CORPORATE GOVERANCE, AUDIT AND STANDARDS COMMITTEE
SEPTEMBER 2023

EXECUTIVE HEAD OF FINANCE
REPORT NO: FIN2314

TREASURY MANAGEMENT AND NON-TREASURY INVESTMENT OPERATIONS 2022/23

SUMMARY:
This report sets out the main activities of the Treasury Management and non-Treasury Investment Operations during 2022/23. Prudential indicators for the 2022/23 financial year have been updated for all treasury management and non-treasury activity during 2022/23.

RECOMMENDATIONS:
Members are requested to:

(i) Note the contents of this report in relation to the treasury management and non-treasury investment operations carried out during 2022/23

1. INTRODUCTION

1.1 This report sets out the Treasury Management and Non-Treasury Investment operations for 2022/23. This report is a statutory requirement under the CIPFA Code of Practice on Treasury Management.

1.2 Full Council originally approved the Annual Treasury Management Strategy and Non-Treasury Investment Strategy for 2022/23 on 24 February 2022. The Council has invested substantial sums of money and is therefore, exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Council's treasury management and non-treasury investment strategies.

2. PURPOSE

2.1 The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management 2017 ("the Code"), which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year. The Code also recommends that members be informed of Treasury Management activities at least twice a year. This report therefore ensures this authority is embracing best practice in accordance with CIPFA's recommendations.

2.2 The CIPFA "Prudential Code" 2017 edition, "Treasury Management Code of Practice" 2017 edition and MHCLG revised guidance December 2021 focus on "non- treasury" investments. With attention on the purchase of investment property and other commercial activities that aim to generate income; but may require external borrowing (or the use of existing cash balances) to raise the cash to finance such activities. Non-treasury investments have been incorporated into the operations report for 2022/23.

2.3 The appendices (A to C) set out the Treasury Management operations, Non-Treasury Investment Operations and Prudential Indicators for 2022/23 and fulfil key legislative requirements as follows:

Appendix A

- The **Treasury Management operations** which sets out how the Council's treasury service operated during 2022/23, in accordance with CIPFA's Code of Practice on Treasury Management and Prudential Code;
- The **Treasury Management Borrowing operations** which sets out the Council's borrowing during 2022/23 in accordance with CIPFA's Code of Practice on Treasury Management, and;
- The **Treasury Management Investment operations** which sets out the Council's Treasury Management investment operations during 2022/23, in accordance with CIPFA's Code of Practice on Treasury Management.

Appendix B

- The **Non-Treasury Investment operations** sets out the Council's Non-Treasury investment performance during 2022/23, in accordance with MHCLG Investment Guidance.

Appendix C

- the **Prudential indicators forecast** sets out the prudential indicators position at the end of 2022/23. Performance is compared to the indicators set out in the Annual Capital Strategy for the year 2022/23.

3 CONCLUSIONS ON THE TREASURY MANAGEMENT AND NON-TRESURY INVESTMENT OPERATIONS DURING 2022/23

3.1 The Council's treasury team continued to concentrate on the security of investments taking due regard for the returns available.

3.2 The return on treasury management activity is in line with the revised budget for 2022/23. Pooled funds have proven to be robust and have performed well

3.3 With increased levels of borrowing the treasury team continually reviews the borrowing strategy, weighing up interest rate levels and risk of refinancing. The cost of both long and short-term borrowing rose dramatically over the year, with rates at the end of March around 2% - 4% higher than those at the beginning of April. Rate rises have been driven primarily by inflation and the need for central banks to control this by raising interest rates. Also, borrowing levels have increased, raising refinancing risk. Levels and length of borrowing will be continually reviewed to mitigate refinancing risk.

3.4 Total borrowing on 31 March was £120m, an increase of £20m from that on 31 March 2023. The increased level of borrowing has been together with the increased interest rate of borrowing, has resulted in an increased cost of borrowing of £0.865m compared to 2021-22 (this was budgeted for).

