour force shrunk by c500k in the year to June. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity, and with average wage increases running at over 6% the MPC will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food (up 18.3% y/y in February 2023) and energy that have endured since Russia's invasion of Ukraine on 22 February 2022.

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

2.7 In the interim, following a Conservative Party leadership contest, Liz Truss became Prime Minister for a tumultuous seven weeks that ran through September and October. Put simply, the markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng, and their reign lasted barely seven weeks before being replaced by Prime Minister Rishi Sunak and Chancellor Jeremy Hunt. Their Autumn Statement of the 17th of November gave rise to a net £55bn fiscal tightening, although much of the "heavy lifting" has been left for the next Parliament to deliver. However, the markets liked what they heard, and UK gilt yields have reversed the increases seen under the previous tenants of No 10/11 Downing Street, although they remain elevated in line with developed economies generally.

2.8 As noted above, GDP has been tepid throughout 2022/23, although the most recent composite Purchasing Manager Indices for the UK, US, EZ and China have all surprised to the upside, registering survey scores just above 50 (below suggests economies are contracting, and above suggests expansion). Whether that means a shallow recession, or worse, will be avoided is still unclear. Ultimately, the MPC will want to see material evidence of a reduction in inflationary pressures and a loosening in labour markets. Realistically, that is an unlikely outcome without unemployment rising and wage settlements falling from their current levels. At present, the bigger rise in employment kept the ILO unemployment rate unchanged at 3.7% in January. Also, while the number of job vacancies fell for the ninth consecutive month in February, they remained around 40% above pre-pandemic levels.

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

2.10 The £ has remained resilient of late, recovering from a record low of $1.035, on the Monday following the Truss government's "fiscal event", to $1.23. Notwithstanding the £'s better run of late, 2023 is likely to see a housing correction of some magnitude as fixed-rate mortgages have moved above 4.5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.

2.11 As for equity markets, the FTSE 100 started 2023 strongly, rising to a record high of 8,014 on 20th February, as resilient data and falling inflation boosted earnings. But global equities fell sharply after concerns over the health of the global banking system emerged early in March. The fall in the FTSE 100 was bigger than the drop in the US S&P 500. Indeed, at around 7,600 now, the FTSE is 5.2% below its record high on 20th February, while the S&P 500 is only 1.9% lower over the same period. That's despite UK banks having been less exposed and equity prices in the UK's financial sector not falling as far. It may be due to the smaller decline in UK interest rate expectations and bond yields, which raise the discounted value of future earnings, compared to the US.

3.0 Local Context

3.1 During 2022/23, the Council maintained an under-borrowed position. This meant that the capital borrowing need (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

3.2 A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

3.3 The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

3.4 The Council's Capital Financing Requirement (CFR) at 31 March 2023 was £134.619m, while usable reserves and working capital which are the underlying resources available for investment were £74.212m**.**

3.5 The Council has an increasing CFR over the next 2 years of £29m, due to the borrowing requirement of £44.5m (GF £30.6m / HRA £13.9m) for financing the capital programme over the forecast period, if reserve levels permit internal borrowing will be considered. The CFR reduces when Minimum Revenue Provision (MRP) are made and the repayment of debt, over the forecast period there are loans due for repayment with a combined total value of £8.6m.

4.0 Borrowing Strategy

4.1 Borrowing Activity in 2022/23

	Balance 1/4/22 £m	New Borrowing £m	Debt Maturing £m	Balance 31/3/23 £m
CFR	137.541			134.619
Short Term Borrowing	10.138	3.701	-3.468	10.331
Long Term Borrowing	86.972	0.000	-6.534	80.438
Total Borrowing	**97.110**	**3.701**	**-10.002**	**90.769**

Other Liabilities – Finance Lease Liability	5.373	0.000	-0.364	5.009
Total External Debt	**102.483**	**3.701**	**-10.366**	**95.778**
Increase/(Decrease) in Borrowing £000				-6.665

4.2 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 Authority's long-term plans change being a secondary objective.

