



Treasury Management and Investment Sub-Committee / Cabinet

19 June 2023 / 06 July 2023

Treasury Management Outturn Report 2022/23

Report by:

ACCOUNTANCY SERVICES MANAGER (Section 151 officer)

Officer Contact:

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Purpose

Under statute and the CIPFA Code of Practice on Treasury Management ("the Code"), Members are required to receive a report on the Treasury Management activities that took place in 2022/23.

Recommendations

That the Council be recommended to approve the Treasury Management Outturn Report 2022/23.

1. Introduction

- 1.1. The CIPFA Code of Practice for Treasury Management sets out the requirements for oversight by the Council of its treasury management operations. As part of the Code, the Council is required to receive an annual report on the performance of the treasury management function which highlights the effects of decisions taken and the circumstances of any non-compliance with the Code and the Council's Treasury Management Strategy.

2. Background

- 2.1. The Council can expect to have cash to invest arising from its revenue and capital balances, and collection of Council Tax. This cash can be usefully invested to produce a return to help support services and Council Tax. The activities around the management of this cash and borrowing are known as 'Treasury Management'.
- 2.2. Treasury Management is defined by the Chartered Institute of Public Finance and Accountancy (CIPFA) 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"
- 2.3. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the DLUHC Guidance.
- 2.4. CIPFA published its revised Prudential Code for Capital Finance and Treasury Management Code on 20th December 2021. The key changes in the two codes are around permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments.
- 2.5. The principles of the Prudential Code took immediate effect although local authorities could defer introducing the revised reporting requirements until the 2023/24 financial year if they wish. Due to the late notice of the changes in December 2021 and therefore the shorter time to interpret and implement the new code, the City Council has chosen to defer the reporting requirements until 2023/24. So this report and the 2022/23 Strategy were compiled on the previous Code's basis.
- 2.6. The Council's investment priorities as required by Government regulations are in order of priority:
 - (a) The security of Capital
 - (b) The liquidity of its investments; and
When these are satisfied
 - (c) Yield

DLUHC and CIPFA both advise that absolute certainty of security of capital and liquidity does not have to be achieved before seeking yield from investments. An appropriate balance of all three should be sought and that balance is determined by the Council in its Treasury Strategy.
- 2.7. The operation of Treasury Management is not without risk and the Council could suffer losses if one of its counterparties had financial difficulties.
- 2.8. The Council formally reviews its investment holdings in the following ways:

- Treasury Management Strategy report in February
- Treasury Outturn report in July
- A half-year update in November
- Treasury Management sub-committee to monitor Treasury Activity during the financial year.

The review of the year's activities is set out in the following appendices:

Appendix A – Economic Environment Update

Appendix B – Borrowing and Actual Investment Activity compared to the Approved 2022/23 Strategy

3. Summary of Review

- 3.1. During the financial year, there were no breaches of the Treasury Management Strategy.
- 3.2. The economic environment for the financial year was marked by rising inflation and interest rates.
- 3.3. The Council's investment holdings on the 31st March 2023 were £42m compared to £76m on 31st March 2022. The average and closing balances for the year were higher than allowed for in the budget. This was due to various balances being held due to later payment of capital spend such as £4.2m payment towards the Chelmer Waterside Scheme and CIL funded capital schemes of £3.1m.
- 3.4. Interest earnings from investments for the year were £1.87m, which was £1.17m higher than the budget, predominantly due to the rising interest rate environment experienced through the financial year. The Bank of England base rose rapidly from 0.75% to 4.25% in the year.
- 3.5. The overall return on investments for 2022/23 was 4.1% compared to 0.75% in the previous year.
- 3.6. The Council was invested in 4 pooled funds at the end of 2022/23 which generated total income returns of £664k at a return of 3.8%. Capital values were down reflecting the upward movement in interest rates, it can be expected that over the next couple of years capital values will recover.

4. Conclusion

- 4.1. It should be noted that the Council's Treasury Management has operated within approved parameters, has resulted in no realised losses and delivered income of £1.87m which has helped to offset financial cost pressures.

List of appendices:

Appendix A – Economic Environment Update

Appendix B – Borrowing and Actual Investment Activity compared to the Approved 2022/23 Strategy

Background papers:

None

Corporate Implications

Legal/Constitutional: None

Financial: As detailed in report.

