Report

NEWPORT CITY COUNCIL
CYNGOR DINAS CASNEWYDD

Cabinet

Part 1

Date: 14 June 2023

Subject Treasury Management Outturn Report – 2022/23

Purpose This report is to inform Cabinet of treasury activities undertaken for the financial year 2022/23 and confirms that all treasury and prudential indicators have been adhered to. The report has been considered by Governance and Audit Committee, who provided no reservations or adverse feedback. Cabinet is asked to make any comments or observations, as needed, which will be included in this report when subsequently sent to Council.

Author Head of Finance / Assistant Head of Finance

Ward All

Summary In line with the agreed Treasury Management Strategy, the Council continues to be both a short-term investor of cash and borrower to manage day-to-day cash flows. Current forecasts indicate that, in the future, temporary borrowing may be required to fund normal day-to-day cash flow activities and longer-term borrowing will increase to fund commitments in the current capital programme, as well as the impact of reduced capacity for 'internal borrowing'.

The Authority also invested in three covered bonds within 2022-23, totalling £10m, in line with the Council's Treasury Management Strategy, which stated that the Council would consider long term investments up to £10m.

During the year, the Council's total borrowing reduced from £142.1m to £138.6m and total investments reduced from £58.3m to £47.2m, meaning overall the Council net borrowing increased by £7.6m to £91.4m as the 31st March 2023.

The report confirms that all prudential indicators were complied with during 2022/23.

Proposal **To note the report on treasury management activities for the period 2022-23 and provide comments to Council.**

Action by Head of Finance / Assistant Head of Finance

Timetable Immediate

This report was prepared after consultation with:

- Treasury Advisors
- Head of Finance

Signed

Background

1. Treasury risk management within Newport City Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which required the Authority to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report. This report fulfils the Authority's legal obligation to have regard to the CIPFA Code.

2. CIPFA published its revised Prudential Code and Treasury Management Code of Practice in December 2021. The new code took immediate effect, although authorities could choose to defer introducing the revised reporting requirements until the 2023/24 financial year, which the Council has elected to do. The key changes within the revised code are;
   - It particularly highlights the requirement that local authorities must not borrow to invest primarily for financial return.
   - The forward-looking prudential indicators must be monitored and reported to members at least quarterly (currently half-yearly) as part of the normal budget monitoring reports.
   - The Authority will also have to explicitly document a formal and comprehensive knowledge and skills schedule to ensure the effective acquisition and retention of treasury management skills for those responsible for the management, delivery, governance, decision-making and compliance with legislative requirements.

3. CIPFA defines Treasury Management as

   The management of the organisation's borrowing, 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.

4. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy. The 2022/23 Treasury Management Strategy was approved by the Council as part of the Capital Strategy in March 2022 and can be viewed at the following location.

   https://democracy.newport.gov.uk/documents/s21100/04%20Cabinet%20Report%20-%20Capital%20Strategy%20and%20Treasury%20Strategy%202022-23.pdf?LLL=0

5. This report presents the following information:

   - details of capital financing, borrowing, any debt rescheduling and investment transactions
   - reports on the risk implications of treasury decisions and transactions.
   - details the monitoring position on treasury management transactions.
   - compliance with treasury limits set and the Prudential Code

6. This report was considered by Governance & Audit Committee on 25th May 2023. No contrary feedback or need for revision was volunteered, and it was endorsed for onward circulation to Cabinet and subsequently Council.

BORROWING STRATEGY / ACTIVITY

Short and Long Term Borrowing

7. Whilst the Council has significant long-term borrowing requirements, the Council's current strategy of funding capital expenditure (from a 'cash' perspective) is through the concept of 'internal borrowing' where the Council seeks to use its existing cash balances and reserves to afford its capital expenditure prior to the necessity to take out external borrowing i.e. we defer taking out new long term borrowing and fund capital expenditure from the Council's own cash resources for as long as we can – which exist because of 'cash-backed' reserves and, to a lesser extent, day to day

positive cash-flows. The Council may undertake borrowing early if there is a clear underlying need for future borrowing and it feels it can minimise risk of future interest rate rises while providing value for money. Any such action will be in line with advice from our treasury advisors.

8. By using an internal borrowing strategy, the Council can also minimise cash holding at a time when counterparty risk remains relatively high, especially within the current economic climate. The interest rates achievable on the Council's investments are also lower than the current rates payable on long-term borrowing so this remains a sensible consideration in operating an 'internal borrowing' arrangement – i.e., it would cost more to borrow than it would to utilise existing investment balances and forego interest receivable. Whilst the strategy minimises investment counterparty risk, the risk of interest rate exposure is increased.

