APPENDIX 2

FLINTSHIRE COUNTY COUNCIL

DRAFT

TREASURY MANAGEMENT

ANNUAL REPORT 2022/23

1.00 INTRODUCTION

The Council approved the Treasury Management Strategy 2022/23 (the Strategy) including key indicators, limits and an annual investment strategy on 15th February 2022.

The Strategy was produced based on the 2017 edition of the *CIPFA Treasury Management in the Public Services: Code of Practice*.

The purpose of this report is to review the outcomes from 2022/23 treasury management operations and compare these with the Strategy.

Treasury management comprises the management of the local authority's 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.

2.00 ECONOMIC & INTEREST RATE REVIEW 2022/23

This is provided by Arlingclose Ltd, the Council's treasury management advisors.

2.01 Economic background

The war in Ukraine continued to keep global inflation above central bank targets and the UK economic outlook remained relatively weak with the chance of a mild recession. The economic backdrop during the January to March period continued to be characterised by high energy and commodity prices, high inflation, and the associated impact on household budgets and spending.

Central Bank rhetoric and actions remained consistent with combatting inflation. The Bank of England, US Federal Reserve, and European Central Bank all increased interest rates over the period, even in the face of potential economic slowdowns in those regions.

Starting the financial year at 5.5%, the annual CPI measure of UK inflation rose strongly to hit 10.1% in July and then 11.1% in October. Inflation remained high in subsequent months but appeared to be past the peak, before unexpectedly rising again in February. Annual headline CPI registered 10.4% in February, up from 10.1% in January, with the largest upward contributions coming from food and housing. RPI followed a similar pattern during the year, hitting 14.2% in October. In February RPI measured 13.8%, up from 13.4% in the previous month.

Following the decision by the UK government under Rishi Sunak and Jeremy Hunt to reverse some of the support to household energy bills announced under Liz Truss, further support in the form of a cap on what energy suppliers could charge household was announced in the March Budget to run from April until end June 2023. Before the announcement, typical household bills had been due to rise to £3,000 a year from April.

The labour market remained tight albeit with some ongoing evidence of potential loosening at the end of the period. The unemployment rate 3mth/year eased from 3.8% April-June to 3.6% in the following quarter, before picking up again to 3.7% between October-December. The most recent information for the period December-February showed an unemployment rate of 3.7%.

The inactivity rate was 21.3% in the December-February quarter, slightly down from the 21.4% in the first quarter of the financial year. Nominal earnings were robust throughout the year, with earnings growth in December-February at as 5.7% for both total pay (including bonuses) and 6.5% for regular pay. Once adjusted for inflation, however, both measures were negative for that period and have been so throughout most of the year.

Despite household budgets remaining under pressure, consumer confidence rose to -36 in March, following readings of -38 and -45 in the previous two months, and much improved compared to the record-low of -49 in September. Quarterly GDP was soft through the year, registering a 0.1% gain in the April-June period, before contracting by (an upwardly revised) -0.1% in the subsequent quarter. For the October-December period was revised upwards to 0.1% (from 0.0%), illustrating a resilient but weak economic picture. The annual growth rate in Q4 was 0.6%.

The Bank of England increased the official Bank Rate to 4.25% during the financial year. From 0.75% in March 2022, the Monetary Policy Committee (MPC) pushed through rises at every subsequent meeting over the period, with recent hikes of 50bps in December and February and then 25bps in March, taking Bank Rate to 4.25%. March's rise was voted by a majority of 7-2, with two MPC members preferring to maintain Bank Rate at 4.0%. The Committee noted that inflationary pressures remain elevated with growth stronger than was expected in the February Monetary Policy Report. The February vote was also 7-2 in favour of a hike, and again with two members preferring to keep Bank Rate on hold.

After reaching 9.1% in June, annual US inflation slowed for eight consecutive months to 6% in February. The Federal Reserve continued raising interest rates over the period with consecutive increases at each Federal Open Market Committee meetings, taking policy rates to a range of 4.75%- 5.00% at the March meeting.

From the record-high of 10.6% in October, Eurozone CPI inflation fell steadily to 6.9% in March 2023. Energy prices fell, but upward pressure came from food, alcohol, and tobacco. The European Central Bank continued increasing interest rates over the period, pushing rates up by 0.50% in March, taking the deposit facility rate to 3.0% and the main refinancing rate to 3.5%.