Potential impact on climate change and the environment: Any fund managers will be required to consider ESG (Environmental, Social and Governance) factors in their investment process. All the fund managers would be expected to have signed up to the UN Principles for Responsible Investment (PRI). PRI argues that active participation in ESG and exercising shareholder rights on this basis can help to improve the performance of companies which may otherwise not address such concerns and so being an engaged corporate stakeholder is a more effective way to bring about change in corporate behaviour on ethical issues.

Further requirements from those identified above are not practical given the limited ability to directly influence any immediate change in the financial markets.

Contribution toward achieving a net zero carbon position by 2030: None

Personnel: None

Risk Management: All treasury management activity requires a careful consideration of risk and reward.

Equality and Diversity: None

Health and Safety: None

Digital: None

Other: None

Consultees: None

Relevant Policies and Strategies:

Treasury Management Strategy 2022/23

Appendix A – Economic Environment Update

Introduction

The amount of interest the Council earns on its balances is a function of the mix of fixed and variable rate investments made by the authority, together with the performance of the shares it holds in pooled investment funds (CCLA, Multi Asset Funds and Money Market Funds).

The interplay of various economic factors including interest rate expectations, property prices and economic growth all affect the performance of the Council's investments.

Economic factors

It is no surprise that UK interest rates have been volatile right across the curve (different duration of bonds) given the inflationary pressures, easing of Covid restrictions, the Russian invasion of Ukraine, and shifts in UK Government economic policy.

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%.

The Bank of England therefore increased the base rate to try to bring inflation back in line with its 2.0% target with the Bank Rate increased steadily throughout 2022/23, starting at 0.75% and finishing at 4.25%. There was a temporary shock to the rates through September and October for seven weeks with rates expecting to peak at over 6% at one point but has since settled.

The Council benefitted from some of these increases with its liquid funds held in money market funds and notice funds that were linked to base rate. The Council's notice accounts are also directly linked to the Bank of England base rate and so received immediate rises in line with the increases.

The valuation of the Council's investment in the CCLA Property Fund decreased by £1,247k in the year, leaving the Council's unrealised gain at £1,319k on its initial investment. Capital valuations have moved downwards and expected to continue during 2023 driven by market factors. Higher inflation has led to high interest rates causing a slowdown in the transaction flows and reductions in valuations. The Fund has a minimum 180-day redemption period which was increased from 90 days as a temporary extension to the redemption period as a proactive measure and not due to any redemption concerns.

The valuations of the Council's investment in the 3 Multi Asset Funds also changed throughout the year, with an overall decrease in value across the 3 of £878k taking the unrealised loss to £1,053k. These investments are seen as medium to long term

investments over a 3-to-5-year period and so capital values will fluctuate up and down during this investment horizon.

The Government has extended the mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investments funds to 31st March 2025.

Appendix B – Borrowing and Actual Investment Activity compared to the Approved Strategy for 2022/23

External borrowing

1. The Council has the freedom to borrow in the following circumstances:

- Short-term borrowing to manage liquidity
- Long-term borrowing only to fund capital expenditure if no other capital resources exist e.g. the Council has spent its capital receipts or expects to do so imminently

The Council did not need to borrow externally in 2022/23.

2. Finance leases are deemed by Government to be a type of borrowing in the Council's Accounts and Treasury reporting must identify that the Council has borrowed money when they are used. At 31st March 2023, the Council had outstanding finance lease liabilities of £1,051K, used to acquire vehicles and equipment to deliver existing services.

Investments

3. Officers with appropriate knowledge and training invest the Council's cash balances. Arlingclose were used as advisers on treasury management to help inform the decision-making process and this changed to Link Treasury Services during the year through a competitive tender exercise.

4. The Council's cash is invested in the following priority order, in accordance with statutory guidance:

- i) Security – protecting the capital sum invested from loss
- ii) Liquidity – ensuring the funds invested are available for expenditure when needed
- iii) Yield – subject to achieving proper security and liquidity, to pursue a yield on investments to support service provision

The regulations and CIPFA both advise that absolute certainty of security of capital and liquidity does not have to be achieved before seeking yield from investments. An appropriate balance of all three should be sought and that balance is determined by the Council in its Treasury Strategy.

5. The Council uses cash-flow planning methods in order to manage its in-house investments. This allows officers to separate in-house funds in to two categories:

- Shorter term, lower yielding investments – these investments are invested for relatively short durations, normally 3-6 months, in order to ensure that the maturity profile of investments matches the peaks and troughs in the Council's liquidity needs – particularly for the final 2 months of the year where council tax income falls significantly due to the 10 monthly instalments most residents choose to pay in.