9. The cost of both long and short-term borrowing rose significantly over 2022-23, with rates at the end of March 2023 around 2% - 4% higher than those at the beginning of April 2022. Rate rises have been driven primarily by inflation and the Bank of England has increased interest rates to try and control this. On 11th May 2023, the Bank of England's Monetary Policy Committee increased the rate by a further 0.25% taking the official bank rate to 4.5%. The Council's treasury advisors predict there could be a further one or two 0.25% rises in bank rate over the short term before a pause to assess the impact. A reduction is currently forecast from quarter 2-3 in 2024 though not down to historically low levels and there are still both upside and downside pressures on the interest rates.

10. Over the short to medium term, the level of borrowing required to fund (from a 'cash' perspective) the capital programme will be substantial. As well as this, the Council will have a requirement to be a net borrower into the long term. Therefore, consideration could be taken to undertake borrowing early, considering recent interest rate rises and the potential for further rate rises in the short term. Essentially, we would reduce our internal borrowing position in the short term. The market position is being constantly monitored to review this and manage, as far as possible, the risk of resulting increase in borrowing costs over the medium term and this would only be done in consultation with the Council's treasury advisors and where it was felt to be appropriate and affordable.

11. The following table compares the borrowing levels at the end of 2022-23 with the equivalent from the end of the previous year. This indicates a net reduction in borrowing of £3.5m during 2022-23, predominantly through the redemption of a small PWLB loan at the end of September, which has not been re-financed, plus we have a number of loans which are Equal Instalments of Principal (EIP) loans, which pays back principal over the life of the loan, so the borrowing levels decline naturally over the life of the loan as an alternative to maturity based loans where the amount borrowed is only repaid when the loan period expires.

Comparison	**2022-23**	**2021-22**
Public Works Loan Board	93,089,897	97,064,396
Interest Free Borrowing	9,905,757	10,079,675
LOBOs	30,000,000	30,000,000
Ex LOBO	5,000,000	5,000,000
Accrued Interest	606,212	0
	138,601,866	**142,144,071**

12. In regard to LOBOs (Lender Option borrower Option), no loans were called during the period. All £30m outstanding is subject to potential change of interest rates by the lender (which would automatically trigger a right to the Council to repay these loans). Should a change of interest rate be requested, then it will be considered in detail and a decision on how to proceed will be made in conjunction with our treasury advisors.

INVESTMENTS ACTIVITY / POSITION

13. The Council's strategies in this area of Treasury Management are;

    (i) to be a short term and relatively low value investor, consistent with the pursuit of an 'internal borrowing strategy' and

    (ii) investment priorities should follow the priorities of security, liquidity, and yield, in that order.

14. The following table compares the investment levels at the end of 2022-23 with the equivalent from the end of the previous year. This indicates a net decrease in investment activity of £11m during 2022/23.

		2022-23		2021-22
Investment	-	47,231,574	-	58,265,000
	-	47,231,574	-	58,265,000

These investments reflect surplus cash invested in financial institutions or organisations to provide a financial return. Appreciating the ongoing conflict in Ukraine, none of our investments directly involve Russian institutions.

15. January 2018 saw the implementation in the UK of the second Markets in Financial Instruments Directive (MiFID II), where treasury consulting firms were obliged to treat all local authorities as retail clients unless they opted up to professional client status and met certain criteria. Those criteria included holding a minimum of £10m investment balance and employing knowledgeable and experienced staff to carry out investment transactions.

16. In February 2023 the Council invested in three covered bonds to satisfy this requirement; Santandar (£3.5m), Lloyds (£4m) and Cie de Financement Foncier (£2.5m). These are longer term investments which helps diversify our investment portfolio. Covered bonds are debt instruments secured by a cover pool of mortgage loans (with property as collateral) or public-sector debt to which investors have a preferential claim in the event of default. In covered bonds, dual recourse means that bondholders have two sources of repayment: the issuer of the bond (a bank or building society), and the cover pool of assets that the bond is backed by. If the issuer defaults, bondholders have recourse to the cover pool, which is regularly monitored to ensure it is more than sufficient to cover the outstanding debt.

    There are several benefits to having covered bonds within the investment portfolio; they have a high credit quality as they are issued by major financial institutions which are regulated entities subject to high levels of supervision. As a result, most UK covered bonds are rated AAA, which is the credit rating for all three bonds which the Authority has invested in.

    Covered bonds avoids 'bail-in' risk. Following the implementation of the Bank Recovery and Resolution Directive (BRRD) in Europe, many unsecured liabilities of financial institutions became subject to "bail-in" requirements. In the event of a default the unsecured depositors will recapitalise the bank. Secured debt obligations, including covered bonds, are exempt from this treatment under the BRRD.

