worcestershire county council

CABINET
20 JULY 2023

2022-23 TREASURY MANAGEMENT ANNUAL REPORT

Relevant Cabinet Member
Mr S E Geraghty

Relevant Chief Officer
Chief Financial Officer

Recommendation

1. The Cabinet Member with Responsibility for Finance (who is also the Leader of the Council) recommends that Cabinet:

a) note and consider the Council's Treasury Management Annual Report 2022-23; and

b) Refer to Full Council for approval in accordance with our Treasury Management Strategy.

Background

2. This report summarises the treasury management performance and position information for Worcestershire County Council for the year ended 31 March 2023.

3. Treasury management at the Council is conducted within the framework of CIPFA's Treasury Management Code of Practice. In adopting the code, recommended best practice is for members to approve an Annual Treasury Management Strategy, and to then receive a mid-year update on progress against the strategy and a year-end review of actual performance against the strategy. The 2022/23 Annual Treasury Management Strategy was approved by Council on 17 February 2022, the mid-year report was approved on 27 October 2022 and this report details the year end activity for 2022/23.

4. Members will be aware that the Strategy for 2023/24 was approved by Full Council on 16 February 2023 with further update reports scheduled for approval by Full Council during the remainder of this cycle.

5. The Council's Capital Financing Requirement (CFR) (or underlying need to borrow) at 31 March 2023 was £691.5 million, compared to £661.1 million at the start of the year. The estimated closing position was £723 million when the 2023/24 Treasury Management Strategy was approved by Council in February 2023. The 2022/23

borrowing need did not increase as much as was expected due to slippage and reprofiling in the capital programme.

6. Total external borrowing and other capital financing liabilities of the Council at 31 March 2023 was £534.5 million and the total interest paid servicing external debt for the year was £28.6 million.

7. The difference between the CFR and external borrowing was c £157 million, which was financed temporarily by 'internal borrowing' i.e. the use of reserves and working capital, which has offset the need to borrow externally.

8. As at 31 March 2023 the Council held cash and cash equivalents of £65.8m and treasury investments valued at £0 million – (in total £44.2 million Treasury Management investments met the cash and cash equivalents criteria, due to investing short term to take advantage of the interest rate increases). The total interest receivable and investment income for the Council for the year was approximately £9 million (£0.9 million related to Treasury Management Investments).

9. The Council 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 Council's Treasury Management Strategy.

10. Treasury risk management at the 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 2021 Edition (the CIPFA Code) which requires the Council 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, and other reports considered during the financial year. fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

11. The Council employs professionally qualified and experienced staff with responsibility for making borrowing and investment decisions. Officers are supported by external advisers who are specialists in their fields. The Council currently employs Link Treasury Services Ltd as treasury management advisers.

12. This approach ensures that the Council has access to a wide pool of relevant market intelligence, knowledge and skills that would be very difficult and costly to replicate internally. However, whilst advisers provide support to the internal treasury function, final decisions on treasury matters always remain with the Council.

External Context

13. Treasury management decisions made by the Council must take into consideration external factors, particularly the wider economic backdrop and the outlook for financial markets and interest rates, and the wider regulatory framework.

14. The continuing economic recovery from coronavirus pandemic, together with the war in Ukraine, higher inflation, and higher interest rates were still the major external factors issues over the year. In response to concerns regarding rising and persistent inflation,

the Bank of England increased the Bank Rate 8 times, from 0.75% in March 2022 to 4.25% in March 2023.

Local Context

15. The Council's balance sheet is summarised in Table 1.

Table 1: Council Balance Sheet

	31 March 2022 Actual £m	31 March 2023 Budget £m	31 March 2023 Actual £m
Capital Financing Requirement	**816.1**	**882.5**	**836.3**
Long Term PFI Liabilities	155.0	155.0	144.8
Underlying need to borrow	**661.1**	**748.2**	**691.5**
External borrowing	488.1	581.0	534.5
Internal Borrowing	173.09	167.2	157.0
Cash and Investments	**50.7**	**50.0**	**44.5**

16. All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves, and capital receipts) or debt (borrowing, leasing and Private Finance Initiative contracts). The Council's cumulative outstanding amount of debt finance is measured by the Capital Financing Requirement (CFR).

17. Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as Minimum Revenue Provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. The CFR increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt.