4.3 The Council has an increasing CFR due to the capital programme and an estimated borrowing requirement as determined by the Liability Benchmark, which also takes into account usable reserves and working capital. Having considered the appropriate duration and structure of the Council's borrowing need based on realistic projections, it was decided not to take any borrowing due to the high interest rates.

4.4 **LOBOs**: The Council holds £3.5m of LOBO (Lender's Option Borrower's Option) 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. All of the £3.5m of LOBOS had options during the year, none of which were exercised by the lender.

4.5 **Debt Rescheduling**: The premium charge for early repayment of PWLB debt remained relatively expensive for the loans in the Council's portfolio and therefore unattractive for debt rescheduling activity. No rescheduling activity was undertaken as a consequence.

5.0 Investment Activity

5.1 The Council's investment policy is governed by MHCLG investment guidance, which has been implemented in the annual investment strategy approved by the Council on 8 March 2022. The policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.). During 2022/23 the Council's investment balances have ranged between £52.8 and £93.6 million.

	Balance 1/4/22 £m	**New Investments £m**	**Investments Redeemed £m**	**Balance 31/3/23 £m**
Short Term Investments	49.790	205.895	-211.110	44.575
Long Term Investments	12.500	0.000	0.000	12.500
Total Investments	**62.290**	**205.895**	**-211.110**	**57.075**
Increase/(Decrease) in Investments £000				-5.215

5.2 Security of capital remained the Council's main objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2022/23.

5.3 Counterparty credit quality is assessed and monitored by Link the Council's treasury advisors, with reference to credit ratings; credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. Link provide recommendations for suitable counterparties and maximum investment periods.

6.0 Compliance with Prudential Indicators

6.1 The Council has complied with its Prudential Indicators for 2022/23, which were set on 8 March 2022 as part of the Council's Treasury Management Strategy Statement.

6.2 **Interest Rate Exposure:** These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates for both borrowing and investments. The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Approved Limit for 2022/23 %	**Maximum during 2022/23 £m**
Fixed Rate		
Borrowing	100%	99.63%
Investments	75%	47.31%
Compliance with Limit		*Yes*
Variable Rate		
Borrowing	20%	0.37%
Investments	100%	52.69%
Compliance with Limit		*Yes*

6.3 **Maturity Structure of Fixed Rate Borrowing.** This indicator is to limit large concentrations of fixed rate debt and control the Council's exposure to refinancing risk.

	Upper Limit %	**Fixed Rate Borrowing 31/03/23 £m**	**Fixed Rate Borrowing 31/3/23 %**	**Compliance?**
Under 12 months	15%	5.834	6.43%	Yes
12 months to 2 years	15%	3.000	3.31%	Yes
2 years to 5 years	30%	14.009	15.43%	Yes
5 years to 10 years	100%	15.994	17.62%	Yes
10 years and above	100%	51.932	57.21%	Yes

6.4 **Principal Sums Invested for over 364 Days.** 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.

Price Risk Indicator	**Limit 2022/23**	**Actual 31/03/23**	**Compliance?**
Limit on principal invested beyond year end	£15m	£12.5m	Yes

6.5 **Authorised Limit and Operational Boundary for External Debt.** The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached. The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit. The s151 Officer confirms that there were no breaches to the Authorised Limit and the Operational Boundary during 2022/23.

	Approved Operational Boundary 2022/23 £m	**Authorised Limit 2022/23 £m**	**Actual External Debt 31/03/23 £m**
Borrowing – incl Finance Leases	179.909	186.909	90.769
Other Long Term Liabilities	0.400	0.600	5.009
Total	**180.309**	**187.509**	**95.778**

6.6 In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary of the treasury management activity during 2022/23. A prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

6.7 The Council also confirms that during 2022/23 it complied with its Treasury Management Policy Statement and Treasury Management Practices.