AUDIT & GOVERNANCE COMMITTEE

DATE	13 July 2023
REPORT OF	Sharon Wroot, Executive Director, Place and Resources
SUBJECT	Treasury Outturn Report 2022-23
STATUS	Open

CONTRIBUTION TO OUR AIMS

Effective treasury management will provide support towards the achievement of Council Plan aims and objectives. Treasury management is an integral part of the Council's finances providing for cash flow management and financing of capital schemes. It therefore underpins all the Council's aims.

EXECUTIVE SUMMARY

The report contains details of treasury management arrangements, activity and performance during the 2022/23 financial year.

During the period covered, the Council complied with its legislative and regulatory requirements.

The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Prudential and Treasury Indicators	31.3.22 Actual £'m	2022/23 Approved Budget £'m	31.3.23 Actual £'m
Capital Expenditure	31.1	60.0	51.4
Capital Financing Requirement	190.3	223.9	203.1
Authorised Borrowing Limit	290.0	290.0	290.0
Operational Boundary	245.0	245.0	245.0
External Borrowing	154.4	196.3	169.6
Investments >365 days	0.0	0.0	0.0

RECOMMENDATIONS

Audit & Governance Committee is requested to:

1) Consider the content of the report and makes any recommendations to Cabinet as necessary in respect of treasury management activity during 2022/23.

REASONS FOR DECISION

The Council's treasury management activity is guided by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year with interim updates on performance against Prudential Indicators reported quarterly. We therefore report in full after Quarter 2 (this Report) and year end with Prudential Indicators being reported additionally after Quarters 1 and 3 in the Commissioning and Resource Report.

1. BACKGROUND AND ISSUES

1.1. CIPFA has defined 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.

1.2. The Treasury Management Strategy Statement (TMSS) for 2022/23 was developed in consultation with our treasury management advisors, Link Asset Services Ltd. This statement also incorporates the Investment Strategy.

1.3 Whilst the Council has appointed advisors to support effective treasury management arrangements, the Council is ultimately responsible for its treasury decisions and activity. No treasury activity is without risk. The successful identification, monitoring and control of risk is therefore an important and integral element of treasury management activities.

1.4 The Council has nominated the Audit & Governance Committee as responsible for ensuring effective scrutiny of the treasury management arrangements.

1.5 Key points to note with specific regard to the Treasury Strategy:

- As the one-off effects of the Covid pandemic subsided, the higher investment balances, which had been maintained as a result of a combination of Central Government support programmes and a general strategy to maintain additional liquidity during the period of uncertainty, adjusted to more typical levels during 2022-23.

- Primary focus during the year was managing the impact of the rapid rise in rates as the Bank of England sought to contain inflation, which hit 40 year highs, driven initially by dramatic energy price spikes following Russia's invasion of Ukraine and then the secondary effects of subsequent rises in wages, service and food prices.

- Starting April at 0.75%, Bank Rate moved up in stepped increases of either 0.25% or 0.5%, reaching 4.25% by the end of the financial year, with further increases in 2023/24.

- Investment returns therefore picked up throughout the course of 2022/23 and even with our cautious approach, additional income over budget of £0.593m was generated during the period, which was made available to frontline services.

- This was partly due to our relatively short duration average investment period allowing us to capture rising rates much quicker than our Benchmarking group.

- The Treasury Management Strategy covers the Council's treasury aims and principles. The Council also considers direct 'commercial' investments from time-to-time with the aim of generating financial return. Although reference is made to these types of investments in the TMSS' these transactions are guided and limited by the Capital Strategy document.

2. RISKS AND OPPORTUNITIES

2.1 No Treasury activity is without risk. Specific risks include, but are not limited to, Counterparty Credit Risk (the risk of an investment not being repaid), liquidity risk (the risk that the Authority does not have its funds in the right place, at the right time and in the right amount to make it's payments as they fall due), interest rate risk (the risk that future rate movements have a revenue implication for the Authority) and reputational risk (see Section 4 below).

2.2 The attached Appendices define our approach toward mitigating these risks.

2.3 Treasury is an Authority-wide function and its environmental sustainability and equalities implications are the same as for the Council itself.

2.4 The Authority will have regard to the environmental and equality activities of its Counterparties (where reported) but

- Prioritises Security, Liquidity and Yield,
- Recognises that as large, global institutions our high-quality counterparties operate across the full range of marketplaces in which they are legally able to, and such exposures are small parts of their overall business.
- Excluding any one counterparty will likely mean others will similarly have to be avoided and thus impact the Authority's capacity to mitigate risk through diversification.

2.5 **General Data Protection Regulation 2018** – Relationships with external providers covered by the Treasury management Practices are governed by and operated in accordance with the act.

3. OTHER OPTIONS CONSIDERED

3.1 These were set out on Page 28 of the Treasury Management Strategy Statement.

4. REPUTATION AND COMMUNICATIONS CONSIDERATIONS

4.1 As you would expect, with large sums of public money involved, any treasury activity carries a high degree of reputational risk. Any losses have not just financial but also significant, ongoing resource implications for the Council.