18. The treasury management position and change during the year is shown in Table 2.

Table 2: Borrowing Changes

	31.03.22 Balance £m	Net Movement £m	31.03.23 Balance £m
Long-term borrowing	409.9	+6.5	416.4
Short-term borrowing	78.2	+39.9	118.1
Total Borrowing	**488.1**	**+46.4**	**534.5**
Investments	7.9	-7.6	0.3
Cash and cash equivalents	42.8	+1.4	44.2

Total Cash and Investments	**50.7**	**-6.2**	**44.5**
Net Borrowing / (Investments)	**437.4**	**+52.6**	**490.0**

Borrowing

19. At 31 March 2023 the Council held £534.5 million of loans (£530.5 million plus accrued interest), which was a net increase of £46.4 million from 31 March 2022, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans as at 31 March 2023 are summarised in Table 3.

Table 3: Borrowing Position

Category	31.03.22 Balance £m	Net Movement £m	31.03.23 Balance £m	31.03.23 Average Rate %	31.03.23 Average Maturity (Years)
Public Works Loan Board	312.0	-12.8	299.2	3.39	18.44
Public Works Loan Board EFW	93.6	-3.3	90.3	3.07	18.91
Banks (LOBO)	50.0	0	50.0	4.54	33.96
Local Authorities	32.5	+58.5	91.0	2.70	1.0
Total External Borrowing	**488.1**	**+42.4**	**530.5**		

20. The chief objective of Worcestershire Council 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 long- term plans change being a secondary objective.

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

22. The Council held £50 million of Lender's Option Borrower's Option (LOBO) at 31 March 2023. These are loans where the lender has the option to propose an increase in the interest rate at set dates (lender's option), following which the Council has the option to either accept the new rate or to repay the loan at no additional cost (borrower's option). No lenders exercised options in 2022/23.

23. In addition, capital finance may be raised by the following methods that are not borrowing but are classed as other debt liabilities: leasing, hire purchase, Private Finance Initiative (PFI) and sale and leaseback. Total debt other than borrowing at 31 March 2023 was £144.8 million.

Cash and Treasury Investments

24. CIPFA 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.

25. Cash, cash equivalents and treasury investments held on 31 March 2023 are summarised in Table 4.

Table 4: Cash and Treasury Investments Position

	31.03.22 Balance £m	Net Movement £m	31.03.23 Balance £m
Cash and Cash Equivalents:	**42.8**	**+0.5**	**44.3**
Money Market Funds	22.5	+23.3	45.8
Ultra-Short Bond Funds	16.0	-6.0	10.0
UK Debt Management Office deposits	0.0	+10.0	10.0
Bank Balances	4.3	-24.8	(21.5)
Investments:	**7.9**	**-7.7**	**0.2**
Local Authorities Fixed Deposits	8.0	-8.0	0.0
Capital Gain/(loss)	(0.1)	+0.3	0.2
Total Cash and Investments	**50.7**	**-6.2**	**44.5**

26. Both the CIPFA Code and government guidance require the Council 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 Council'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.

27. The year started in an environment of extremely low short-dated cash rates which had been in place since the start of the pandemic. This resulted in the return on cash and cash equivalents such as Low Volatility Net Asset Value (LVNAV) Money Market Funds being close to zero at the start of the year. However, higher returns on cash instruments followed the increases in Bank Rate in May 2022 and a further 7 increases during the financial year, with Bank of England Base Rate increasing from 0.75% to 4.25% by year end. The increased rates were used to try combat inflation, which had increased to over 11% against a long-term target of 2%.

28. Similarly, deposit rates with the Debt Management Account Deposit Facility (DMADF) initially remained very low with rates ranging from 0% to 0.1% but following the increases to Bank Rate increased to around 4% depending on the deposit maturity.

Treasury Performance

29. The Council measures the financial performance of its treasury management in terms of its impact on the revenue budget as shown in Table 5.

Table 5: Treasury Performance

	Budget £m	Actual £m	Variance £m
Interest Payable	20.3	14.5	(5.7)
MRP	11.1	14.7	3.6
Interest and Investment Income	(0.6)	(1.1)	(0.5)
Net (Surplus) / Deficit	**30.8**	**28.1**	**(2.7)**

Compliance

30. All treasury management activities undertaken during the year complied with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

31. Compliance with the authorised limit and operational boundary for external debt is demonstrated in Table 6.

Table 6: Debt Limits

	Maximum 2022/23 £m	31.03.23 Actual £m	Operational Boundary £m	Authorised Limit £m	Complied Yes / No
Borrowing	565.0	534.5	770.0	790.0	Yes
Other Long-Term Liabilities	155.0	144.8	10.0	13.0	No*
Total Capital Financing	**720.0**	**679.3**	**780.0**	**803.0**	**Yes**

**When compiling the 2022-2023 TMSS the PFI Liability, which should have been shown as other Long-Term Liabilities, was included in the Borrowing figure in error. A small estimate was then used for the Other Long-Term Liabilities. However, the key to this table is that, despite the presentational error, at no point did the total borrowing exceed either the Operational Boundary or Authorised Limit, so the Council was fully compliant with the code*.

