PAPER C1 - Appendix 4
Somerset West and Taunton Council Annual Treasury Management Outturn Report 2022-23

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1 Executive Summary / Purpose of the Report

1.1 To provide Members with an update on the Treasury Management activity of Somerset West and Taunton Council and performance against the Prudential Indicators for 2022/23.

1.2 Treasury management performance during the year has reflected the agreed strategy for the Council. Investment security remains with good credit ratings across the portfolio, whilst liquidity remains high and liquidity. As foreast, there was high borrowing activity during the year, with £74million advanced to the Council. Vigilant action during the early part of the financial year provided favourable interest rates ahead of substantial increases in the money market as the year progressed. A suitable spread of loan durations were obtained, enabling substantial flexibility to become available when the new Unitary Council takes on the mix of loan and investment portfolios from the combining councils, whilst building in some benefit from low interest rates for borrowing that is due to mature in the medium term.

2 Background and Full details of the Report

2.1 The Council's Treasury Management Strategy for 2022/23 was approved at Full Council on 29th March 2022. The Council invests substantial sums of money and is therefore exposed 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 remains central to the Council's Treasury Management Strategy.

2.2 Treasury risk management at the Council is conducted within the framework of specific Codes of Practice issued by the Chartered Institute of Public Finance and Accountancy, CIPFA. In abbreviated format, they are referred to as the 'Treasury Management Code of Practice' and the 'Prudential Code'.

2.3 The first Code is the Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. The version that is relevant to the start of the financial year 2022/23 requires the Council to approve a Treasury Management Strategy before the start of each financial year and to approve, as a minimum, a half-year and annual treasury outturn report. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

2.4 Working alongside the Treasury Management Code, the 2017 CIPFA The Prudential Code includes a requirement for local Councils to provide a Capital Strategy. This is a comprehensive and high-profile document approved by Full Council covering capital expenditure and financing, treasury management and non-treasury investments.

2.5 Similarly to the Treasury Management Code of Practice, CIPFA published a new release of the Prudential Code in December 2021. The Council's latest Capital Strategy, complying with CIPFA's requirement, was approved by Somerset West and Taunton Full Council on 29th March 2022.

2.6 For continuity and clarity, CIPFA defines Treasury Management as:

> "The management of the local Council's cash flows, its borrowings and its investments, the management of the associated risks, and the pursuit of the optimum performance or return consistent with those risks".

2.7 Overall responsibility for treasury management remains with the Council with operational responsibility delegated to the S151 Officer. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

3 Local Context

3.1 On 31st March 2023, the Council had net cash investments of £74.368m arising from its revenue and capital income and expenditure. 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. These components, which stem from the Council's Balance Sheet, are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.23 Actual £m
General Fund CFR	133.968
HRA CFR	117.752
Total CFR	**251.720**
Less: External borrowing	-174.500
Internal borrowing	**77.220**
Less: Usable reserves	-80.873
Less: Working capital	-70.715
Net Investments	**-74.368**

3.2 The Council pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, to reduce risk and keep interest costs low.

3.3 The treasury management position as at 31st March 2023 and the change during the year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.22 Balance £m	In-year Movement £m	31.3.23 Balance £m
Long-term borrowing Short-term borrowing	-105.500 -75.000	17.000 -11.000	-88.500 -86.000
Total borrowing	**-180.500**	**6.000**	**-174.500**
Long-term investments Short-term investments Cash and cash equivalents	0.003 17.449 23.465	-0.003 -1.764 -21.774	0.000 15.685 1.691
Total investments	**40.917**	**-23.541**	**17.376**
Net Borrowing	**-139.583**	**-17.541**	**-157.124**

Borrowing Update

3.4 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 unless these loans are for refinancing purposes.

3.5 The Council currently holds £95.223m in commercial investments that were purchased prior to the change in the CIPFA Prudential Code.