5. FINANCIAL CONSIDERATIONS

5.1 As set out in the Appendices.

6. CHILDREN AND YOUNG PEOPLE IMPLICATIONS

6.1. As an Authority-wide corporate function, the immediate impacts of day-to-day Treasury operations on children and young people are the same as for the Council as a whole. However, certain Treasury decisions, most notably those relating to Long-Term Borrowing transactions, will place a greater burden on young residents, over time, relevant to other demographics.

7. CLIMATE CHANGE AND ENVIRONMENTAL IMPLICATIONS

7.1 In line with the Authority's declaration of a Climate Emergency, the S151 Officer will aim to assess and monitor, not just Environmental but all, Environmental, Social and Governance (ESG) factors when selecting investment options. Full assessment is however restricted by the fact that, at the time of writing, there is no consistent rating framework with which to measure and benchmark specific counterparty ESG metrics. Until this market data gap is fully resolved, our approach to managing the risks associated with the Environmental activities of our Counterparties is as follows:-:-

- As the Ratings Agencies headline ratings on our Counterparties now incorporate ESG risk assessments alongside more traditional financial risk metrics and so provide both an holistic risk measure and a proxy for ESG 'scoring' in the absence of anything more robust

- The Council will continue to Prioritise Security, Liquidity and Yield, in that order

- The Council recognises that as large, global institutions our high-quality counterparties operate across the full range of marketplaces in which they are legally able to, and as a result climate change considerations are an increasingly important and heavily scrutinised part of their overall business.

- Excluding any one counterparty will likely mean others will similarly have to be avoided and thus impact the Authority's capacity to mitigate risk through diversification.

- The Council notes that bonds issued by Supranational institutions offer strong ESG credentials, combined with the explicit underwriting support of all major developed countries. This results in excellent ratings (typically AA+ - AAA) being applied. As such, the Council actively seeks exposure to these assets (commensurate with its investment horizon) and in doing so, contributes to market liquidity and therefore capital raising abilities of these bodies who then deploy that capital in ESG positive schemes.

8. FINANCIAL IMPLICATIONS

8.1 As set out in the appendix.

9. MONITORING COMMENTS

9.1 In the opinion of the author, this report does not contain recommended changes to policy or resources (people, finance or physical assets). As a result no monitoring comments have been sought from the Council's Monitoring Officer (Chief Legal Officer) or AD People and OD.

10. BACKGROUND PAPERS

10.1 CIPFA Treasury Management Code and Guidance Notes

11. CONTACT OFFICER(S)

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Appendix 1

Treasury Outturn Report 2022/23

Contents

Abbreviations Used In This Report

- **BoE:** the Bank of England (see also MPC below)
- **CFR:** capital financing requirement - the council's annual underlying borrowing need to finance capital expenditure and a measure of the council's total outstanding indebtedness.
- **CIPFA:** Chartered Institute of Public Finance and Accountancy – the professional accounting body that oversees and sets standards in local authority finance and treasury management.
- **Gilts:** gilts are bonds issued by the UK Government to borrow money on the financial markets. The yields on Gilts are (usually) fixed and so will change inversely to the price of gilts i.e. a rise in the price of a gilt will mean that its yield will fall.
- **LOBO:** a loan carrying provision for the lender to periodically amend the interest rate applicable. If the lender chooses to exercise this option the borrower then receives the secondary option to choose to repay the loan without penalty.
- **DLUHC:** the Department for Levelling Up, Housing and Communities - the Government department that directs local authorities in England.
- **MPC:** the Monetary Policy Committee is a committee of the Bank of England, which meets eight times a year, to determine monetary policy by setting the official interest rate in the United Kingdom, (the Bank of England Base Rate, commonly called Bank Rate), and by making decisions on quantitative easing.
- **MRP:** minimum revenue provision - a statutory annual minimum revenue charge to reduce the total outstanding CFR, (the total indebtedness of a local authority).
- **PWLB:** Public Works Loan Board – the section within H.M. Treasury which provides loans to local authorities to finance capital expenditure.
- **RPI/CPI:** the Retail Price Index (RPI) is a measure of inflation that measures the change in the cost of a representative sample of retail goods and services. The main difference between RPI and Consumer Price Index (CPI) is in the way that housing costs are treated and RPI is often higher than CPI for these reasons.
- **S151 Officer:** an Officer appointed under section 151 of the Local Government Act to carry out the duties of 'Responsible Financial Officer' as defined by CIPFA
- **SONIA:** the Sterling Overnight Index Average. Generally, a replacement set of indices (for LIBID) for those benchmarking their investments.
- **TMSS:** the annual treasury management strategy statement reports that all local authorities are required to submit for approval by the full council before the start of each financial year.

Key Messages:

All investment and borrowing transactions were in line with the Approved 2022-23 treasury Strategy.

There were no in-year policy changes to the TMSS; the details in this report update the outturn position set against the updated economic environment and budgetary changes already approved.

Our central case at the start of the year was for interest rates to continue to rise to a peak of around 2.5 – 3% by mid-2023 whilst we did flag that this still has some uncertainty attached, base rate actually reached 4% by the end of March.

This report covers Treasury and it's related financial transactions. A Capital Strategy is reported separately covering non-treasury related investments.