- Longer term, higher yielding investments – these are investments of ‘core cash’ which the Council does not require for operational purposes within the short to medium term. Core cash comes from the Council having for example reserves, such as the General revenue balance. These core cash balances can be invested for a year or more in appropriate counterparties in-order-to generate higher yields without causing liquidity issues.
6. During 2022/23 the Council’s investment portfolio decreased from £76.0m to a closing balance of £42m. The movement is due to temporarily holding government grant funding from previous year that was either repaid or spent and also spend on the capital programme.

Compliance with Treasury Management Strategy

7. A summary of the approved treasury management strategy, together with actual outcomes is presented below:

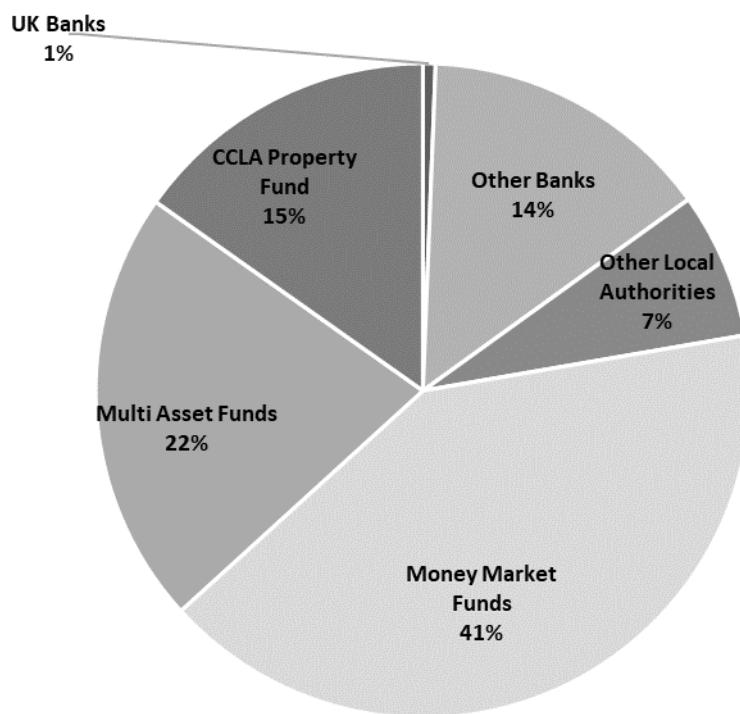
- a. **To ensure that there are no breaches of the approved counterparty limits or durations** No breach occurred.
- b. **To maintain a target balance of £15m of short notice funds to manage liquidity** The Council held less than £15m in liquid funds for a period of 5 days at the beginning of March, however this was planned with notice funds maturing, so caused no liquidity problems and within target of available cash within 35 days.
- c. **To maintain long term investments within set limit of £20m** Long term investments holding were within parameters

The total bail in risk moved by 1% from 77% to 78% mostly due to year end cash movements and size of portfolio. The smaller the portfolio the higher the bail in risk as the more of the funds will be held in liquid deposits (money market funds).

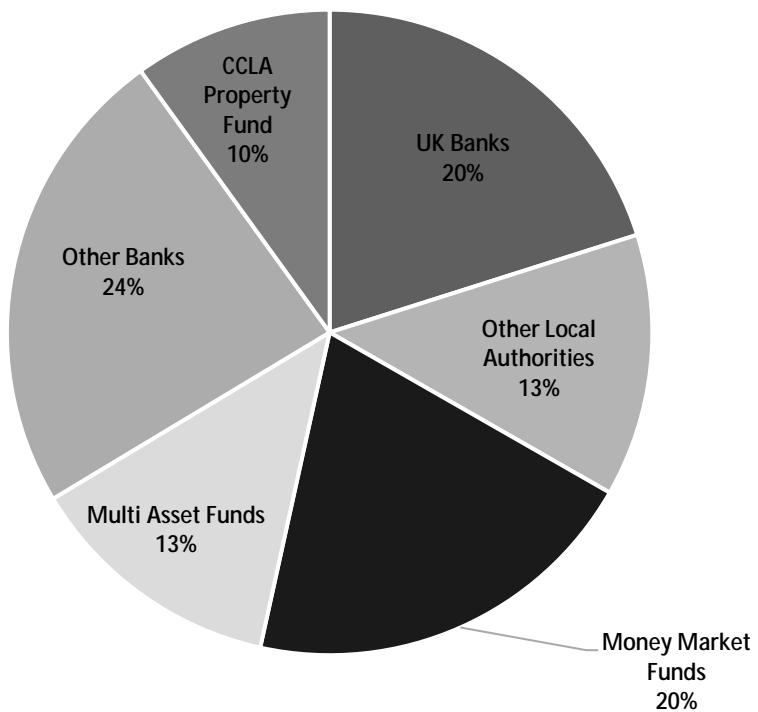
As at 31st March the Council’s exposure to bail in risk (direct lending to banks and building societies) was 15%, against 44% at the end of the previous financial year.