    Covered bonds also have a high yield compared to risk and offer greater diversification than many debt instruments with comparable risk exposure, such as government bonds.

17. Currently the Council also has £7m invested with the CCLA Money Market Fund, which can be redeemed without notice, so is extremely liquid.

18. As outlined previously, with the Bank of England increasing its base rate 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. By end March 2023, the rates on DMADF deposits ranged between 4.05% and 4.15%.

19. All the investments that the authority makes, with the exception of the covered bonds outlined above, are for less than 364 days. The Authority keeps Cash extremely liquid, with the majority of our investments for less than 35 days although the Authority does invest with other local authorities for slightly longer periods. As at 31st March 2023 the Authority's investments had an interest rate of between 2.8% and 4.4%.

NON-TREASURY INVESTMENTS

20. 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. This is replicated in the Investment Guidance issued by the Department for Levelling Up, Housing and Communities (DLUHC) and Welsh Government, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

    The Authority also held such investments in:

    - directly owned property such as office and commercial units of £10.6m
    - loans to developers £10.3m
    - shareholding in subsidiaries £0.3m (Newport Transport)

    Directly held property is subject to annual valuation review which can change the value of the holding.

    The developer loans activity reflects those regenerative partnership projects that are included within the capital programme to assist developers with cash flow loans on particular projects and which are required to be repaid plus interest.

OTHER TREASURY CONSIDERATIONS FOR 2022-23

Economic background and Counter Party Update

21. Appendix A outlines the underlying economic environment as provided by the Council's Treasury Management Advisors, Arlingclose. This is very useful context in informing annual strategy and assisting in effective treasury decisions.

22. In March 2023, following the failure of two US regional banks and the state-sponsored takeover of Credit Suisse by UBS, our treasury management advisors Arlingclose advised that they were reducing their recommended duration for unsecured investments in all banks to 35 days. This was a precautionary stance given the difficulty in projecting the wider market impact of what seemed relatively idiosyncratic problems. Importantly, the long-term rating of Santander UK, (the Council's bankers), remains at A+; above the Council's minimum level of A-.

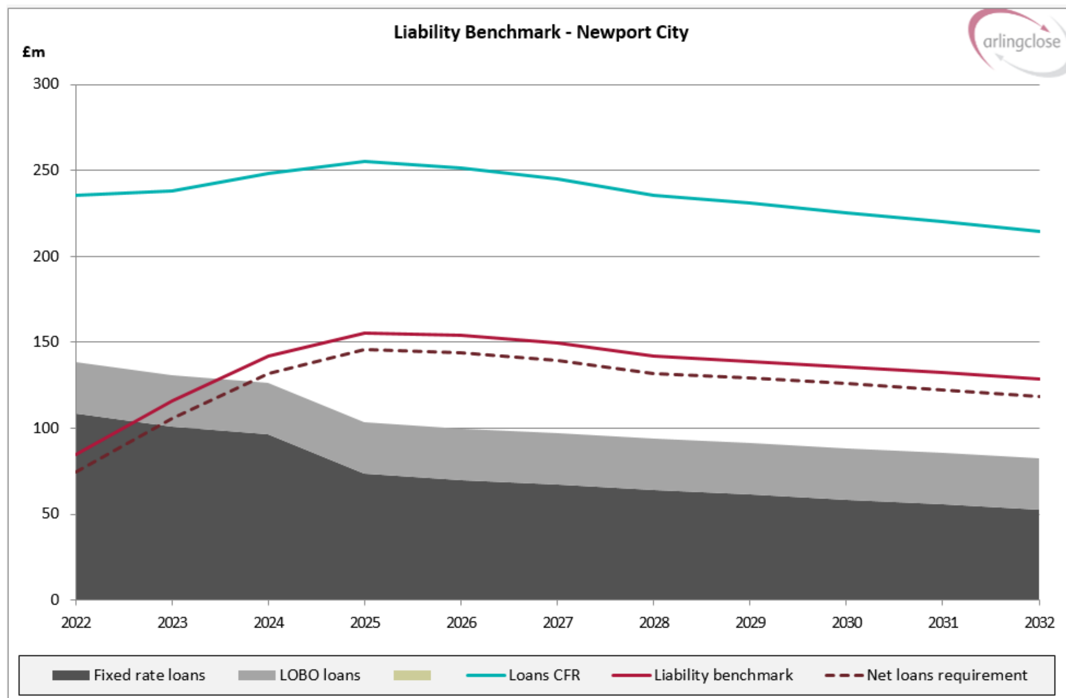
Compliance with Prudential Indicators approved by Council

23. The Authority measures and manages its exposures to treasury management risks using various indicators which can be found in Appendix B. The Authority has complied with the Prudential Indicators for 2022/23, set in March 2022 as part of the Treasury Management Strategy