S151 Officer Overview

The Council operates a balanced budget, which broadly means cash raised during the year will meet its non-capital expenditure, however there will always be timing differences in how funds are received and expenses settled. A fundamental element of treasury management is to ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, whilst retaining adequate liquidity before considering optimising investment return.

Our 2022-23 Treasury Strategy was tailored to allow the Council to manage risks related to cash investments and has, once again, stood up well to the ongoing pressures seen as a result of post-Covid 19 inflation and interest rate rises, despite both surpassing our expectations going into the period. Managing circumstances a standard deviation or two beyond that expected is a key determinant of successful Treasury Management delivery. Rare or 'Once in a generation/lifetime' events happen all the time. The role of Treasury Management at North East Lincolnshire Council is to ensure those occurrences do not endanger the larger mission of the Authority.

Beyond that high level brief, the main functions of Treasury can be divided into 4 main parts:-

1. The arrangement of funding for the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending plans as they fall due. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.
2. Safeguarding surplus funds – investing the Council's funds in line with the principles of Security, Liquidity and Yield priority.
3. Day-to-day cash flow management – ensuring the Authority has funds available in the right place, at the right time, in the right size to meet it's payment obligations as they fall due.
4. Horizon scanning of financial data and market intelligence and sharing this with the wider organisation as appropriate.

In a rising rate environment, such as that seen during 2022-23 we have predominantly opted for shorter term borrowing, hoping to 'ride out' the cycle before locking in loans for the long-term. Notably, as no-one has certain knowledge of how long higher rates will prevail, this policy is intended to be balanced with occasional , proportionate long-term transactions, such as that completed in August 2022 (see P11). At the time of writing, rates were still on an upward trajectory but we continue to monitor rate paths and develop a borrowing strategy that best meets the requirements of the Authority's plans.

Sharon Wroot, S151 Officer

8 June 2023

Key Messages:

No Treasury activity is without risk. These risks include, but are not limited to, Credit Risk, Liquidity Risk, Interest Rate Risk, Inflation Risk and Reputational Risk.

The Council uses in-house knowledge, advisors (Link Treasury Services), treasury management software (Treasury Live) and the CIPFA Treasury Management Code to manage these risks.

Scrutiny of Treasury activity is undertaken by Audit and Governance Committee and reported twice-yearly to Full Council. Going forward, in accordance with Code revisions, updates on Prudential Indicators will also be provided as part of quarterly budget updates Reports.

Introduction and External Context

This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2021) to provide a review of treasury management activities and the actual prudential and treasury indicators for 2022/23. This report also references the most recent Revisions to the Code and meets the requirements of both the CIPFA Code of Practice on Treasury Management, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

This report covers the following:

- An economic review for the 2022/23 financial year;
- A summary of the Council's capital expenditure, as set out in the Capital Strategy, and performance against its prudential indicators;
- Impact of this activity on the Council's underlying indebtedness, (the Capital Financing Requirement);
- A review of the Council's treasury investments during 2022/23;
- A review of the Council's borrowing strategy for 2022/23;
- A review of any debt rescheduling undertaken during 2022/23;
- A review of compliance with Treasury and Prudential Limits for 2022/23.

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to the above treasury management report by the Audit Committee before they were reported to the full Council. Member training on treasury management issues was undertaken during 2022/23 in order to support members' scrutiny role.

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. This report covers treasury activity and the associated monitoring and control of risk.

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Key Messages:

The Council has taken a cautious approach to investing, but is also fully appreciative that the external risk environment looks very different to that which has existed for the last decade or so. High inflation reduces our spending power and rising rates, although positive for investments, have a much larger cost impact on future borrowing.

As of June 2023 our advisors, Link Group are forecasting further increases in Bank Rate through to a peak of 5.00% by the end of 2023, although the picture remains somewhat uncertain in terms of path for inflation, the housing market and the potential for a slowdown in growth or even a recession.

Introduction and External Context

Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022/23.

Bank Rate increased steadily throughout 2022/23, starting at 0.75% and finishing at 4.25%.

In the interim, following a Conservative Party leadership contest, Liz Truss became Prime Minister for a tumultuous seven weeks that ran through September and October. Markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng, and precipitated their replacement by Prime Minister Rishi Sunak and Chancellor Jeremy Hunt. Their Autumn Statement of the 17th of November gave rise to a net £55bn fiscal tightening, although much of the “heavy lifting” has been left for the next Parliament to deliver. However, the markets liked what they heard, and UK gilt yields have reversed the increases seen under the previous tenants of No10/11 Downing Street, although they remain elevated in line with developed economies generally.

The Authority does not typically have sufficient surplus cash balances to be able to place deposits for more than around six months so as to earn higher rates from longer deposits. In a rising rate environment this has the beneficial effect of being able to capture uplifts in rates sooner however.

Investment balances that had been boosted by central Government support schemes and temporary loans from other Local Authorities gradually adjusted back to more typical levels during the period as support scheme monies were spent and temporary loans allowed to mature. This reversion has also provided benefits in terms of reducing the counterparty risk, by having fewer investments placed in the financial markets.