Exposure	2020/21	2021/22	2022/23
Bail In Risk -Direct investment	11%	44%	15%
Bail In Risk – Pooled Fund Managers and Money Market Funds	48%	33%	63%
Exempt from Bail In (including CCLA)	41%	23%	22%
Total	100%	100%	100%

Investment at 31/03/23 By Sector



Investment at 31/03/22 By Sector



Counter Party

Money Market Funds & Long-Term Funds	Credit Rating (Fitch)	Sum Invested (31/03/2023)	Limits 2022/23
Black Rock Money Market Fund	AAAmmf	£5,900,370	£6,000,000
Insight Money Market Fund	AAAmmf	£5,512,300	£6,000,000
Aberdeen Money Market Fund	AAAmmf	£5,067,920	£6,000,000
Deutsche Money Market Fund	AAAmmf	£20	£6,000,000
Invesco Money Market Fund	AAAmmf	£550	£6,000,000
BNP Paribas Money Market Fund	AAAmmf	£541,730	£6,000,000
CCLA Property Fund	N/A	£6,318,540	£8,000,000
Aegon Multi Asset Fund	N/A	£3,147,290	
Ninety-One Multi Asset Fund	N/A	£2,984,780	
CCLA Multi Asset Fund	N/A	£2,814,790	
			Total of £10,000,000

Banks & Building Societies

Natwest	A+	£258,260	£3,000,000
Barclays	A+	£640	£3,000,000
Toronto Dominion	AA-	£3,000,000	£3,000,000
Royal Bank of Canada	AA-	£3,000,000	£3,000,000

Local Authorities

London Borough of Barking & Dagenham	N/A	£3,000,000	£10,000,000
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Total Investments