Treasury Management Indicators

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

Security

33. The policy objective for the County Council is the prudent investment of its cash balances. The investment priorities are firstly the security of capital (protecting sums from capital loss) and secondly the liquidity of investments (ensuring cash is available when required). Only when these two priorities are met will the third of achieving the optimum return on investments, be taken into account.

34. The County Council will not borrow money purely to invest. The County Council will only borrow up to 2 years in advance of cash being required to fund its capital

expenditure and the amount borrowed will not exceed the annual borrowing requirement.

35. The investments, which the County Council can use for the prudent management of cash balances are categorised as ‘Specified Investments’ and ‘Non-Specified Investments’.

36. A Specified Investment offers high security and high liquidity, must be in sterling and have a maturity date of less than a year. Any Specified Investment must be with the United Kingdom Government, a local authority in England or Wales or a similar body in Scotland or Northern Ireland, a parish or community council, a AAA-rated Money Market Fund, a bank which is part- owned by the UK Government, or with a body of high credit quality. The County Council defines a body of high credit quality as counterparties who satisfy the criteria as described below:

- For overnight investments, or money placed in instant access accounts and Notice Accounts, the council defines a body of high credit quality as firstly having the below Short-Term ratings as a minimum:

Agency:	**Short-Term rating:**
Fitch	F1
Moody’s	P-1
Standard and Poor’s	A-1

- For **unsecured** term deposits between 2 and 364 days, the council will firstly define a bodyof high credit quality as having the below Long-term ratings as a minimum:

Agency:	**Long-Term rating:**
Fitch	A+
Moody’s	A1
Standard and Poor’s	A+

37. The County Council will undertake continued due diligence and will not automatically lend to Counterparties that merely satisfy the above criteria. As additional consideration, the County Council will assess for each:

- Input from Treasury Advisors
- Other market data from a reputable source
- Press coverage
- Market presence by the Counterparty
- Availability of suitable products from the Counterparty
- Ease of execution with the Counterparty
- Level of Customer service from the Counterparty

38. The above list is not exhaustive, the County Council may at any time exclude a Counterparty should it perceive any reasonable doubt concerning its Creditworthiness;

the 2011 Code and subsequent revisions advise that subjective criteria may be used, in line with the Council's risk appetite.

- For **secured** term deposits, the council defines high credit quality as an **instrument** that has the above ratings with every agency that rates it.

- Enhanced Money Market funds or Cash Plus funds, which carry a AAA-rating from at least one rating agency.

39. Non-Specified Investments have a range of vehicles not covered by the definition of Specified Investments, which are set out in the Treasury Management Practices (TMPs) and generally carry more risk.

40. The only types of non-specified investments the County Council will enter into or hold during the financial year are as below:

- A routine term deposit with a counterparty as described above for Specified Investments, for a period of more than 1 year. This type of investment will be considered when rates are favourable and cash balances allow. The Council's prudential indicators allow no more than £10 million to be invested in this category.
- Investments in Pooled Property Funds, these will be considered as having a 5 to 10-year term.

41. The credit ratings of Fitch, Moody's and Standard and Poor's are monitored at least weekly, ratings-watches and downgrades are acted upon immediately. Any other information that is deemed relevant to the creditworthiness of any Counterparty will be acted upon, in line with the 2009 code revision.

Table 7: Security

	Credit Rating	**Amount In C&CE (£m)**	**Amount In Investments (£m)**	**Total Investment (£m)**
Aberdeen Bond Fund	AAA	7.50	0.18	7.68
Federated Bond Fund	AAA	2.50	0.06	2.56
Payden & Rygel	AAA	0	-0.08	-0.08
Insight MMF	AAA	15.00	0.01	15.01
LGIM MMF	AAA	15.00	0.05	15.05
Blackrock MMF	AAA	13.70	0.05	13.75
Aberdeen MMF	AAA	8.78	0.00	8.78
Barclays	A	5.00	0.02	5.02
BofS	AA-	0.00	0.00	0.00
DMADF	AA-	10.00	0.00	10.00
		77.48	**0.29**	**77.77**

Liquidity

42. The County Council may hold cash within its current account overnight as a transactional control to mitigate the risk of going overdrawn and incurring penalty and interest charges. The County Council may also leave funds in this account when it is impractical and/or not economically feasible to invest elsewhere. These balances are considered as cash or cash equivalents and not investments.