Liability Benchmark Indicator

24. CIPFA recommends that the optimum position for external borrowing should be at the level of the Liability Benchmark (i.e., all balance sheet resources should be used to maximise internal borrowing). If the outputs show future periods where external loans are less than the Liability Benchmark, then this indicates a borrowing requirement thus identifying where the authority is exposed to interest rate, liquidity and refinancing risks. Conversely, where external loans exceed the Liability Benchmark then this will highlight an over borrowed position which will result in excess cash in the organisation requiring investment thus exposing the authority to credit and reinvestment risks and a potential cost of carry. The treasury strategy should explain how the treasury risks identified by the Liability Benchmark are to be managed over the coming years.

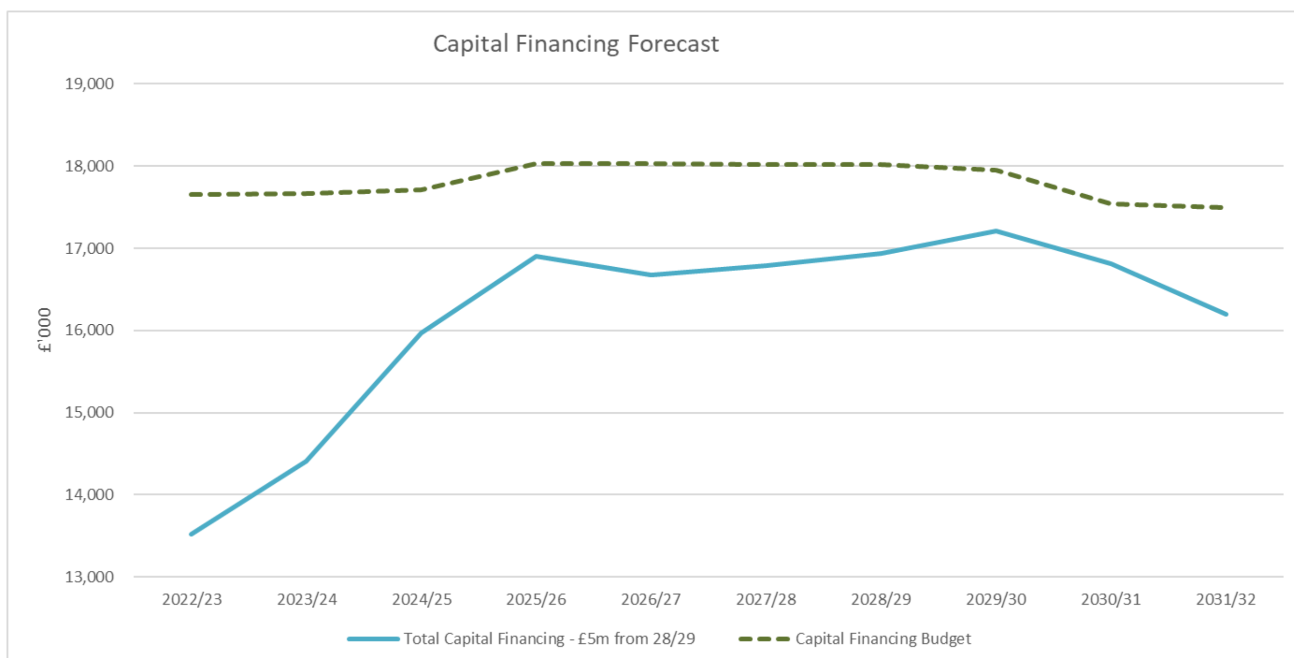
25. A recent change in guidance recommended sharing details of benchmark liability periodically with members. The Liability Benchmark is effectively the Actual/Real Net Borrowing Requirement of a local authority plus a liquidity allowance. In its simplest form, it is calculated by deducting the amount of investable resources available on the balance sheet (reserves, cash flow balances) from the amount of outstanding external debt and then adding the minimum level of investments required to manage day-to-day cash flow.



26. The chart above contains a number of elements, which are explained below:
    - The blue line reflects the accumulated value of historic, and future, unfunded capital expenditure – i.e. expenditure initially funded by borrowing and then funded via the revenue budget, over time, in the form of MRP (Minimum Revenue Provision). In effect, this line represents the gross amount of borrowing required.
    - The solid red line is the calculated actual/real level of borrowing required, taking into account the Council's internal borrowing capacity (i.e. the value of balance sheet resources at any point in time). The gap between the blue and red lines represents the internal borrowing capacity.
    - The grey shaded areas represent the actual borrowing undertaken by the Council as of 31 March 2023 and shows how these loans reduce as they are scheduled for repayment.
    - The white gap between the solid red line and the grey shaded areas represents the estimated amount of new borrowing required over the next ten years. A large proportion of this new borrowing would be to replenish existing maturing borrowing, with the remainder being required as a result of the Council's capital expenditure plans.