While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

Key Messages:

The Treasury Management Strategy Statement, (TMSS), for 2022/23 was approved by this Council in February 2022. No changes are considered necessary during the year despite the uncertainty seen as a consequence of rising rates and inflation.

The Authority has an increasing CFR over the next four years due to the capital programme, and with reduced investments will therefore need to borrow up to £54m over the next few years. An additional £40m will be required to replace maturing loans.

Since the 2008 financial crisis the Authority has adopted a cautious approach whereby investments are framed by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

Local Context

The Treasury Management Strategy Statement, (TMSS), for 2022/23 was approved by this Council on 24 February 2022.

There were no in-year policy changes to the TMSS – pleasing to note in the face of challenging economic circumstances; the Strategy did is job in protecting public funds whilst allowing sufficient flexibility to cope with exceptional operational demands.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council must ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This means that the Council is not borrowing to support revenue expenditure.

The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator and we are on target to achieve the original forecast.

	31 March 2022 Principal	Rate/ Return	Average Life yrs		31 March 2023 Principal	Rate/ Return	Average Life yrs
Total debt	*£154.4m*	*3.17%*	*27.0*		*£169.6m*	*3.48%*	*24.4*
Capital Financing Requirement (CFR)	*£190.8m*				*£207.6m*		
Over / (under) borrowing	*(£36.4m)*				*(£38.0m)*		
Total investments	*£44.7m*	*0.54%*	*0.04*		*£15.5m*	*3.52%*	*0.07*
Net debt	£109.7m				£154.0m		

The overall level of investment balances was higher through the Covid-19 pandemic, as the Authority sought additional liquidity and central Government provided additional support. Those balances reduced as expected during 2022-23 and, looking forward, it is anticipated that the Authority will revert to using internal borrowing to both defer more expensive long-term borrowing and reduce it's credit risk exposure.

Key Messages:

When undertaking new borrowing the Council will review both the source and tenure of loans it seeks to take.

At 31/03/2023 the Authority owed £170m in loans, (up £15m on 2022) as a result of funding previous years' capital programmes.

The Council's current borrowing portfolio is predominantly of a long-term and fixed nature. Whilst this provides certainty of cost it can restrict flexibility to restructure debts as plans and finances change.

No rescheduling was undertaken during the year as the differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Borrowing Strategy

The first key control over the treasury activity is the CFR, a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2022/23 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if such borrowing proves prudent, meets the CFR criteria above and after due evaluation is believed to represent a Value for Money proposition.

	2022/23 Outturn Original Estimate £m	Mid-year Position 30.9.2022 £m	2022/23 Final Position £m
Borrowing	196.3	155.2	169.6
Other Long Term liabilities	0.0	0.0	0.0
Total debt	196.3	155.2	169.6
CFR (year end position)	223.9		206.6

A breakdown of our debt portfolio by type as at period end is shown below:-

Type of Loan	Amount	% of Portfolio
PWLB Fixed	£76.8m	45%
LOBO	£21.0m	12%
Market Fixed	£43.7m	26%
Short-term Fixed	£28.0m	16%
Variable Rate	£0.1m	1%
Total	£169.6m	

Key Messages:

Affordability and the "cost of carry" remained strong influences on the Authority's borrowing strategy. As short-term interest rates are likely to remain, at least over the forthcoming two years, lower than long-term rates, the Authority determined it was largely more cost effective in the short-term to use its own funds to defer borrowing.

Borrowing short-term from other local authorities provides a useful source of funding below current long-term rates and with the ability to exit loans within a reasonable timeframe.

Importantly however, whilst the above represents the default strategy, there always remains a risk of higher rates in the future. As such, the Authority continues to assess longer term options.

Borrowing Strategy (continued)

- During 2022/23, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were initially low and minimising counterparty risk on placing investments also needed to be considered.

- The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this has been kept under review to avoid incurring higher borrowing costs in the future when this Authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt. To actively mitigate some of this risk, a new loan of £5m over 29 years was arranged and drawn from PWLB in August 2022 at a rate of 2.97%. Additional short-term loans were obtained from the Local Authority lending market during 2021/22 (see P11 for details).

- It is anticipated that further borrowing will be undertaken during the 2023/24 financial year.

- Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Director of Finance monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks :

- where there was a significant perceived risk of a sharp FALL in long and short term rates, (e.g. due to a marked increased risk of recession or risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

- where there was a significant risk of a sharp RISE in long and short term rates, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the future (See August 2022 loan transaction referred to above).

Key Messages:

The Authority's traditional source of long-term borrowing is the Public Works Loan Board (part of HM Treasury).

The rate at which the Authority can borrow is determined by the Gilt Market (the Government's own primary source of borrowing) and fluctuates with market conditions. On top of this 'base rate' PWLB apply a margin, typically 0.8% for NELC.

Longer term rates continued to rise during 2022-23 as future hikes in Bank Rates were anticipated by markets. Significantly higher volatility also remained a regular feature across the majority of financial markets.