Borrowing Strategy and Activity

3.6 As outlined in the treasury strategy, the Council's main objectives when borrowing was to achieve a low but certain cost of finance while retaining flexibility should any of the plans changed, particularly with the transfer to a single Unitary Council on 1st April 2023. The Council's borrowing strategy continued to address the key issue of affordability without compromising the longer-term stability of the debt portfolio and, where practicable, to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

3.7 The cost of both long and short-term borrowing rose dramatically over the year, with rates at the end of March around 2% - 4% higher than those at the beginning of April. Rate rises have been driven primarily by inflation and the need for central banks to control this by raising interest rates. Particularly dramatic rises were seen in September after Liz Truss' 'mini-budget' included unfunded tax cuts and additional borrowing to fund consumer energy price subsidies: over a twenty-four-hour period some PWLB rates increased to 6%. Rates have now fallen from September peaks but remain volatile and well above recent historical norms. The PWLB 10 year maturity certainty rate stood at 4.33% at 31st March 2023, 20 years at 4.70% and 30 years at 4.66%.

3.8 A new HRA PWLB rate of gilt yield plus 0.4% (0.4% below the currently available certainty rate) was announced on 15th March 2023. This discounted rate is to support local authorities borrowing for Housing Revenue Accounts and the delivery of social housing and is expected to be available from June 2023, initially for a period of one year.

3.9 As at 31st March 2023 the Council held £174.5m of loans as part of its strategy for funding previous and current years' capital programmes. This represented a decrease of £6m compared to the previous financial year-end, 31st March 2022. Outstanding loans on 31st March are summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.22 Balance £m	**Net Movement £m**	**31.3.23 Balance £m**
Public Works Loan Board (Long-term)	87.500	-7.000	80.500
Public Works Loan Board (Short-term)	5.000	2.000	7.000
Banks (Fixed term)	3.000	0.000	3.000
Local Councils (Long-term)	15.000	-10.000	5.000
Local Councils (Short-term)	70.000	9.000	79.000
Total borrowing	**180.500**	**-6.000**	**174.500**

3.10 For clarification, long-term loans are defined as any loan with a maturity date exceeding 365 days from the date of a reported balance. The Council's chief objective when taking new borrowing during 2022/23 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 Council's long-term plans change being a secondary objective.

3.11 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 borrowing need based on realistic projections, it was decided to take a mixture of short-term and long-term borrowing. The Council currently has £88.5m of longer-term borrowings in respect of the Housing Revenue Account and General Fund, details of which are shown below. These loans provide some longer-term certainty and stability to the debt portfolio. It is also worthy of note that loans shown in the table with a higher rate of interest reflect historically higher interest rates at the time when they were advanced to the Council.

Table 4: External Long-term Borrowing Position as at 31 March 2023

Long-dated Loans borrowed	**Amount £m**	**Rate %**	**Maturity Date**
Public Works Loan Board	6.0	2.82	28 Mar 2025
Waverley Borough Council	5.0	1.20	16 Feb 2026
Public Works Loan Board	7.0	2.92	28 Mar 2026
Public Works Loan Board	16.0	3.01	28 Mar 2027
Public Works Loan Board	7.0	3.08	28 Mar 2028
Public Works Loan Board	5.0	3.15	28 Mar 2029
Public Works Loan Board	5.5	3.21	28 Mar 2030
Public Works Loan Board	1.0	8.38	03 Aug 2056
Public Works Loan Board	1.0	7.38	06 May 2057
Public Works Loan Board	2.0	6.63	05 Sep 2057
Public Works Loan Board	10.0	1.64	12 Nov 2070
Public Works Loan Board	20.0	1.89	26 Mar 2071
Barclays	3.0	4.25	14 Jun 2077
Total borrowing	**88.5**		

3.12 The Council's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short- and long-term borrowing was maintained.

Treasury Investment Activity

3.13 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held for a wide range of purposes. During the year, the Council's investment balances ranged between £17.025m and £62.000m due to timing differences between income and expenditure as well as cashflow movements. The investment position is shown in Table 5, below.