27. Several key conclusions from the chart are outlined below:
    - In 2022 and 2023, it can be seen that actual borrowing exceeds the amount of calculated borrowing. The level of borrowing held is the result of historical borrowing commitments, coupled with the larger than anticipated investment levels (mainly due to the volume of external grants received during the COVID-19 pandemic period) increasing the internal borrowing capacity and, in effect, reducing the calculated need to borrow. As noted above in the investment section of this report; the Council was investing about £47m at 31 March 2023 and the graph above reflects that.
    - Between 2023 and 2025, the gross need to borrow increases (blue line) but the calculated need for actual/real borrowing increases more sharply (red line). This is because the Capital Programme commitments add to the need to borrow but, at the same time, the internal borrowing capacity is predicted to reduce as reserves are utilised and investment levels reduce.
    - During the same window, actual borrowing held (grey shaded areas) reduces as loans are repaid. The combination of this, and the sharp increase in the need to borrow, means that actual new borrowing in the region of £50m could be required by the end of 2025.
    - There is then a relatively stable period where the gross borrowing requirement, the calculated actual need to borrow and the actual loans held all steadily reduce until 2032. This would achieve one of the Council's aims of stabilising the Capital Financing Requirement (CFR) in order to mitigate the impact of a rising CFR on capital financing costs incurred within the revenue budget and comply with the requirement for capital expenditure plans to be affordable, prudent and sustainable over the medium term.
    - It should be noted that capital expenditure beyond 2027/28 is based on £5m unfunded expenditure per year, for modelling purposes only. Until that point, there is no new borrowing assumed, however this stance will be subject to an annual review as part of the rolling approach to capital programme management.

28. The chart below provides a graphical illustration of the impact that the current capital expenditure plans (plus an assumed £5m of unfunded capital expenditure per year from 2028/29 onwards) will have on the capital financing revenue budget and is a translation of the information outlined in the Liability Benchmark graph above. Essentially, the Councils revenue budget impact from the above liability benchmark position and forecast



29. As can be seen from the blue line, there is a broadly similar trajectory to capital financing costs as there is to the liability benchmark line outlined in the Liability Benchmark chart. The costs are projected to increase sharply up to 2025/26 and then plateau thereafter. This is to be expected, as the capital financing costs (comprising MRP and interest) are the product of unfunded capital

expenditure. The dashed line identifies the revenue budget currently projected to be available for meeting those costs and confirms that, currently, there is anticipated to be sufficient revenue budget available. However, the uncertainty regarding interest rates means there is a risk that interest rates raise beyond current assumptions and the current headroom could be exhausted, potentially leading to a pressure upon the medium term financial plan.

Outlook for short to medium term

30. As outlined in the Liability Benchmark graph, and elsewhere in the report, the Council has a longer term underlying need to borrow. This is driven by the increasing expenditure on the Capital Programme, with a significant peak expected in 2023/24 and 2024/25, as well as the need to refinance existing borrowing. It is anticipated that the need to borrow will crystallise towards the latter part of the 2023/24 financial year, unless there is slippage against the Capital Programme, in which case that need could be deferred until 2024/25. In the intervening period, the Council should be able to manage its cashflow requirements through its internal borrowing strategy and gradually reducing the level of investments held. If there are any short term cashflow needs, these can be addressed via short term borrowing.

31. Due to the current increases in interest rates, and the possibility of one more rise before current advice suggests that the peak is reached, the Council will continue to defer the need to take out long term borrowing for as long as possible. It is hoped that, by adopting this approach, interest rates may have reduced from their current levels, although not to the level pre-2020, reducing to some extent the impact upon the revenue budget of undertaking new borrowing.

32. Aside from LOBOs, which could potentially see interest rate rises, all of the external borrowing is on a fixed rate basis. Therefore, and in line with advice from the treasury advisors, the intention is to hold off undertaking any borrowing until absolutely necessary, in anticipation that rates will reduce, even if not to the levels available in recent years. This position will be reviewed on a regular basis in conjunction with the treasury advisors, especially in light of the volatile economic context and the regularly changing borrowing rates.