2.02 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.

3.00 BORROWING REQUIREMENTS AND DEBT MANAGEMENT

3.01 PWLB (Public Works Loans Board) Certainty Rate

The Council qualified for the PWLB Certainty Rate, allowing the authority to borrow at a reduction of 20 basis points on the Standard Rate for a further 12 months from April 2022.

3.02 Borrowing Activity in 2022/23.

The total long-term borrowing outstanding, brought forward into 2022/23 was £294.6 million.

	Balance 01/04/2022 £m	Debt Maturing £m	New Debt £m	Balance 31/03/2023 £m
Capital Financing Requirement	**352.6**	(6.2)	8.9	**355.3**
Short Term Borrowing	10.0	(10.0)	12.0	12.0
Long Term Borrowing	294.6	(4.8)	5.4	295.2
TOTAL BORROWING	**304.6**	**(14.8)**	**17.4**	**307.2**
Other Long-Term Liabilities	3.3	(0.6)	0.00	2.7
TOTAL EXTERNAL DEBT	**307.9**	**(15.4)**	**17.4**	**309.9**
Increase/ (Decrease in Borrowing (£m)	-	-	2.0	

The Council's Capital Programme is financed by a combination of capital receipts and grants, capital expenditure charged to the revenue account (CERA) and borrowing. The borrowing strategy in recent years, in accordance with advice received from the Council's treasury management advisors, Arlingclose, has been to use existing cash balances and short-term borrowing to confirm the long-term borrowing requirement. This is to ensure that the Council does not commit to long-term borrowing too early and borrow unnecessarily, which will be costly. This is balanced against securing low interest costs and achieving cost certainty over the period for which the funds are required so as not to compromise the long-term stability of the portfolio.

Short term borrowing continued to be available throughout the year and was utilised as far as possible without exposing the Council to excessive refinancing risk. The total short term (temporary) borrowing as at 31st March 2023 was £12m with an average rate of 4.55%.

The relative costs and benefits of internal / short-term borrowing and long-term borrowing were monitored closely, in conjunction with Arlingclose, throughout the year. Although Arlingclose's advice was to keep borrowing short, the Council continued to have a long-term borrowing requirement. In February, the borrowing rates became volatile and fell to a low level. After discussing with Arlingclose, the following loan was taken out:

Start Date	Maturity Date	Amount	Rate	Loan Type
10 Feb 2023	10 Feb 2041	£5.0m	3.91%	EIP

On 31st March 2023, £271.5m of the Council's loans were in the form of fixed rate with the PWLB, £18.95m were variable rate in the form of LOBOs (Lender Option Borrower Option) and £4.71m were interest free loans from the Government, available for specific schemes. The Council's average rate for long term borrowing was 4.53%.

The Council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) as at 31st March 2023 was £355.3m. The Council's total external debt was £309.9m.

3.03 Lender Option Borrower Option loans (LOBOs)

The Council holds £18.95m of LOBOs, loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. All these LOBOs had options during the year, none of which were exercised by the lender.

3.04 Debt Rescheduling

Options for debt rescheduling were explored in conjunction with the Council's treasury management advisors. The premium charged for early repayment of PWLB debt remained relatively expensive for the loans in the Council's portfolio and therefore unattractive for debt rescheduling activity. As a consequence, no rescheduling activity was undertaken.

The Corporate Finance Manager, in conjunction with the Council's treasury management advisors, will continue to review any potential opportunities for restructuring the Council's debt in order to take advantage of potential savings as interest rates change and to enhance the balance of the long-term portfolio (amend the maturity profile and/or the balance of volatility).

3.05 CIPFA Prudential Code Update

CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the Authority. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield unless these loans are for refinancing purposes.

The Council will follow the same process as the Prudential Code.

4.00 INVESTMENT ACTIVITY

4.01 Guidance

The Welsh Government's Investment Guidance gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

4.02 Investment Activity in 2022/23

Summary of investments as at 31st March 2023.