Borrowing Strategy (continued)

PWLB rates are based on gilt (UK Government bonds) yields through H.M.Treasury determining a specified margin to add to gilt yields (see below). The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields. Inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation, however, from early 2022, yields rose dramatically in all the major developed economies, first as economies opened post-Covid; then because of the inflationary impact of the war in Ukraine in respect of the supply side of many goods. At present the major Central Banks are all being challenged by persistent inflation, exacerbated by very tight labour markets and resulting wage pressures.

Going into 2022/23, interest rate forecasts had initially suggested only gradual rises in short, medium and longer-term fixed borrowing rates during 2022/23 but by August it had become clear that inflation was moving up towards 40-year highs, and the Bank of England engaged in monetary policy tightening at every Monetary Policy Committee meeting during 2022, and into 2023, either by increasing Bank Rate by 0.25% or 0.5% each time. At period end, the CPI measure of inflation was still above 10% in the UK but was expected to fall back towards 4% by year end. Nonetheless, there remain significant risks to that central forecast.

Revised PWLB Guidance for 2021/22 restored standard and certainty margins but introduced a prohibition denying access to PWLB borrowing for any local authority which had purchase of assets for yield in its three-year capital programme.

The current margins over gilt yields are as follows: -.

- PWLB Standard Rate is gilt plus 100 basis points (G+100bps)
- PWLB Certainty Rate is gilt plus 80 basis points (G+80bps)
- Local Infrastructure Rate is gilt plus 60bps (G+60bps)

On 31 March 2023, all gilt yields from 1 to 50 years were between 3.64% and 4.18%.

At period end there was expected to be a fall in gilt yields and PWLB rates across the whole curve over the next one to two years as Bank Rate first peaks, and is then cut as the economy slows, unemployment rises, and inflation (CPI) moves toward the Bank of England's 2% target.

Borrowing in advance of need

The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed, so expects to retain access to PWLB.

Key Messages:

Several short-term loans were agreed during 2022-23 in order to defer long-term borrowing during a period of elevated rates. There was one transaction of a long-term nature, chosen to balance out the risk that rates remain much higher than in recent years. This £5m loan has locked in a lifetime cost £1.7m lower than a similar loan taken at period end.

Borrowing Strategy (continued)

Borrowing – the following loans were taken during the period: -

Counterparty	Start Date	Maturity Date	Amount	Rate
Middlesborough Council	01/08/2022	15/08/2022	£5,000,000	1.40%
PWLB	09/08/2022	09/08/2051	£5,000,000	2.97%
West of England Combined Authority	18/08/2022	17/08/2023	£5,000,000	1.30%
Lancashire County Council	31/08/2022	30/11/2022	£5,000,000	1.50%
Renfrewshire Council	21/11/2022	21/08/2023	£5,000,000	2.90%
Oxfordshire County Council	23/11/2022	21/11/2025	£5,000,000	2.25%
Warwickshire County Council	13/02/2023	15/01/2024	£5,000,000	4.00%
Northern Ireland Housing Executive	15/03/2023	15/09/2023	£10,000,000	4.70%

Key Messages:

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

All other things being equal we would expect to see balances fall each year by the amount of corporately funded capital expenditure less any new borrowing. However, during 2022/23 higher balances were maintained for part of the period as a result of Government support programmes (primarily Covid related). These monies were deployed during the year and, by period end, balances had reverted to more typical levels.

Investment Activity

The Authority has held significant invested funds, representing income received in advance of expenditure plus balances and reserves held.

During 2022/23 total investment balances ranged between £15.5m and £58.4 million. The average balance maintained was £36m (including central Government support programme monies) with a weighted average maturity of 23 days. During the period our target rate of SONIA was 2.26% and our average rate achieved was 1.80%. This is mainly due to maturity lag before we could capture rapidly rising rates. We had an average carry of 25 days, whereas SONIA is calculated on a daily basis. When rates rise as dramatically as they have, they are therefore immediately reflected in the benchmark rate, but we only access the higher rates on maturity of our existing deposits. Obviously, this works in the opposite direction should rates fall.

Investment Policy – the Council's investment policy is governed by DLUHC guidance, which has been implemented in the annual investment strategy approved by the Council. Investment activity during the year conformed to the Investment Strategy for 2022/23 which aimed to reduce risk by;

- Setting value and term limits for counterparties based on Credit rating, available collateral and sector.
- Utilising data tools available via Treasury Live and Link Asset Services to monitor risk.
- Ensuring a minimum level of liquidity was maintained to allow payments to be made as they fell due

The Council aims to achieve an adequate return (yield) on its investments commensurate with robust levels of security and liquidity. In the current economic climate, it is considered appropriate to keep investments short term to cover cash flow needs using our suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

Creditworthiness – Credit metrics for the financial institutions we interact with have remained remarkably resilient throughout the Covid pandemic and no changes to TMSS limits, or indeed (more restrictive) operational limits were necessary during the period. Even so in a post 'Bail-in' regulatory environment NELC seeks to largely avoid direct bank exposure.