Risks

Risk	**Impact of Risk if it occurs* (H/M/L)**	**Probability of risk occurring (H/M/L)**	**What is the Council doing or what has it done to avoid the risk or reduce its effect**	**Who is responsible for dealing with the risk?**
Investment counterparty not repaying investments	High but depending on investment value	Low	The Council only invests with institutions with very high credit scores. It employs advisors to monitor money market movements and changes to credit scores and acts immediately should things change adversely. The lower levels of funds available for investment will also alleviate the risk. Colleagues also monitor financial circulars and Treasury consultants' advice to be able to respond in a timely fashion and withdrew its investment from one local authority recently.	Members, Head of Finance, Treasury staff, based on advice from treasury advisors
Interest Rates moving adversely against expectations	Medium	Medium	Interest rates are currently volatile, however the Council's external borrowing is based on fixed interest rates, although	Head of Finance, Treasury staff,

			there is a degree of risk in relation to LOBOs. The Council will continue to monitor interest rates in anticipation of a medium term need to borrow and will work with its treasury advisors to identify the optimum time to undertake any new borrowing.	treasury advisors

* Taking account of proposed mitigation measures

Links to Council Policies and Priorities

It is the Council's policy to ensure that the security of the capital sums invested is fully recognised and has absolute priority. The Council follows the advice of the Welsh Government that any investment decisions take account of security, liquidity and yield in that order.

Options Available and considered

The Prudential Code and statute requires that, during and at the end of each financial year, reports on these matters are presented to Council for approval.

Preferred Option and Why

The approach required by statute is quite prescriptive, such that there are not many choices/options. This report is a regular half yearly event. The Governance and Audit Committee acts as the main scrutiny mechanism before a similar report is received by Cabinet/Council. The approach remains unchanged in advocating that the Cabinet notes the contents of the report in relation to Treasury activities and indicators, and provides endorsement or feedback pertinent to add to the final Council report.

Comments of Chief Financial Officer

Decisions made on treasury matters will be made with a view to comply with the Treasury Management Strategy, Prudential Indicators, taking advice, where needed, from our Treasury Advisers.

The report highlights that the Council continues to hold high investment levels, partly due to slippage within the Capital Programme and additional cash received via Welsh Government grants towards the end of the financial year. The underlying medium-term need to borrow remains and it is anticipated that new borrowing may be required towards the end of the 2023/24 financial year. However, should there be further slippage within the Capital Programme, it is possible that the need may be deferred until 2024/25. This would potentially be beneficial to the Council, in that interest rates may have reduced from their current levels by then, thus mitigating to some extent the impact upon the revenue budget of undertaking new borrowing. The Council's approach will, therefore, continue to defer the need to borrow for as long as possible, in order to avoid the peak of interest rates anticipated during this summer. Regular and close monitoring of this position will be undertaken with the Council's treasury advisors and, should the advice change, I have delegated authority to undertake borrowing as required.

The report also highlights the decision taken in the final quarter of the 2022/23 financial year to invest £10m in covered bonds. This investment ensures that the Council can maintain its professional client status under the MIFID II directive and, also, will generate a secure and positive return on investment. In addition, covered bonds are regarded as an extremely secure investment, one which is not subject to bail-in, thereby ensuring that the investment priority of security over yield is adhered to. It is, therefore, positive that the Council has been able to lock-in a good level of return for a number of years, in a product that provides the level of security desired.

Comments of Monitoring Officer
There are no legal implications. The in year and annual treasury management report is consistent with relevant Chartered Institute of Public Finance and Accountancy Guidance, Treasury Management principles and the Council's investment Strategy.

Comments of Head of People, Policy and Transformation
There are no direct HR implications associated with the report.

The Well-being of Future Generations Act requires public bodies to balance short-term needs with the needs to safeguard the ability to meet long-term needs as outlined in the approach taken.

Scrutiny Committees
N/A

Fairness and Equality Impact Assessment:
- **Wellbeing of Future Generation (Wales) Act**
- **Equality Act 2010**
- **Socio-economic Duty**
- **Welsh Language (Wales) Measure 2011**

For this report, a full Fairness and Equality Impact Assessment has not been undertaken. This is because this report is not seeking any strategic decisions or policy changes, with its purpose being to update on the treasury management activities for the year retrospectively. However, fairness and equality are considered as part of service delivery and will feature in annual finance reports, such as the Treasury and Capital Strategy.

In terms of the Wellbeing of Future Generations (Wales) Act, and the five ways of working contained within it, this report highlights examples of these being supported. This report is a backwards looking report of the treasury management activities of the Council. It shows that we followed the treasury management strategy and the compliance with prudential code and treasury management indicators. This links into the long-term objectives of the authorities and ensures that the Councils' activities are carried out in an affordable, prudent and sustainable manner.

In the case of the Welsh Language, the service will continue to ensure that, wherever possible, services or information is available in the medium of Welsh.

