ANNEX 4

ANNUAL TREASURY MANAGEMENT OUTTURN REPORT
2022/23

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1. Introduction

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 Council to approve treasury management semi-annual and annual **reports.**

The Council's treasury management strategy Statement for 2022/23 was approved by Council 7 April 2022. The investment and borrowing of cash expose the Council 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 are therefore central to the Council's Treasury Management Strategy.

2. External Context

Source: Arlingclose

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 Council 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 Council'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 caution is merited with certain authorities.

3. Local Context

On 31 March 2023, the Council had net borrowing of £7.0m.

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.

The council's borrowing was mainly around short term cashflow purpose. These factors are summarised the table below.

Table 1: Balance Sheet Summary	31/03/2023 Actual £000
General Fund CFR	94,300
External borrowing	(7,000)
Internal borrowing	**87,300**
Less: Balance sheet resources	103,294
Net investments	**15,994**

The Treasury Management Strategy for 2022/23 continued the policy of internal borrowing wherever possible. This maintains borrowing below its underlying level by using available reserves and working capital to reduce the need for external borrowing. This minimises interest rate risks and keeps interest costs and the 'cost of carry' lower.

The treasury management position at 31 March 2023 and the change during the year is set out in the table below.

Table 2: Treasury Management Summary	31/03/2022 Balance £000	Movement £000	31/03/2023 Balance £000	31/03/2023 Rate %
Short-term borrowing	-	(7,000)	(7,000)	4.00%
Cash and cash equivalents	26,682	(10,688)	15,994	4.01%
Net investments	**26,682**	**(17,688)**	**8,994**	**0.01%**

Borrowing Guidance

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.

Borrowing Strategy and Activity

The Council's primary consideration when borrowing money has been to strike a balance between securing low interest rates and achieving cost certainty over a period for which funds are required.

This position provides short term efficiencies with the flexibility to secure longer dated loans as and when the level of funds available for internal borrowing reduces, or financial forecasts indicate that external borrowing rates may increase.

No new long-term borrowing was undertaken during 2022/23, as internal borrowing was maximised, and short-term borrowing was utilised to manage cash flow.

Outstanding loans on 31 March 2023 are summarised in the table3 below.

Table 3: Borrowing Position	**31/03/2022 Balance £000**	**Net Movement £000**	**31/03/2023 Balance £000**	**31/03/2023 Weighted Average Rate %**	**31/03/2023 Weighted Average Maturity (months)**
Short-term borrowing	-	(7,000)	(7,000)	4.00%	1

Treasury Investment Activity

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 investments before seeking the highest 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.

The Council holds invested funds, representing income received in advance of expenditure, plus reserves and balances held which have not been utilised for internal borrowing.

During 2022/23 the Council's treasury investment balance has ranged between £13.0 million and £50.8 million.

This reflects the Council's strategic policy to maintain sufficient liquidity during this time and continue to borrow over shorter periods when appropriate and the receipt of additional funding from capital receipts.

The Council invests temporary cash surplus exclusively through the use of money market funds (MMF). No new fixed term deposits have been agreed during 2022/23, due to cash balances being held to maintain sufficient liquidity.

The year-end investment position and the year-on-year change is set out in the table below.

Table 4: Treasury Investment Position	31/03/2022 Balance £000	Net Movement £000	31/03/2023 Balance £000	31/03/2023 Income Return %	31.3.23 Weighted Average Maturity (Days)
Banks & building societies (unsecured)	8,182	812	8,994	3.90%	1
Money Market Funds	18,500	(11,500)	7,000	4.16%	1
Total investments (Weighted Average)	**26,682**	**(10,688)**	**15,994**	**4.01%**[1]	**1**[1]

Note 1: Weighted Average

The weighted average return on all investments received in the year to 31 March 2023 was 4.01%.

Money Market Fund rates have been increasing over the year, reflecting increases to the Bank of England Base Rate. There is a short time lag of between 2 to 4 weeks of Money Market Fund catching up with the official rate, as fund managers roll maturing instruments into new instruments at higher investment rates.

Bank Rate 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 2022, rose by around 3.5% for overnight/7-day maturities and 3.3% for 6 to 12-month maturities.

Table 5: Investment Benchmarking – Treasury investments managed in-house	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
Reigate & Banstead Borough Council at 31 March 2023	4.90	A+	100%	1	4.01%
Similar Local Authorities	4.74	A+	63%	56	3.57%
All Local Authorities	4.71	A+	59%	12	3.67%

The Council benchmarks the performance of its internally-managed investments against that of other Arlingclose clients.

Internally managed investments include all investments (except externally managed pooled funds) but do include MMFs. The performance of these investments against relevant measures of security, liquidity and yield are shown in the table above.

Non-Treasury Investments

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 (explicitly to further service objectives); and/or
- for commercial purposes (primarily for financial return).

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.

During 2022/23 the Council held £15.0m of investments for commercial purposes:

- £1.1m shares in Pathway For care Limited; and
- Loans of £13.3m to Greensand Holdings Limited and £0.6m to Horley Business Park Development LLP.

Compliance

All treasury management activities undertaken during 2022/23 complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy. Compliance with specific investment limits, the authorised limit and operational boundary for external debt, is demonstrated in tables 6 & 7 below.

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

Table 6: Debt Limits	2022/23 Maximum	31/03/2023 Actual	2022/23 Operational Boundary	2022/23 Authorised Limit	Complied?
Borrowing	7,000	7,000	69,000	79,000	Yes

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 £000	31/03/2023 Actual £000	2022/23 Counterparty Limit £000	Complied?
The Council's own banker for day-to-day banking transactional purposes	19,368	8,984	20,000	Yes
UK Banks	800	10	10,000	Yes

Table 7: Investment Limits	2022/23 Maximum £000	31/03/2023 Actual £000	2022/23 Counterparty Limit £000	Complied?
Non-UK Domicile Banks	-	-	10,000	Yes
Building Societies	-	-	10,000	Yes
Money Market Funds	10,000	7,000	10,000	Yes
UK Government (including gilts, Treasury Bills and the DMADF)	-	-	unlimited	Yes
Local authorities, parish councils etc.	-	-	10,000	Yes
Supranational institutions (e.g. European Investment Bank or World Bank)	-	-	10,000	Yes

Treasury Management Indicators

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

Security: The Council understands that credit ratings are good, but not perfect, predictors of investment default.

Full regard is therefore given to other available information on the credit quality of the organisations in which it invests.

Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate.

No investments will be made with an organisation if there are substantive doubts about its credit quality. In addition, if insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or with other Local Authorities.

Liquidity: The Council manages its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments.

The Council maintains a bank overdraft of £100,000, utilises overnight access Money Market Funds and accesses short-term borrowing to meet cash flow requirements. The local authority market also provides readily available funds.

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:

Table 8: Investment Time Limits	2022/23 £000	2023/24 £000	2024/25 £000
Limit on principal invested beyond year end	20,000	20,000	20,000
Complied?	Yes	Yes	Yes

Maturity structure of borrowing: This indicator is set to control the council's exposure to refinancing risk.

The upper and lower limits show the maximum and minimum maturity exposure to fixed rate borrowing as agreed in the Treasury Management Strategy:

Table 9: Maturity Limits	31/03/2023 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	100%	100%	0%	Yes
12 months to 2 years	-	100%	0%	Yes
2 years to 5 years	-	100%	0%	Yes
5 years to 10 years	-	100%	0%	Yes
10 years and above	-	100%	0%	Yes