CORPORATE AND REGENERATION SCRUTINY COMMITTEE - 9TH JANUARY 2024

SUBJECT: **TREASURY MANAGEMENT AND CAPITAL FINANCING PRUDENTIAL INDICATORS OUTTURN REPORT FOR 2022/23**

REPORT BY: **CORPORATE DIRECTOR FOR EDUCATION AND CORPORATE SERVICES**

1. PURPOSE OF REPORT

1.1 To present Members with details of Treasury Management activities and Capital Financing, together with the related Prudential Indicators for 2022/23

2. SUMMARY

2.1 In October 2010 the Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Service: Code of Practice (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports.

2.2 Under the provisions of the Local Government Act 2003, The Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 [The Capital Regulations], and the CIPFA's "The Prudential Code for Capital Finance in Local Authorities" [the Code], the Authority is obliged to approve and publish a number of indicators relevant to Capital Finance and Treasury Management.

2.3 The updated 2021 Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, which is to be a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The capital strategy for 2022/23 was submitted to Full Council on the 24th February 2022.

2.4 The Authority's Annual Treasury Strategy and Capital Financing Prudential Indicators for 2022/23 were also approved by Council on the 24th February 2022.

3. RECOMMENDATIONS

3.1 Members are asked to note the contents of this report.

4. REASONS FOR THE RECOMMENDATIONS

4.1 Compliance with the CIPFA "Code of Practice for Treasury Management in the Public Services".

5. THE REPORT

5.1 Treasury Management

5.1.1 Borrowing Activity

The Authority is operating a policy of internal borrowing in order to reduce risk and keep its interest costs low. As at the 31st March 2023 the internal borrowing position was £51.2m.

The Annual Treasury Management Strategy was approved by Council in February 2022. As part of the strategy approval was given to borrow £42m in 2022/23 to part fund the General Fund capital programme if required. A further £17.7m was approved for the HRA to fund the WHQS and Affordable Housing capital programme. During the reported period the only external borrowing that has taken place is a £600k Welsh Government loan in relation to the development of Ffos Market in Caerphilly, otherwise internal funds have been used in place of borrowing. No borrowing was required by the HRA as underspends in Revenue were used to fund the Capital programme.

During the period covered by this report, PWLB loans to the value of £3.5m were repaid on maturity. Such loans had an average interest rate of 4.42%. £30k of the WRU Loan and £517k of the Salix Loan was also repaid. Total debt outstanding as at 31st March 2023 was £315.8m and comprised of £246.4m PWLB loans; £30m market loans (LOBOs); £10m Bank loan; £25.9m WG loans, £30k WRU loan; and a £3.4m Salix Energy Finance loan.

With respect to the £30m LOBO loans, the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. During the reporting period our total LOBO portfolio with a value of £30m had a rate option reviewed, and the lenders chose not to exercise the option. The LOBO's represent 9.5% of the Authority's debt portfolio, which is exposed to interest rate risk.

The loans from Welsh Government are charged at zero interest providing we meet the loan obligations, the loans will be repaid though future capital receipts generated from projects.

5.1.2 Rescheduling

The Annual Strategy allows for the utilisation of debt rescheduling providing for both in year and future year savings and additional revenue resources. No rescheduling opportunities were utilised during the period covered by this report.

5.1.3 Investments

At the end of 2022/23 the Authority was holding £57.5m of long-term investments where the maturity date is greater than 365 days. These investments are in accordance with the approved Investment Strategy. The long-term investments comprise of UK Gilts, Bonds, Loans to Registered Providers, Loans to Local Authorities, Real Estate Investment Trusts (REITS) and pooled funds. The value of short-term deposits as at 31st March 2023 was £106.5m.

The total investments held as at 31st March 2023 were £164m and had a total average rate of income return of 2.89%. The minimum target rate which was set for our return on investments in the Treasury Management Strategy 2022/23 was the base rate in place at that time. Over the reporting period, the base rate has increased from 0.75% to 4.25%, with an average rate of 2.29%. Our return of 2.89% exceeded the average target rate for the year.

Our investments in pooled funds allow the Authority to generate enhanced income returns and the intention is to hold them for a minimum of five years as per the Treasury Strategy 2022/23. These investments generated an income return of 4.36% during the reporting period.

The Authority continued to maintain cash surpluses to subsidise the capital programme and delay any borrowing.