Country	Total	<1 month	1 –12 months	>12 months
	£m	%	£m	£m
UK BANKS	1.0	1.0		
UK BUILDING SOCIETIES				
OVERSEAS				
MMF's	28.0	28.0		
LOCAL AUTHORITIES				
DMO	5.0		5.0	
TOTAL	**34.00**	**29.00**	**5.00**	

The investment for £5m was classified as a short-term investment in the Council's Balance Sheet. The remainder of the investments had maturities of less than 3 months, so were classified as cash.

Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Strategy for 2022/23. Investments during the year included:

- Deposits with the Debt Management Office
- Deposits with other local authorities
- Investments in AAA-rated Low Volatility Net Asset Value (LVNAV) money market funds
- Call accounts and deposits with banks and building societies

4.03 Credit Risk

The Council assessed and monitored counterparty credit quality with reference to credit ratings, credit default swaps, GDP of the country in which the institution operate, the country's net debt as a percentage of GDP, and share price. The minimum long-term counterparty credit rating determined by the Council for the 2022/23 treasury strategy was A-/A-/A3 across rating agencies Fitch, S&P and Moody's.

4.04 Counterparty Update

Early in the period, Moody's affirmed the long-term rating of Guildford BC but revised the outlook to negative. The agency also downgraded Warrington BC and Transport for London.

In July, Fitch revised the outlook on Standard Chartered and Bank of Nova Scotia from negative to stable and in the same month Moody's revised the outlook on Bayerische Landesbank to positive. In September, S&P revised the outlook on the Greater London Authority to stable from negative and Fitch revised the outlook on HSBC to stable from negative.

The following month Fitch revised the outlook on the UK sovereign to negative from stable. Moody's made the same revision to the UK sovereign, following swiftly after with a similar move for a number of local authorities and UK banks including Barclays Bank, National Westminster Bank (and related entities) and Santander. During the last few months of the reporting period there were only a handful of credit changes by the rating agencies, then in March the collapse of Silicon Valley Bank (SVB) in the US quickly spilled over into worries of a wider banking crisis as Credit Suisse encountered further problems and was bought by UBS.

Credit Default Prices had been rising since the start of the period on the back of the invasion of Ukraine, and in the UK rose further in September/October at the time of the then-government's mini budget. After this, CDS prices had been falling, but the fallout from SVB caused a spike on the back of the heightened uncertainty. However, they had moderated somewhat by the end of the period as fears of contagion subsided, but many are still above their pre-March levels reflecting that some uncertainty remains.

On the back of this, Arlingclose reduced its recommended maximum duration limit for unsecured deposits for all UK and Non-UK banks/institutions on its counterparty list to 35 days as a precautionary measure. No changes were made to the names on the list.

As market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remains under constant review.

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

4.05 Liquidity

In keeping with the WG's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of money market funds and call accounts.

4.06 Yield

Due to the increases in the UK bank rate, the short-term money market rates have been higher than expected. The Council's budgeted investment income for the year had been prudently estimated at £0.010m, based on an average rate of 0.1%. The average investment balance was £49.7m during the period and interest earned was £0.940m, at an average interest rate of 1.87%.

4.07 Loans to NEW Homes

The loans to NEW Homes do not meet the definition of an investment and are not therefore included in the Council's investment figures. They are classed as capital expenditure.

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5.00 COMPLIANCE

The Council can confirm that it has complied with its Prudential Indicators for 2022/23. These were approved by Council as part of the Treasury Management Strategy on 15th February 2022.

In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during 2022/23. None of the Prudential Indicators have been breached and a prudent approach has been taking in relation to investment activity with priority being given to security and liquidity over yield.

The treasury function operated within the limits detailed in the Treasury Management Policy and Strategy Statement 2022/23.

6.00 OTHER ITEMS

The following were the main treasury activities during 2022/23:

