AGENDA ITEM 7
REPORT TO THE TEES VALLEY
COMBINED AUTHORITY CABINET

30th June 2023

REPORT OF GROUP DIRECTOR OF FINANCE AND RESOURCES

TREASURY MANAGEMENT OUTTURN REPORT 2022/23

SUMMARY

This report informs Members of the 2022/23 performance against the treasury management and prudential indicators set in the Treasury Management Strategy, approved by the Authority in January 2022.

RECOMMENDATIONS

It is recommended that the Combined Authority Cabinet:

i. Note the contents of this report.

DETAIL

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

2. The Authority's treasury management strategy for 2022/23 was approved at Cabinet meeting on 28th January 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 is therefore central to the Authority's treasury management strategy.

3. The 2021 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by Cabinet covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy, complying with CIPFA's requirement, was also approved by full Cabinet at the 28th of January 2022 meeting.

External Context

Economic Background

4. 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.

5. 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.

6. 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.

7. 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%.

8. 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.

9. 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%.

10. 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.

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11. 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.

12. 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

13. 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.

14. 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.

Local Context

15. The treasury management position on 31st March 2023 and the change during the year is shown in Table 1 below.

Table 1: Treasury Management Summary

	31.3.22 Balance £m	Movement £m	30.3.23 Balance £m
Long-term borrowing Short-term borrowing	134.96 15.00	74.10 10.00	102.36 25.00
Total Borrowing	**149.96**	**84.10**	**234.06**
Long-term investments Short-term investments Cash and cash equivalents	0.00 0.00 125.40	0.00 0.00 (46.50)	0.00 0.00 78.90
Total Investments	**125.40**	**(46.50)**	**78.90**
Net Investments / (Debt)	**(24.56)**	**(130.60)**	**(155.20)**

16. Delivery of the investment plan has continued at pace during the year, with the increased delivery of capital projects increasing the borrowing requirement. During the year, the Authority took advantage of a drop in interest rates below our internally set targets and secured additional borrowing from PWLB.

17. The increased delivery of the investment plan has also led to a reduction in cash held, as grants paid in advance from Government have been utilised, on delivery of a variety of projects and programmes.

Borrowing Strategy

18. 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.

19. At 31st March 2023, the Authority held £234m of loans as part of its strategy for funding the capital programmes within the Investment Plan, outstanding loans on 31st March 2023 are summarised in Table 2 below.

Table 2: Borrowing Position

	31.3.22 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 Loans Board	28.26	74.10	102.36	3.63	22.09
UK Infrastructure Bank	106.70	0.00	106.70	1.99	48.59
Local Authorities (Short Term)	15.00	10.00	25.00	3.50	0.27
Total borrowing	149.96	84.10	234.06	2.87	31.86

20. The Authority's chief objective when borrowing 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 Authority's long-term plans change being a secondary objective.

21. The Authority has an increasing capital financing requirement due to the capital programme within the investment plan and an estimated borrowing requirement as determined by the Liability Benchmark which also takes into account usable reserves and working capital.

Other Debt Activity

22. Although not classed as borrowing, the Authority has entered into finance leases which are held as long term liabilities on the balance sheet. The total value of these leases at 31st March is £146m.

Treasury Management Activity

23.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.

24. 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 fluctuated due to timing differences between income and expenditure. The investment position at the end of March 2023 is shown in table 3 below.

Table 3: Treasury Investment Position

Counterparty	Amount	Start	Maturity
	£ m	Date	Date
Natwest SIBA	11.40	n/a	Call Account
Blackrock	15.00	07-Dec-16	Money Market Fund
Aberdeen Standard	12.00	06-Oct-16	Money Market Fund
Federated	10.50	06-Oct-16	Money Market Fund
Legal & General	15.00	06-Oct-16	Money Market Fund
Insight	15.00	07-Dec-16	Money Market Fund
	78.90		

25. 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.

26. The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 4 below.

Table 4: Investment Benchmarking – Treasury investments managed in-house.

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
31.03.2020	4.30	AA-	92%	11	0.50
31.03.2021	4.63	A+	75%	10	0.02
31.03.2022	4.13	AA-	38%	3	0.01
31.03.2023	4.72	A+	100%	1	3.62
Similar LAs	4.92	A+	58%	58	3.59
All LAs	4.71	A+	59%	12	3.66

Non-Treasury Investments

27. The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

28. The Authority can lend money to its subsidiaries, constituent Local Authorities, and local businesses to support delivery of the Strategic Economic Plan and stimulate local economic growth. Loans are not issued by the Authority for purely financial return, they are provided if the proposal meets the priorities set out in the Investment Plan and related strategies. Loans may be given in order to comply with state aid regulations, or alternatively it may be that the applicant has the ability to repay the support via increased revenues as a result of the investment.

29. As at the end of March 2023 also held £243m of such investments in;

- loans to subsidiaries £234.2m
- loans to constituent local authorities £5.9m
- loans to local businesses £2.9m

Compliance

30. The Group Director of Finance and Resources reports that all treasury management activities undertaken during complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 5 below.

Table 5: Debt Limits

	Maximum in Year £m	31.03.23 Actual £m	2022/23 Operational Boundary £m	2022/23 Authorised Limit £m	Complied Yes / No
Borrowing Finance Leases	234.06 146.00	234.06 146.00	302.39 172.65	362.87 207.18	Yes Yes
Total	380.06	380.06	475.04	570.05	Yes

31. Compliance with specific investment limits is demonstrated in table 6 below.

Table 6: Investment Limits

	Maximum in Year	31.3.23 Actual	2022/23 Limit	Complied? Yes/No
Any single organisation, except the UK Central Government	£15m	£0m	£15m per organisation	Yes
UK Central Government	£54m	£0m	Unlimited	Yes
Any group of organisations under the same ownership	£0	£0	£15m per organisation	Yes
Any group of pooled funds under the same management	£0	£0	£37.5m	Yes
Negotiable instruments held in a broker's nominee account	£0	£0	£37.5m	Yes
Foreign countries	£0	£0	£15m	Yes
Registered providers and registered social landlords	£0	£0	£37.5m	Yes
Unsecured investments with building societies	£0	£0	£15m	Yes
Loans to unrated corporates	£0	£0	£15m	Yes
Money Market Funds	£75m	£67.5m	Unlimited	Yes
Real estate investment trusts	£0	£0	£37.5m	Yes

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

33. 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 are set out in table 7 below.

Table 7: Borrowing Maturity

	31.3.23 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	10.7%	100%	0%	Yes
12 months and within 24 months	0%	100%	0%	Yes
24 months and within 5 years	0%	100%	0%	Yes
5 years and within 10 years	0%	100%	0%	Yes
10 years and above	89.3%	100%	0%	Yes

34. 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.

Table 8: Long Term Investments

	2022/23	2023/24	2024/25
Actual principal invested beyond year end	£0	£0	£0
Limit on principal invested beyond year end	£15m	£10m	£5m
Complied?	Yes	Yes	Yes

FINANCIAL IMPLICATIONS

35. None

LEGAL IMPLICATIONS

36. None

RISK ASSESSMENT

37. None

CONSULTATION & COMMUNICATION

38. None

Name of Contact Officer: Gary Macdonald
Post Title: Group Director of Finance and Resources
Telephone Number: 01325 792600
Email Address: gary.macdonald@teesvalley-ca.gov.uk