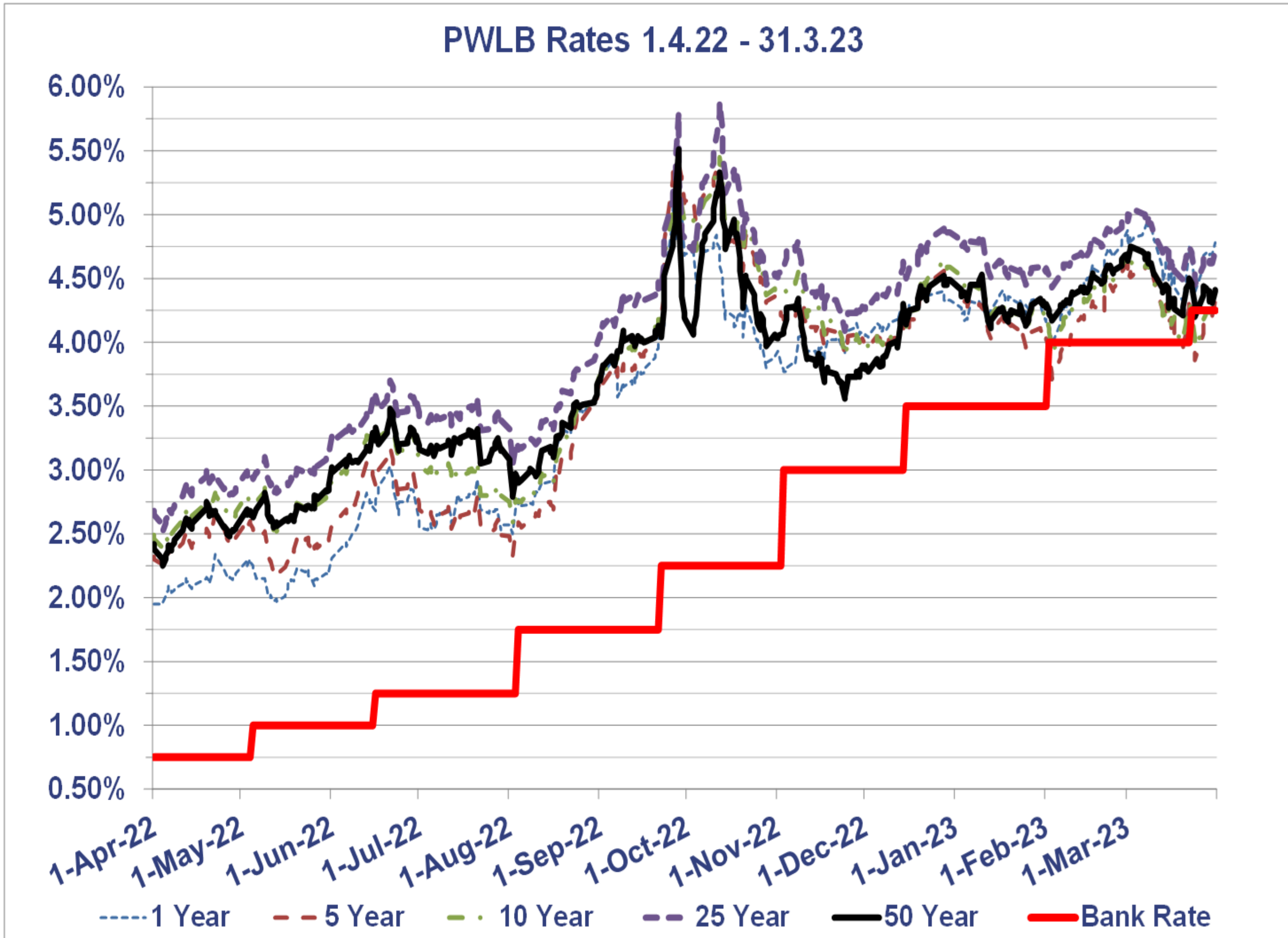
Key Messages:

After a decade or so of near zero investment returns, the BoE finally moved to combat inflation in late 2021 and announced hikes at all of its eight meetings in 2022/23 (see red line across).

Our short term average investment duration allowed the Authority to swiftly capture these upward movements in rates and total investment income for the year was well ahead of budget at £0.643m compared to an annual budget expectation of £0.050m. An increased budget has been set for 2023/24.

As ever, interest rates are a two-sided coin and increasing costs on the debt side in future years will far outweigh this higher income.

Short-Term Investment Rates



The Chart shown above clearly demonstrates how the BoE's urgency toward fighting inflation affected short-term rates but also shows how longer term market rates (on which our borrowing is based) predicted these rises in advance and are now indicating an expected pivot in the near term.

Key Messages:

Counterparty credit quality is assessed and monitored with reference to credit ratings (the Authority's minimum long-term counterparty rating for institutions defined as having "high credit quality" is A-); credit default swap prices, financial statements, and reports from quality financial news feeds.

Higher average balances were maintained at the beginning of the period, a result of a combination of an active strategy to maintain liquidity during the uncertainty around Covid-19 crisis and subsequent central government assistance schemes, this position was fully unwound by period end.