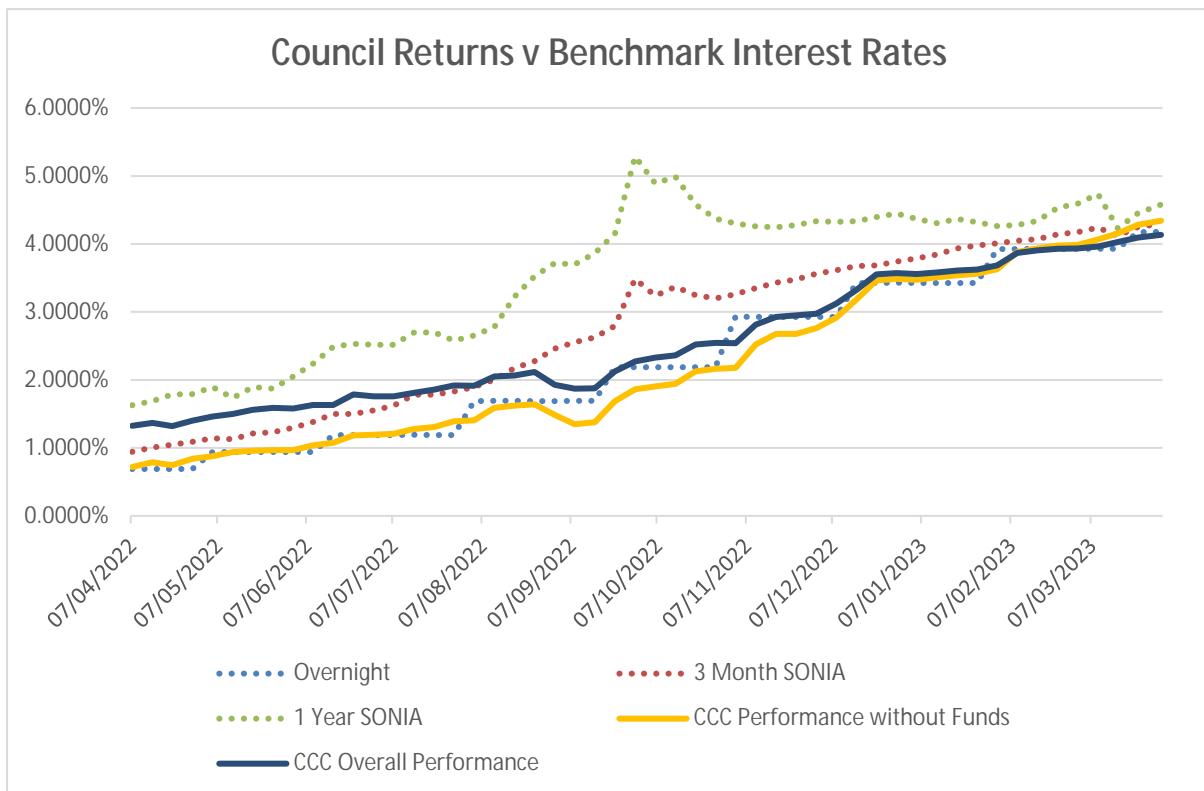
£41,547,190

Return on investments

8. Interest rates has been at the highest levels since 2008 going from 0.75% at the beginning year with 8 successive interest rate rises during 2022/23 and ending the year at 4.25%. The increases have led to higher interest returns than originally expected. At the time of writing the base rate was at 4.5% and still expected to rise further.

The Council changed treasury advisors during the year and joined the benchmarking club that Link Treasury Services provide and form a pool of 19 authorities within the benchmarking group. From the March 2023 benchmarking report, the council's performance was above the return expected for the level of risk taken compared to other local authorities. The main driver for this was due to the large portion of its holding being held in money market funds and as a result picking up the rate rises faster than those who had entered into fixed investments for longer durations and these funds would typically hold lower risk as they are more liquid. However, officers expect performance to be more in line with other authorities in future as Council spends its cash balances to fund its capital programme.

The below table highlights Sterling Overnight Rate (SONIA) as a comparison against the returns the City Council generated.



The Council earned a total of £1,867k in investment income during the 2022/23 financial year, which was £1,166k additional income over the £701k budget. This was predominantly due to higher interest rate levels than expected but budget was set around the beginning of 2022.

	Market investments (excluding CCLA and Multi Asset Funds)	Multi Asset Funds Income & CCLA Property Fund Yield (Based on April 2022 Valuation)	All Investments Income Yield
Year ending 31/03/2023			
Average yield	4.3%	3.8%	4.1%

The yields above have used the opening balance on any fund investments.

8.1 Funds

The City Council held funds in 3 Multi-Asset Funds during the financial year and also maintained its investment in the CCLA Property Fund. All of the Council's investments in these types of funds are seen as strategic and are therefore invested for the medium to long term for a rolling period of 3 to 5 years. The total balance invested makes up part of the Council's core cash that it is expected to hold for the long term.

Income returns on the 4 funds are outlined below along with the closing capital value of the fund, initial investment value and unrealised gain or loss.

Fund	Initial Investment Value £	1/04/2022 Investment Value £	31/03/2023 Investment Value £	Unrealised Gain/(Loss) (since inception) £	Income Return (Based on 1 st April 2022 Valuation)
CCLA Property Fund	5,000,000	7,565,769	6,318,537	1,318,537	3.62%
CCLA DIF	3,100,000	3,089,233	2,814,794	(285,206)	2.75%
Aegon DIF	3,600,000	3,584,400	3,147,286	(452,714)	5.00%
Ninety One DIF	3,300,000	3,151,873	2,984,782	(315,218)	4.01%

Total Income from the 4 funds above during 2022/23 was £664,369.

The unrealised loss on the fund assets during the financial year was £2,125,876 which generated a significant (but unrealised) total loss for 2022/23. The valuation of the funds has been affected by the higher interest rates and global economy. These remain long term investments where valuations would be expected to pick up over the next few years. as interest rates stabilise. The fund portfolio has a net unrealised gain of £265K when comparing to initial investment value.

Conclusion

The Council has operated within its Treasury Management Framework. This has enabled the Council to safeguard its financial assets and produce a good level of return relative to the prevailing market interest rates and other local authorities compared to via Links benchmarking.