Table 5: Treasury Investment Position

	31.03.22 Balance £m	**Net Movement £m**	**31.03.23 Balance £m**
Banks and Building Societies (unsecured)	1.630	-0.319	1.311
Government (including local authorities)	2.898	-2.898	0.000
Money Market Funds	17.900	-17.900	0.000
Cash Plus Funds	0.983	-0.012	0.971
Strategic Bond Funds	1.985	-0.032	1.953
Equity Income Funds	1.980	-0.212	1.768
Property Funds	5.697	-0.821	4.876
Multi Asset Income Fund	6.688	-0.542	6.146
Total Investments	**39.761**	**-22.736**	**17.025**

Investments as at 31 March 2023

Borrower	Amount £	Rate of Interest %	Date of Investment	Date of Maturity
National Westminster Bank	1,311,644	Variable	N/A	On Demand
CCLA Local Authority Property Fund	4,875,987	Variable	N/A	On Demand
Ninety-One (Formerly Investec)	2,607,296	Variable	N/A	On Demand
Columbia Threadneedle	1,768,039	Variable	N/A	On Demand
Royal London Enhanced Cash Fund	970,718	Variable	N/A	On Demand
Payden Sterling Reserve Fund	1,953,067	Variable	N/A	On Demand
AEGON Diversified Income Fund (Formerly Kames)	1,661,901	Variable	N/A	On Demand
Schroder Income Maximiser Fund	1,876,815	Variable	N/A	On Demand
TOTAL	**17,025,467**			

3.14 Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority'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.

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

3.16 By end March 2023, the rates on DMADF deposits ranged between 4.05% and 4.15%.

3.17 The progression of risk and return metrics are shown in the extracts from Arlingclose quarterly investment benchmarking in Table 6, overleaf.

Table 6: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
31.03.2022	4.54	A+	87%	1	3.87%
31.03.2023	**5.33**	**A+**	**100%**	**1**	**-5.03%**
Similar Local Authorities	4.74	A+	63%	56	0.73%
All Local Authorities	4.71	A+	59%	12	1.59%

3.18 Arlingclose provided the Council with a report as at 31st March 2023 which shows the current value of the Council's investments are held in externally managed strategic pooled funds was £12.766m, where short-term security and liquidity are lesser considerations, and the objectives are, instead, regular revenue income and long-term price stability. These funds generated dividends of £0.622m in 2022/23, an income return of 4.33% which is used to support services in year, however had an unrealised capital loss of £1.613m (-11.22%).

3.19 While the CCLA Property Fund had the largest capital loss, there has also been significant downturn in the bond sector over the last year as rising interest rates have depressed bond capital values.

3.20 For fixed income bond investors, 2022 was a very difficult year - bonds had their worst year of performance in several decades; long-term government bonds had their worst year ever as central banks delivered larger interest rates hikes than initially expected and promised more to combat inflation. As policy rates rapidly rose from very low levels, bond investors suffered large crystalised or unrealised losses from rising sovereign and corporate bond yields (i.e. falling prices) as well as from widening credit spreads as concern grew over the risk of defaults in a recessionary environment. The return on the All-Gilts index was -16.3% over the 12 months to March 2023. Negative yielding bonds all but disappeared globally.

3.21 UK and global equities remained volatile against a backdrop of high and sticky inflation, rapid policy rates tightening and an increasing risk of recession. There was a large sell-off in global equities in April, and again in June and September for both UK and global equities. The total return on the FTSE All Share index for the 12 months ending March 2023 was 2.9% and 5.4% for the FTSE 100.

3.22 The negative correlation between bonds and equities, which had featured for some years, turned positive in 2022 as both bonds and equities sold off simultaneously against an outlook of sticky inflation and high interest rates. Simultaneously, tighter financial conditions, higher bond yields and challenges in some segments of commercial real estate (e.g. offices post-COVID, high street shops and shopping centres) saw commercial property values fall during 2022, with a large fall in the final calendar quarter.