The Equality Act 2010 contains a Public Sector Equality Duty, which came into force on 06 April 2011. The Act identifies a number of 'protected characteristics', namely age; disability; gender reassignment; pregnancy and maternity; race; religion or belief; sex; sexual orientation; marriage and civil partnership. The new single duty aims to integrate consideration of equality and good relations into the regular business of public authorities. Compliance with the duty is a legal obligation and is intended to result in better-informed decision-making and policy development and services that are more effective for users. Nothing in this report is considered to have a direct equality impact.

Consultation
N/A

Background Papers
Reports to Council March 2022 and February 2023: Capital Strategy and Treasury Strategy.

Dated: 7 June 2023

APPENDIX A

Introduction

The Authority's treasury management strategy for 2022/23 was approved at a meeting on 1st March 2022. The Authority has borrowed and invested 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 Authority's treasury management strategy.

The 2021 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 1st March 2022.

External Context

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 Authority 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 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 caution is merited with certain authorities.

Local Context

On 31st March 2023, the Authority had net borrowing of £91.4m 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. The work on the 2022-23 statement of accounts is currently a work in progress, so the figures in the table below are currently draft and will be updated if required once the draft accounts for 2022-23 have been completed.

Table 1: Balance Sheet Summary

	31.3.23 Actual £m
General Fund CFR	282.4
Less: *Other debt liabilities	38
Borrowing CFR	**244.4**
Less: Usable reserves	-149
Less: Working capital	-4
Net borrowing	**91.4**

* Finance leases, PFI liabilities and transferred debt that form part of the Authority's total debt

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

The treasury management position 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	Movement £m	31.3.23 Balance £m	31.2.23 Rate %
Long-term borrowing	132	(3.3)	128.7	3.6
Long term interest free borrowing	10.1	(0.2)	9.9	-
Short-term borrowing	0	-	-	-
Total borrowing	**142.1**	**(3.5)**	**138.6**	**3.6**
Long-term investments	0	(10.0)	(10.0)	4.5
Short-term investments	(36.0)	5.8	(30.2)	-
Cash and cash equivalents	(22.3)	15.3	(7.0)	0.6
Total investments	**(58.3)**	**11.1**	**(47.2)**	**5.2**
Net borrowing	83.8	7.6	91.4	8.8

The main movement in the year is the increase in long-term investments. The authority invested in three covered bonds with Santandar (£3.5m), Lloyds (£4m) and Cie de Financement Foncier (£2.5m) as per the Capital and Treasury and Management Strategy for 2022/23.

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 unless these loans are for refinancing purposes.

The Authority is not planning to purchase any investment assets primarily for yield within the next three years and so is able fully access the PWLB.

Borrowing Strategy and Activity

As outlined in the treasury strategy, the Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing lower 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. The Authority's borrowing strategy continues 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.

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%.

Aside from LOBOs, which could potentially see interest rate rises, all of the external borrowing is on a fixed rate basis. Therefore, and in line with advice from the treasury advisors, the intention is to hold off undertaking any borrowing until absolutely necessary, in anticipation that rates will reduce, even if not to the levels available in recent years. This position will be reviewed on a regular basis in conjunction with the treasury advisors, especially in light of the volatile economic context and the regularly changing borrowing rates.

Whilst the Council has significant long-term borrowing requirements, as mentioned previously in the report the Council's current strategy of funding capital expenditure is through the use 'internal borrowing'. Over the medium term, it is anticipated that the level of borrowing required to facilitate the new capital programme will be substantial. The Council may undertake borrowing early if there is a clear underlying need for future borrowing and it feels it can minimise risk of future interest rate rises while providing value for money. But currently, in line with advice from the treasury advisors, the intention is to hold off undertaking any borrowing until absolutely necessary, in anticipation that rates will reduce, even if not to the levels available in recent years.

At 31st March 2023 the Authority held £138.6m of loans, a decrease of £3.5m to 31st March 2023, as part of its strategy for funding previous [and current] years' capital programmes. Outstanding loans on 31st March are summarised in Table 3 below.

Table 3A: Borrowing Position

	31.3.23 Balance £m	**Net Movement £m**	**31.3.23 Balance £m**	**31.3.23 Weighted Average Rate %**	**31.3.23 Weighted Average Maturity (years)**
Public Works Loan Board	97.0	(3.9)	93.1	3.7	17.9
Banks (LOBO)	30.0	-	30.0	4.4	31.2
Banks (fixed term)	5.0	-	5.0	3.8	54.9
Local authorities (long-term)	-	-	-	-	-
Local authorities (short-term)	-	-	-	-	-
Other inc. WG loans	10.1	(0.2)	9.9	-	0.4
Accrued interest	-	0.6	0.6		
Total borrowing	**142.1**	**(3.5)**	**138.6**	**3.6**	**21.3**

The Authority's borrowing decisions are not predicated on any one outcome for interest rates.