Investment Activity

Investments	Balance on 31/03/2022 £m	Investments Made £m	Maturities/ Investments Sold £m	Balance on 31/03/2023 £m	Avg Rate/Yield (%) and Avg Life (years)
UK Government: - DMADF - Treasury Bills	30.1 6.5	684.8 14.5	(701.8) (21.0)	13.1 0	1.97% 10 days 1.45% 50 days
Bonds issued by Multilateral Development Banks	-	10.1	(8.1)	2.0	1.68% 103 days
Direct Unsecured Investments (call accounts, deposits) with financial institutions - rated A- or higher - rated below A-	0.7 -	47.6	(48.1)	0.3	2.18% at Call
Tradable Investments with Financial institutions Corporates (CDs) rated A- or higher	2.0	2.0	(4.0)	0	1.52% 52 days
Money Market Funds	8.4	20.0	(28.1)	0.3	1.85% at Call
TOTAL INVESTMENTS	47.7	769.0	(812.7)	15.5	1.80% 25 days
Increase/ (Decrease) in Investments £m				(32.2)	

Given the increased risk and continued low returns from short-term unsecured bank investments, but having no funds available for longer-term investment, the Authority is unable to simply diversify into more secure and/or higher yielding asset classes such as repurchase agreements or covered bonds which are secured on financial assets. Eliminating Credit Risk by running down balances whilst still maintaining adequate liquidity therefore remains a key strand of operational activity.

Key Messages:

Figuratively the Authority's risk profile remained fairly steady for most of the year, (with a narrow set of counterparties our risk profile primarily moves with UK sovereign rating where there were no changes during the period).

The small movement in risk at period end is a reflection of the proactive decision to withdraw the majority of funds held in Money Market Funds following the emergence of the banking crisis that led to the failures of several US regional banks and Credit Suisse. These monies were instead placed with the UK Government where the rating is technically lower than the diversified Money Market Funds but in reality is the safest home for our funds during times of market stress.

Investment Activity (contd.)

Credit Risk

Counterparty credit quality as measured by credit ratings is summarised below:

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating
31/03/2022	3.45	AA
30/06/2022	2.88	AA
30/09/2022	2.39	AA+
31/12/2022	3.31	AA
31/03/2023	3.61	AA-

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 26
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

The Table above is a useful way to simply quantify the overall risk taken during the period covered. It does have its limitations, however. The Authority maintains several Money Market Fund (MMF) accounts for daily liquidity. These funds take deposits from NELC and other corporates and lends them out to banks and other financial institutions. Because the lent-out monies are distributed across c40-50 banks the funds are considered well diversified and Ratings Agencies grant them an MMF specific AAA rating. The sector is highly regulated and rules are in place to protect investors. Some of these rules mean that should only a handful of banks be unable to repay their loans or should there be a 'run' on the funds in times of market stress, the Authority could be 'locked out' of accessing its deposits or, in the worst case, lose a portion of its invested amount called a 'haircut'. These characteristics lead us to closely monitor the Funds and take swift action whenever necessary to protect taxpayer funds. Such an occurrence came to pass in March 2023 when failures and 'runs' at some international banks led to the pre-emptive decision to pull our deposits from these funds and instead place them with the UK Government. A consequence of this was that, as the UK has an AA- Sovereign rating, our average rating fell, even though in reality, our risk profile was improved.

Key Messages:

In an environment where direct unsecured bank deposits present increased risk but low return NELC has sought to avoid this imbalance by utilising UK Government based investments and diversified funds.

Ultimately we seek to minimise counterparty risk by limiting our cash levels whilst still maintaining adequate liquidity.

There were no operational breaches of the limits set in the TMSS.

Investment Activity (contd.)

Benchmarking

- Comparisons are made to other Authorities using the Treasury Live database which looks at over £8Bn of local Authority investments. As at the outturn date this shows that compared to other Authorities:-
  - NELC hold less cash. Average balance £16m vs £100m average for the Group
  - NELC invest for shorter periods. Only 25 days vs 121 days on average across the Group
  - NELC take less risk than the Group collectively.
  - NELC Deliver better return. 4.04% vs 3.36% average return for the Group
- The above shows how the Council has been able to take advantage of rising rates more quickly due to its shorter average investment term. NELC is of the view that, in a post Bail-in environment elimination of credit risk through lower balances is worth potential lower overall return. To ensure this strategy does not replace credit risk with liquidity risk NELC maintains a liquid balance at least £10m.
- Whilst we regularly monitor performance against data on 80 other Authorities' activity (as summarised above), in January 2022 Audit and Governance Committee requested that we obtain some additional specific data on what Unitary Authorities (like NELC), are investing in, to ensure we are not 'missing out' on anything those 'peers' are doing. Data was shared with us (confidentially and anonymised) by our Advisors, Link Asset Services. Against this narrower grouping we are even more 'in the bunch' with the only difference being those who have historically lent (sometimes long-term) to other Authorities. We have reviewed the data and considered LA lending but for the time being the S151 Officer has taken the decision not to do so.

Operational Breaches

- There were no breaches of limits set within the TMSS during the period.

Key Messages:

The Authority confirms compliance with its Prudential Indicators for 2022/23, which were set in February 2022 as part of the Authority's Treasury Management Strategy Statement.