3.23 Dividends continued to be received from the Council's bond, equity, multi-asset and property funds, the payout increasing slightly for most funds in the portfolio.

3.24 Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's medium- to long-term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns should exceed cash interest rates.

Non-Treasury Investments

3.25 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 (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).

3.26 Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) also broadens the definition of investments to include all such assets held partially or wholly for financial return. This represented a significant feature of CIPFA's new Code of Practice published in December 2021.

3.27 The Council holds £95.223m of such commercial property investments held as directly owned property and £4.011m as loans to local businesses, charities, partnerships and sports clubs as at 31 March 2023.

3.28 Commercial property investments generated £6.871m of gross investment income representing an average rate of return of 6.90% and the loans to local businesses generated £162k of investment income representing an average rate of return of 3.42%.

Treasury Performance

3.29 The Council measures the financial performance of its treasury management activities in terms of its impact on the revenue budget as shown Table 7 below.

Table 7: Performance

	Budget 2022/23 £m	**Actual 2022/23 £m**	**Variance 2022/23 £m**
Interest Paid	3.831	3.257	-0.574
Interest Received	-1.297	-1.298	-0.001

3.30 The above excludes interest paid relating to commercial properties.

Compliance

3.31 The Section 151 Officer is pleased to report that all treasury management activities undertaken during the year fully complied with the CIPFA Code of Practice and with every one of the Council's approved Treasury Management Strategy parameters – see Table 8, below.

Table 8: Investment Limits

	2022/23 Maximum	31.3.23 Actual	2022/23 Limit	Complied
The UK Government	£10.7m	£nil	Unlimited	Yes
Local Authorities and Other Government Entities	£nil	£nil	£7.0m	Yes
Secured Investments	£nil	£nil	£7.0m	Yes
Banks (Unsecured)	£3.2m	£1.3m	£7.0m	Yes
Building Societies (Unsecured)	£nil	£nil	£7.0m	Yes
Registered Providers (Unsecured)	£nil	£nil	£7.0m	Yes
Money Market Funds	£7.0m	£nil	£7.0m	Yes
Strategic Pooled Funds	£5.0m	£5.0m	£7.0m	Yes
Real Estate Investment Trusts	£nil	£nil	£7.0m	Yes
Other Investments	£nil	£nil	£5.0m	Yes

3.32 Compliance with the authorised limit and the operational boundary for external debt is demonstrated in Table 9 below, relating to 2022/23:

Table 9: Debt Limits

	2022/23 Maximum	31.3.23 Actual	2022/23 Operational Boundary	2022/23 Authorised Limit	Complied
Borrowing	£188.5m	£174.5m	£310.0m	£370.0m	Yes
Total debt	**£188.5m**	**£174.5m**	**£310.0m**	**£370.0m**	Yes

Treasury Management Indicators

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

3.34 **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	31.3.23 Actual	2022/23 Target	Complied
Portfolio average credit rating	A+	A-	Yes

3.35 **Liquidity:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

	31.3.23 Actual	2022/23 Target	Complied
Total cash available within 3 months	£12.62m	£20.00m	No

The reason for this target not being complied with was due to Somerset West and Taunton Council utilising its balances ahead of the creation of the Unitary Council with effect from 1st April 2023, rather than renewing short term borrowing.

3.36 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates, and that the business cases for commercial properties (costs and income) are stand alone.

3.37 Maturity **Structure of Borrowing:** This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	31.3.23 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	49.28%	100%	0%	Yes
12 months and within 24 months	3.44%	100%	0%	Yes
24 months and within 5 years	20.06%	100%	0%	Yes
5 years and within 10 years	6.02%	100%	0%	Yes
10 years and above	21.20%	100%	0%	Yes

3.38 Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

3.39 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:

	2022/23	**2023/24**	**2024/25**
Actual principal invested beyond year end	£nil	£nil	£nil
Limit on principal invested beyond year end	£30m	£25m	£25m
Complied	Yes	Yes	Yes