43. The County Council will aim to have not less than 50% of its investments returnable within 28 days with at least 20% within 7 days, with our performance shown in Table 8.

Table 8: Liquidity

	31.03.23 Actual	**2022/23 Target**	**Complied Yes/No**
Total cash available within 28 days	100%	> 50%	Yes

Investments longer than one year

44. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested at the period end are shown in Table 9.

Table 9: Investments longer than one year

	2022/23 £m	**2022/23 Limit £m**	**Complied Yes/No**
Actual principal invested beyond one year	0.0	25.0	Yes

Maturity Structure of Borrowing

45. This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing are shown in Table 10.

Table 10: Maturity Structure of Borrowing

	31.03.23 actual (£m)	**% of Total Borrowing**	**Upper Limit**	**Lower Limit**	**Complied Yes/No**
Under 12 months	118.1	22	14	0	No
Maturing in 1-2 years	46.9	9	13	0	Yes
Maturing in 2-5 years	33.6	6	5	0	No
Maturing in 5-10 years	47.8	9	10	0	Yes

Maturing in more than 10 years	288.0	54	58	25	Yes
Total	**534.5**	**100**	**100**		

46. When compiling Table 10 for the TMSS 2022-23, the actual level of borrowing at that time, in each category, was used as the upper and lower limits in error. The limit structure would never support a strategy of only borrowing as a last resort and then only taking short term borrowing. The revised table based on strategic need should looked like Table 11, the same limits as agreed in the 2023-24 Treasury Management Strategy Statement:

Table 11

	31.03.23 actual (£m)	**% of Total Borrowing**	**Upper Limit**	**Lower Limit**	**Complied Yes/No**
Under 12 months	118.1	22	25	0	Yes
Maturing in 1-2 years	46.9	9	25	0	Yes
Maturing in 2-5 years	33.6	6	50	0	Yes
Maturing in 5-10 years	47.8	9	75	0	Yes
Maturing in more than 10 years	288.0	54	100	25	Yes
Total	**534.5**	**100**			

Financial Implications

47. This report summarises the performance of the Council's Treasury Management activity in 2022/23. There are no other financial implications arising from this report.

Climate implications

48. There are no direct climate implications arising from this report. However, Worcestershire County Council owns units in a few pooled investment funds which will have holdings in companies in all sectors of the economy, including the extraction, refinement, and supply of fossil fuels.

Well-being and Health Implications

49. There are no well-being and health implications arising from this report.

Other Implications

50. There are no other implications arising from this report.

Risk Assessment

51. Having considered the risks associated with this decision, the level of risk has been identified as:

Current Risk: HIGH

Residual Risk: Medium

52. Treasury management is an inherently risky area of activity, due to the amounts of debt and investments involved, and many suitable controls are embedded in its operation. The key treasury management risks are highlighted as part of the treasury management strategy approved by Council as part of the budget setting process. This report highlights any variances from this strategy and draws out any specific risks which have arisen.

Equalities Impact Assessment

53. There are no equalities implications arising from this report.

Legal and HR Implications

54. This report is not considered to have any specific legal and HR implications.

Appendices

Appendix 1: External Context (Link Treasury Services Ltd April 2023)

Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) the following are the background papers relating to the subject matter of this report:

- Treasury Management Strategy 2022/23

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Footnote:
Issues relating to financial, legal, environmental, economic and equalities implications have been considered and any information relevant to the decision is included within the report.

Appendix 1: External Context (Link Treasury Services Ltd April 2023)

The Economy and Interest Rates

UK. Economy.

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.

Market commentators' misplaced optimism around inflation has been the root cause of the rout in the bond markets with, for example, UK, EZ and US 10-year yields all rising by over 200bps in 2022. The table below provides a snapshot of the conundrum facing central banks: inflation is elevated but labour markets are extra-ordinarily tight, making it an issue of fine judgment as to how far monetary policy needs to tighten.