The portfolio as at 31st March 2023 comprised of the following types of investments:

Counterparty	Investment Product	Sector	£m
Banks & Building Societies	Bonds and Fixed Term Deposits.	Financial	18.0
Banks	Short Term Notice	Financial	10.0
Money Market Fund	Cash Pooled Fund	Financial	40.0
UK Government	Gilts and DMO	UK Government	11.5
Local Authorities and Housing Associations	Fixed-term cash deposits	Local Government	65.0
External Fund Managers	Property Pooled Fund	Property	9.1
External Fund Managers	Bond Pooled Fund	Mixed	2.1
External Fund Manager	Equity Pooled Fund	Mixed	5.2
External Fund Manager	Multi Asset Pooled Fund	Mixed	2.2
REIT	Pooled Fund	Property	0.9
Total Investments as	**at 31st March 2023**		**164.0**

5.1.4 Economic Outlook

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 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 this reporting 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.

The labour market remained tight albeit with some ongoing evidence of potential loosening at the end of the period. The unemployment rate 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 GDP 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 hikes of 50bps in December and February and then 25bps in March, taking Bank Rate to 4.25%.

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.

As at the 31st March 2023 the interest rates forecasts were as per table below.

Official Bank Rate	Upside Risk	Arlingclose (Central case)	Downside Risk
2023 Q4	0.25	5.25%	-0.00
2024 Q1	0.50	5.25%	-0.25
2024 Q2	0.50	5.25%	-0.50
2024 Q3	0.75	5.00%	-0.75
2024 Q4	0.75	4.75%	-1.00
2024/2025	0.75	4.00%	-1.00

5.1.5 Borrowing Update

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.

The authority is not planning to purchase any investment assets primarily for yield within the next 3 years.

The UK Infrastructure Bank, which is wholly owned and backed by HM Treasury, has been set up with £4bn of funding earmarked for lending to Local Authorities. Loans will be available for qualifying projects at gilt yield plus 0.6%, which is 0.2% lower than the PWLB certainty rate.

5.1.6 Counterparty Update

Credit Default Swap Prices (CDS) 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 Silicon Valley Bank 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.

5.1.7 Non-Treasury Investments

The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. Such investments can comprise of property; shared ownership housing; loans to local businesses/ subsidiaries; and shareholdings. During the reported period the Authority did not hold any non-treasury related investments.

5.2 Prudential Indicators

5.2.1 Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose. In accordance with best professional practice, the Authority does not associate borrowing with particular items or types of expenditure. In practice, the raising and repaying of loans is determined primarily by professional, expert advice and may not necessarily take place in the relevant year. To create an operating environment within which the Treasury Manager can legitimately react to appropriate advice, the various authorised limits as identified in Appendix 1 are set at a level in excess of the CFR. In the financial year to date, the Authority has been operating within the approved limits.

Appendix 1 shows a CFR value of £363.256m as at 31st March 2023. Certain capital schemes have been delayed or the scheme extended which has resulted in a lower funding requirement than budgeted.

5.2.2 Prudential Indicators – "Prudence"

The Prudential Indicators for Treasury Management are shown in Appendix 1, and the Authority is currently operating within the approved limits.

5.2.3 Prudential Indicators – "Affordability"

There is a requirement to analyse and report the capital financing costs and express those costs as a percentage of the net revenue streams of the Authority. These are identified in Appendix 2. The General Fund currently shows a projected reduction from the original budget as a consequence of not needing to borrow. HRA shows an overspend as MRP has been charged on the underlying need to borrow irrespective of whether the actual external borrowing has taken place. This allows for the £17.9m that was due to be borrowed in 2019/20.

5.2.4 Capital Expenditure and Funding

A summary of capital expenditure and funding is attached at Appendix 3 and shows that there will be an underspend on the core capital budget for HRA. This underspend is mainly as a result of delays in awarding contracts for the PAMS programme due to resource issues. Any underspend is ringfenced and is therefore carried forward accordingly. The HRA budget is as per the approved HRA Business Plan 2022/23. The outturn for General Fund includes expenditure which has been funded from outside our Core Capital Budget.

6. ASSUMPTIONS

6.1 The details set out in the report are based on actuals that have occurred between 1st April 2022 and 31st March 2023

7. SUMMARY OF INTEGRATED IMPACT ASSESSMENT

7.1 This report is for information only and no Integrated Impact Assessment is required.

8. FINANCIAL IMPLICATIONS

8.1 As detailed throughout the report.

9. PERSONNEL IMPLICATIONS

9.1 There are no personnel implications arising from this report.

10. CONSULTATIONS

10.1 There are no consultation responses that have not been reflected in this report.

11. STATUTORY POWER

11.1 Local Government Acts 1972 and 2003.

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Appendices:

Appendix 1 – Treasury Management Prudential Indicators – Prudence
Appendix 2 – Capital Finance Prudential Indicators – Affordability
Appendix 3 – Capital Expenditure and Funding