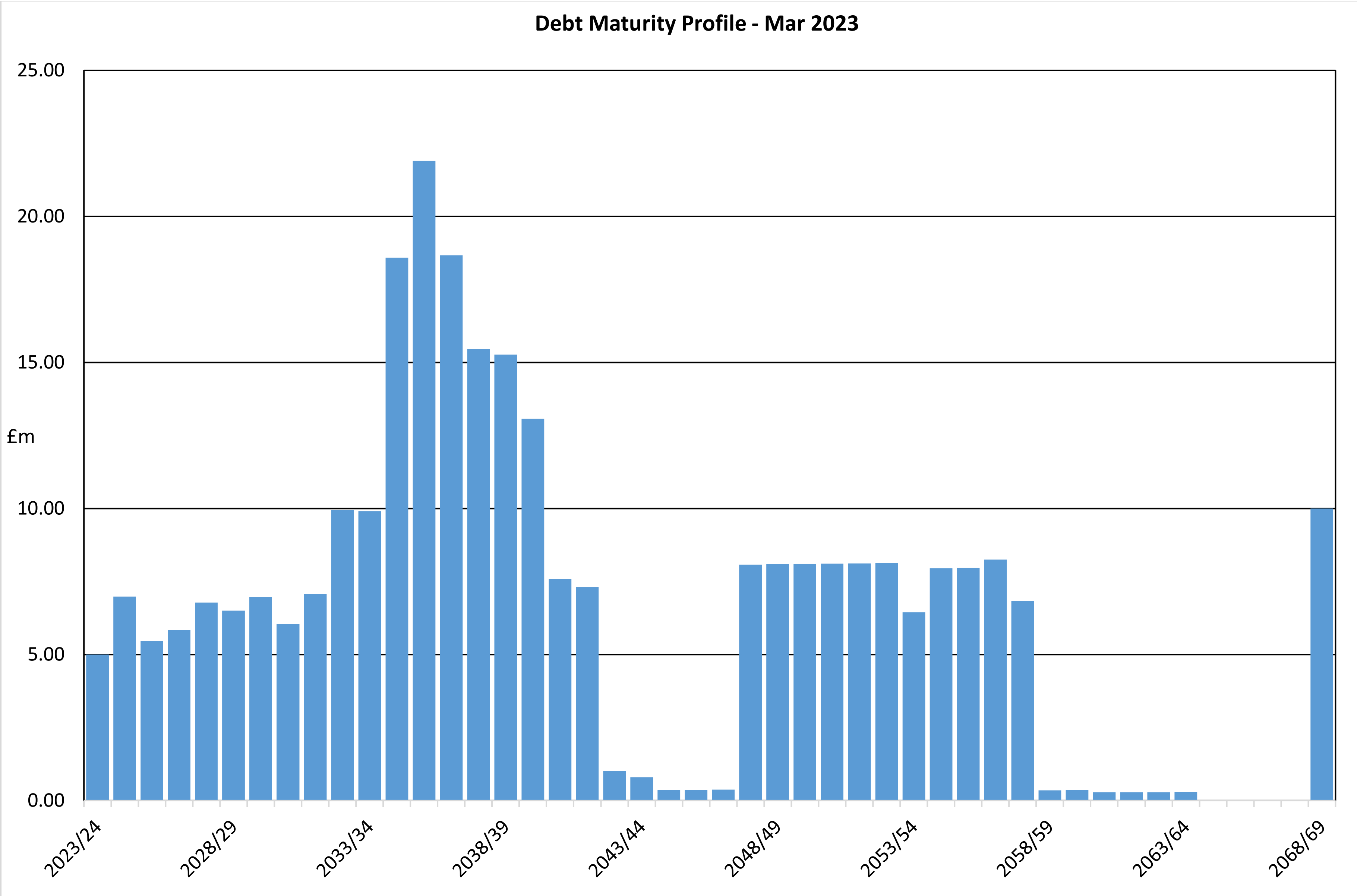
- The Council's Governance and Audit Committee received a Mid-Year Report on 14th November 2022.

- Quarterly update reports were presented to the Governance and Audit Committee.
- The 2023/24 Investment Strategy Statement was approved by Council on 23rd February 2023.
- The Council's cash flow was managed on a daily basis. During the year the Council acted both as a borrower and as a lender and was a net borrower over the year in question. The maximum investments the Authority had on deposit at any one time were £74.2m and the maximum long-term borrowing at any one time was £296.5m.

7.00 CONCLUSION

The treasury management function has operated within the statutory and local limits detailed in the 2022/23 Treasury Management Strategy.

The Treasury Management Policy was implemented in a pro-active manner with security and liquidity as the primary focus.



Debt Maturity Profile - Mar 2023
25.00
20.00
15.00
£m
10.00
5.00
0.00
2023/24
2028/29
2033/34
2038/39
2043/44
2048/49
2053/54
2058/59
2063/64
2068/69