	UK	Eurozone	US
Bank Rate	4.25%	3%	4.75%-5%
GDP	0.1%q/q Q4 (4.1%y/y)	+0.1%q/q Q4 (1.9%y/y)	2.6% Q4 Annualised
Inflation	10.4%y/y (Feb)	6.9%y/y (Mar)	6.0%y/y (Feb)
Unemployment Rate	3.7% (Jan)	6.6% (Feb)	3.6% (Feb)

Q2 of 2022 saw UK GDP deliver growth of +0.1% q/q, but this was quickly reversed in the third quarter, albeit some of the fall in GDP can be placed at the foot of the extra Bank Holiday in the wake of the Queen's passing. Q4 GDP was positive at 0.1% q/q. Most recently, January saw a 0.3% m/m increase in GDP as the number of strikes reduced compared to December. In addition, the resilience in activity at the end of 2022 was, in part, due to a 1.3% q/q rise in real household disposable incomes. A big part of that reflected the £5.7bn payments received by households from the government under the Energy Bills Support Scheme.

Nevertheless, CPI inflation picked up to what should be a peak reading of 11.1% in October, although hopes for significant falls from this level will very much rest on the movements in the gas and electricity markets, as well as the supply-side factors impacting food prices. On balance, most commentators expect the CPI measure of inflation to drop back towards 4% by the end of 2023. As of February 2023, CPI was 10.4%.

The UK unemployment rate fell through 2022 to a 48-year low of 3.6%, and this despite a net migration increase of c500k. The fact remains, however, that with many economic participants registered as long-term sick, the UK labour force shrunk by c500k in the year to June. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity, and with average wage increases running at over 6% the MPC will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food (up 18.3% y/y in February 2023) and energy that have endured since Russia's invasion of Ukraine on 22 February 2022.

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. Put simply, the markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng, and their reign lasted barely seven weeks before being replaced 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.

As noted above, GDP has been tepid throughout 2022/23, although the most recent composite Purchasing Manager Indices for the UK, US, EZ and China have all surprised to the upside, registering survey scores just above 50 (below suggests economies are contracting, and above suggests expansion). Whether that means a shallow recession, or worse, will be avoided is still unclear. Ultimately, the MPC will want to see material evidence of a reduction in inflationary pressures and a loosening in labour markets. Realistically, that is an unlikely outcome without unemployment rising and wage settlements falling from their current levels. At present, the bigger rise in employment kept the ILO unemployment rate unchanged at 3.7% in January. Also, while the number of job vacancies fell for the ninth consecutive month in February, they remained around 40% above pre-pandemic levels.

Our economic analysts, Capital Economics, expect real GDP to contract by around 0.2% q/q in Q1 and forecast a recession this year involving a 1.0% peak-to-trough fall in real GDP.

The £ has remained resilient of late, recovering from a record low of $1.035, on the Monday following the Truss government's "fiscal event", to $1.23. Notwithstanding the £'s better run of late, 2023 is likely to see a housing correction of some magnitude as fixed-rate mortgages have moved above 4.5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.

As for equity markets, the FTSE 100 started 2023 strongly, rising to a record high of 8,014 on 20th February, as resilient data and falling inflation boosted earnings. But global equities fell sharply after concerns over the health of the global banking system emerged early in March. The fall in the FTSE 100 was bigger than the drop in the US S&P 500. Indeed, at around 7,600 now, the FTSE is 5.2% below its record high on 20th February, while the S&P 500 is only 1.9% lower over the same period. That's despite UK banks having been less exposed and equity prices in the UK's financial sector not falling as far. It may be due to the smaller decline in UK interest rate expectations and bond yields, which raise the discounted value of future earnings, compared to the USA.

USA. The flurry of comments from Fed officials over recent months suggest there is still an underlying hawkish theme to their outlook for interest rates. Markets are pricing in a further interest rate increases of 25-50bps, on top of the current interest rate range of 4.75% - 5%.

In addition, the Fed is expected to continue to run down its balance sheet once the on-going concerns about some elements of niche banking provision are in the rear-view mirror.

As for inflation, it is currently at c6% but with the economy expected to weaken during 2023, and wage data already falling back, there is the prospect that should the economy slide into a recession of any kind there will be scope for rates to be cut at the backend of 2023 or shortly after.

EU. Although the Euro-zone inflation rate has fallen below 7%, the ECB will still be mindful that it has further work to do to dampen inflation expectations and it seems destined to raise rates to 4% in order to do so. Like the UK, growth has remained more robust than anticipated but a recession in 2023 is still seen as likely by most commentators.