Compliance with Prudential Indicators

Treasury Management Indicators

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

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

	2022/23	2023/24	2024/25
Upper limit on fixed interest rate exposure	£290m	£300m	£300m
Actual*	£145m	£155m	£170m
Upper limit on variable interest rate exposure	£90m	£90m	£90m
Actual*	£25m*	£35m (est)	£35m (est)

*= Peak position for 2022/23

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 fixed rate borrowing were:

	Upper	Lower	Actual
Under 12 months	70%	0%	30%
12 months and within 24 months	30%	0%	1%
24 months and within 5 years	50%	0%	8%
5 years and within 10 years	50%	0%	9%
10 years and within 20 years	75%	0%	9%
20 years and within 30 years	75%	0%	16%
Over 30 years	100%	0%	27%

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. Note: LOBO option dates are included as potential repayment dates.

Key Messages:

For 2022/23 a minimum cash level of £10m was targeted and there were no breaches of this, or other Indicators.

Compliance with Prudential Indicators (contd.)

Principal Sums Invested for Periods Longer than 365 days: 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 total principal sum invested to final maturities beyond the period end will be:

	2022/23	2023/24	2024/25
Limit on principal invested beyond year end	£21m	£21m	£21m
Actual	£0m	£0m	£0m

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.

	Target	Actual
Portfolio average credit rating	A	AA-

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, without additional borrowing.

	Target	Actual (Low)
Total cash available within 1 month	£10m	£16m

Key Messages:

Borrowing remains comfortably below control levels as a result of continued internal borrowing support for the Capital Programme.

Borrowing levels were projected to be £196m at the end of 2022/23 when the TMSS was set in Feb 2022. The actual position as at 31.3.2023 was £170m. The difference was represented by cash and Reserves at the period end and was expected to be utilised to fund Capital Spend during 2023/24.

Compliance with Prudential Indicators (contd.)

Other Prudential Indicators

The following prudential indicators are relevant to the treasury function as they concern limits on borrowing and the adoption of the CIPFA Treasury Management Code.

Operational Boundary for External Debt: The operational boundary is based on the Authority's estimate of most likely, i.e., prudent, but not worst-case scenario for external debt.

Operational Boundary	2022/23 £m	2023/24 £m	2024/25 £m	2025/26 £m
Borrowing	£220m	£220m	£230m	£240m
Other long-term liabilities	£30m	£30m	£30m	£30m
Boundary for Total Debt	£250m	£250m	£260m	£270m

Authorised Limit for External Debt: The authorised limit is "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2022-23 the Council has maintained gross borrowing well within its authorised limit.

Authorised Limit	2022/23 £m	2023/24 £m	2024/25 £m	2025/26 £m
Borrowing Limit	£250m	£260m	£265m	£275m
Other long-term liabilities	£40m	£40m	£40m	£40m
Total Debt Limit	£290m	£300m	£305m	£315m
Actual/projected Peak Debt levels	£170m	£189m (est)	£215m (est)	£226m

Adoption of the CIPFA Treasury Management Code: The Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition in February 2022.

Key Messages:

The Local Government Act 2003 requires the Authority to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow.

The Authority confirms compliance with its Capital Finance Prudential Indicators for 2022/23, which were set in February 2022 as part of the Authority's Treasury Management Strategy Statement.

Changes to the 2023/24 and later programmes may occur as these are progressed in the coming months.

Compliance with Capital Finance Prudential Indicators

The Local Government Act 2003 requires the Authority to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure

The Authority's planned capital expenditure and financing as at 31.3.2023 may be summarised as follows.

Capital Expenditure and Financing	2022/23 Original £m	2022/23 Changes £m	2022/23 Draft Outturn £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
Total Expenditure	60.0	(8.6)	51.4	93.7	83.6	30.2
Capital Receipts	0.4	-	0.4	5.0	4.0	0.0
Government Grants	35.6	(4.4)	31.2	54.7	44.2	9.4
Ring-fenced External Funding	0.9	-	0.9	1.9	0.7	0.0
Borrowing	23.1	(4.2)	18.9	32.1	34.7	20.8
Total Financing	60.0	(8.6)	51.4	93.7	83.6	30.2

Key Messages:

The table across shows how much of the Council's budget is/is expected to be needed to service its debt, including repayments and interest.

The percentage of the Council's income required to service it's net debt in 2022/23 came in below projections due to a combination of slippage in the capital programme and a much higher than anticipated income from investments as a result of rising rates.

Compliance with Capital Finance Prudential Indicators (contd.)

Ratio of Financing Costs to Net Revenue Stream

This is a voluntary indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the Council's entire revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2022/23 Original Estimate %	2022/23 Outturn %	2023/24 Estimate %	2024/25 Estimate %	2025/26 Estimate %
General Fund	7.90	7.20	8.17	9.35	10.11

The percentage of the Council's income required to service its net debt came in below 2022/23 projections due to a combination of slippage in the capital programme and a much higher than anticipated income from investments as a result of rising rates.

There are a range of factors that affect these future estimates, some internal such as what the capital investment delivers, and others an impact of interest rate changes. Any future borrowing must be in accordance with prudential borrowing principles. Borrowing must be affordable, sustainable and prudent.