SWANAGE TOWN COUNCIL

Annual Treasury Report 2022/23

Contents

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1. Background

The Council's Treasury Management Strategy for 2022/23 is underpinned by having due regard to the Chartered Institute of Public Finance and Accountancy's Guidance for Smaller Public Organisations on the Application of the CIPFA Code of Practice for Treasury Management *in the Public Services: Code of Practice (2014 Edition) and Cross-Sectoral Guidance Notes 2017 Edition* (the CIPFA Code) and the Department for Levelling Up, Housing and Communities (DLUHC) *Guidance on Local Authority Investments,* updated February 2018. The Code recommends that members approve a treasury management annual report after the end of each financial year. This report fulfils the Authority's obligation to have regard to the CIPFA Code and any other appropriate guidance.

The Authority's Treasury Management and Investment Strategy for 2022/23 was approved by full Council on 17/01/2022 which can be accessed on https://www.swanage.gov.uk/Publications-Finance.aspx

The Authority has 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 are therefore central to the Authority's treasury management strategy.

2. 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 households 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 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. The October-December period it 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 meeting, 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, as ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remain under constant review.

Local authorities remain under financial pressure, but Arlingclose continues to take a positive view of the sector, considering its credit strength to be high. Section 114 notices have been issued by only a handful of authorities with specific issues. While Arlingclose's advice for local authorities on its counterparty list remains unchanged, a degree of caution is merited with certain authorities.

3. Local Context

On 31st March 2022 the Authority held investments valued at £6.7m, with usable reserves and working capital being the underlying resources available for investment. On 31st March 2023, the Authority held investments valued at £6.1m. These year-end values include unrealised gains from the Council's strategic investments, being £0.96m in 2022 and £0.28m in 2023.

4. Borrowing Strategy and Debt Management

The Authority is debt free. Usable reserves are forecast to fall to £2.54m by March 2026, as capital receipts and earmarked reserves are used to finance the Council's extensive capital programme. The 2023/24 capital expenditure plans and treasury strategy did not imply a need to borrow over the 3-year forecast period, however this will be reviewed during the course of the 2023/24 financial year as plans for the Seafront Stabilisation Scheme are developed.

5. 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 represent 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 balances and reserves held. During the year the Authority's cash investment balances remained relatively stable, with fluctuations in the value of its long-term strategic investments. The investment position is shown in table 1 below.

Table 1: Treasury Investment Position

Investment Portfolio	31.03.22 Balance £	Net Movement £	31.03.23 Balance £	31.03.23 Income Return %
Banks and building societies (unsecured)	534,427	43,223	577,650	
Money Market Funds	750,000	0	750,000	
UK Govt – DMO Deposit/Gilts	452,108	41,367	493,475	
Total Internal Investments	**1,736,535**	**84,590**	**1,821,125**	**3.73%**
*Investments in Pooled Funds:				
Property	3,580,092	-590,185	2,989,907	
Bond	469,529	-47,150	422,379	
Multi Asset	919,299	-48,775	870,524	
Total External Funds	**4,968,920**	**-686,110**	**4,282,810**	**3.69%**
TOTAL INVESTMENTS	**6,705,455**	**-601,520**	**6,103,935**	**3.70%**

*Funds stated at Fair Value-Issued by Arlingclose

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 0.41% - 0.57% p.a. in early April and between 3.98% -4.11% at the end of March.

The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 2 below, which only includes the Council's internally managed investments.

Table 2: Investment Benchmarking-Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return
31.03.2022	4.44	AA-	74%	42	0.22%
31.03.2023	5.09	A+	73%	52	3.73%
Similar LAs	4.92	A+	58%	58	3.59%
All LAs	4.71	A+	59%	12	3.67%

Externally Managed Pooled Funds

£4.2m (£4m book value) of the Authority's investments are held in externally managed strategic pooled funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. In terms of measuring the performance of these funds, the current value is used.

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 rate 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.

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.

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.

Dividends continued to be received from the Authority's bond, multi-asset and property funds, the payout increasing for all funds in the portfolio.

The change in the Authority's funds' capital values and income earned over the 12-month period is shown in Table 3 below.

Table 3: Strategic Investment Returns – 12 months to 31st March 2023

Fund Name	Book Value £m	Current Value £	Capital Growth £	Dividends Earned £	Capital Return %	Income Return %	Total Return %
CCLA-LAMIT Property Fund	2.50	2,989,907	-590,185	129,487	-16.49	3.62	-12.87
M & G Strategic Corporate Bond Fund	0.50	422,379	-47,150	16,869	-10.04	3.59	-6.45
Ninety-One Diversified Income Fund	1.00	870,524	-48,775	36,843	-5.31	4.01	-1.3
Total	4.00	4,282,810	-686,110	183,199	-13.81	3.69	-10.12

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 will exceed cash interest rates.

In future years, when investment income exceeds budget, Council may wish to consider transferring this surplus to an earmarked treasury management reserve to manage future volatility.

Due to accounting practices, these funds are currently stated at cost price in the Council's Annual Return, £4m in total, and as such these funds have an overall unrealised gain of £0.28m at 31st March 2023. Two of the funds are showing an unrealised loss. Unrealised capital losses, or gains, will not have an impact on the General Fund until such a time as the Council redeems all or part of the units held in the funds.

Treasury Performance

The budget for investment income in 2022/23 was £140,000, with actual income of £208,002. This is primarily due to the Council retaining a higher level of reserves than estimated, due to delays in implementing its extensive capital programme, combined with much higher interest rates on its short-term investments than forecast.

Non-Treasury Investments

The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return.

The Council did not invest in non-treasury investments during the year.

6. Compliance & Treasury Management Indicators

This report provides members with a summary report of the treasury management activity during 2022/23, having due regard to both the CIPFA Code of Practice and DLUCH Guidance. A prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

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

Security: The Authority 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.

Credit Risk Indicator	31.3.23 Actual	2022/23 Target	Complied?
Portfolio average credit rating	A+	A	Yes

Liquidity: The Authority 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.

Liquidity Risk Indicator	31.3.23 Actual	2022/23 Target	Complied?
Total cash available within 3 months	£1.82m	£0.75m	Yes

The Authority can confirm that during 2022/23 it complied with its **Treasury Management Policy Statement** and **Treasury Management Practices**.