Other Debt Activity

Although not classed as borrowing, the Authority previously raised capital finance to afford Glan Usk School and the Southern Distributor Road. The Accounts for 2022-23 are still being prepared at the time this report is finalised, but as an illustration the 2021-22 Statement of Accounts indicated an outstanding

liability of £39m to pay to the operator.

Treasury Investment Activity

CIPFA published a revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes on 20th December 2021. These define treasury management investments as investments that arise from the organisation's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances ranged between £98.7m and £43.7m million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

	31.3.22 Balance £m	Movement £m	31.3.23 Balance £m	31.3.23 Income Return %	31.3.23 Weighted average maturity Years
Banks & building societies (unsecured)	(2.3)	2.3	-	-	-
Government (incl. local authorities)	(46.0)	15.8	(30.2)	3.7	0.1
Money Market Funds	(10.0)		(7.0)	4.1	On Call
Covered Bonds	-	(10.0)	(10.0)	5.2	4.5
Total investments	**(58.3)**	**8.1**	**(47.2)**	**4.1**	**1.0**

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.

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.

By end March 2023, the rates on DMADF deposits ranged between 4.05% and 4.15%. The return on the Council's sterling Low Volatility Net Asset Value (LVNAV) Money Market Funds ranged between 0.58% in early April and between 4.1167% at the end of March.

Given the risk of short-term unsecured bank investments, in February 2023 the Authority has invested in alternative and/or higher yielding asset classes as shown in table 4 above. £10m that is available for longer-term investment was invested in covered bonds.

Non-Treasury Investments

The definition of investments in CIPFA's revised 2021 Treasury Management Code covers all the financial assets of the Authority as well as other non-financial assets which the Authority 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).

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.

The Authority also held investments in

- directly owned property such as office and commercial units of £10.6m
- loans to developers £10.3m
- shareholding in subsidiaries £0.3m

These investments generated £0.45m of investment income for the Authority after taking account of direct costs.

Compliance

The Head of Finance reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 7 below.

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

	2022/23 Maximum	31.03.23 Actual	2022/23 Operational Boundary	2022/23 Authorised Limit	Complied? Yes / No
Borrowing	141.9	138.6	192	271	ü
PFI and Finance Leases	40	38	41	41	ü
Total debt	**181.9**	**176.6**	**233**	**312**	ü

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 8: Investment Limits

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£5m 5 years	£10m 20 years	£10m 50 years	£5m 20 years	£5m 20 years
AA+	£5m 5 years	£10m 10 years	£10m 25 years	£5m 10 years	£5m 10 years
AA	£5m	£10m	£10m	£5m	£5m

	4 years	5 years	15 years	5 years	10 years
AA-	£5m 3 years	£10m 4 years	£10m 10 years	£5m 4 years	£5m 10 years
A+	£5m 2 years	£10m 3 years	£5m 5 years	£5m 3 years	£5m 5 years
A	£5m 13 months	£10m 2 years	£5m 5 years	£5m 2 years	£5m 5 years
A-	£5m 6 months	£5m 13 months	£5m 5 years	£5m 13 months	£5m 5 years
None	£1m 6 months	n/a	£10m 25 years	Not Applicable	£5m 5 years
Pooled funds and real estate investment trusts		£10m per fund or trust			

There was no non-compliance within 2022-23.

Treasury Management Indicators

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

Security: Other Councils have adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating *or* (credit score) 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.

This is a functionality that we are potentially looking to introduce in future years strategy but in the interim the Council still uses the table overleaf prescriptively in considering investments.

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

	31.3.23 Actual	**2022/23 Limit**	**Complied**
Upper limit on one-year revenue impact of a 1% rise in interest rates (borrowing)	0	200,000	ü
Upper limit on one-year revenue impact of a 1% fall in interest rates (investments)	70,000	100,000	ü

The authority did not undertaken any new long term borrowing in 2022/23, and the figures in the table above are only calculated on those investments which has a variable interest rate.

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

	31.03.23 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	4%	60%	0%	ü
12 months and within 24 months	5%	40%	0%	ü
24 months and within 5 years	22%	40%	0%	ü
5 years and within 10 years	9%	40%	0%	ü
10 years and within 20 years	24%	30%	0%	ü
20 years and within 30 years	7%	20%	0%	ü
30 years and within 40 years	18%	20%	0%	ü
40 years and within 50 years	4%	20%	0%	ü
50 years and above	7%	20%	0%	ü

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.

Principal Sums Invested for Periods Longer than a year: The purpose of this indicator is to control the Authority'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	10	10	10
Limit on principal invested beyond year end	10	10	10
Complied	ü	ü	ü