3.5 The Council's non-treasury investments risk exposure on 31 March 2023 of £125.9m of which £111.9m is funded via external loans.

3.6 Rate of return across all Council's investments have been variable. However, aggregate rate of return on all Council investments is in line with estimated return for 2022/23 due to the cost associated with commercial property being clarified during the financial year.

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APPENDIX A

TREASURY MANAGEMENT OPERATION FOR 2022/23

1 INTRODUCTION

1.1 The purpose of the treasury management operation is to ensure that cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in counterparties or instruments commensurate with the Council’s low risk approach, pursuing optimum performance while ensuring that security of the investment is considered ahead of investment return. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure.

1.2 The second main function of the treasury management service is the funding of 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 obligations. The management of longer-term cash may involve the arrangement of long and/or short-term loans (external borrowing) or may use longer term cash flow surpluses in lieu of external borrowing (internal borrowing).

2 TREASURY MANAGEMENT ADVICE

2.1 The Council continued to engage the services of Arlingclose for independent treasury advice during the year 2022/23. Arlingclose provide specialist treasury support to 25% of UK local authorities. They provide a range of treasury management services including technical advice on debt and investment management and long-term capital financing. They advise on investment trends, developments and opportunities consistent with the Council’s Treasury Management Strategy.

2.2 With the exception of pooled funds all investment activity is carried out by the Council’s own treasury team with advice from Arlingclose, and having due regard to information from other sources such as the financial press and credit-rating agencies.

2.3 Pooled funds are managed at the discretion of the external fund managers associated with each fund. It should however be noted that whilst the funds are externally managed, the decision as to whether to invest lies solely with the Council in accordance with its Treasury Management Strategy.

2.4 The needs of the Council’s treasury management staff for training in investment management are assessed on an ongoing basis and as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. During 2022/23, staff attended relevant workshops provided by Arlingclose and other service providers.

3 EXTERNAL CONTEXT

3.1 The Council's treasury management advisors have provided commentary on the economic background that prevailed during 2022/23. This commentary is provided at **Appendix D**.

4 LOCAL CONTEXT

4.1 On 31 March 2023, the Council had net borrowing of £96.9m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes for the 2022/23 financial year is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The projected CFR is summarised in **Appendix C**.

4.2 The treasury management position on 31 March 2023 and the change during the year is shown in the table below.

	31-Mar-22 Balance £m	Movement £m	31-Mar-23 Balance £m	31-Mar-23 Rate %
Long Term Borrowing	-	5.0	5.0	4.2%
Short Term Borrowing	100.0	15.0	115.0	1.1%
Total Borrowing	**100.0**	**20.0**	**120.0**	
Long Term Investments	22.9	(1.6)	21.3	4.5%
Short Term Investments	-	-	-	
Cash & Cash Equivalents	13.7	(11.9)	1.8	2.1%
Total Investments	**36.6**	**(13.5)**	**23.1**	
Net Borrowing/(Investments)	**63.4**	**33.5**	**96.9**	

4.3 **Liability benchmark:** To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as CFR, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk.

	31-Mar-23 Budget £m	31-Mar-23 Outturn £m
Outstanding Borrowing	125.0	120.0
Investment Minimum	(10.0)	(10.0)
Investments held that can be redeemed	23.9	20.4

5 BORROWING ACTIVITY IN 2022/23

5.1 At 31 March 2023 the Council held £120m of loans, an increase of £20m since 31 March 2023, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 31 March 2023 are summarised in the table below.

	31-Mar-22 Balance £m	Movement £m	31-Mar-23 Balance £m	31-Mar-23 Rate %
Long Term Borrowing	-	5.0	5.0	4.2%
Short Term Borrowing	100.0	15.0	115.0	1.1%
Total Borrowing	**100.0**	**20.0**	**120.0**	

5.2 The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

5.3 With short-term interest rates remaining much lower than long-term rates, the Council considered it to be more cost effective in the near term to use short-term loans.

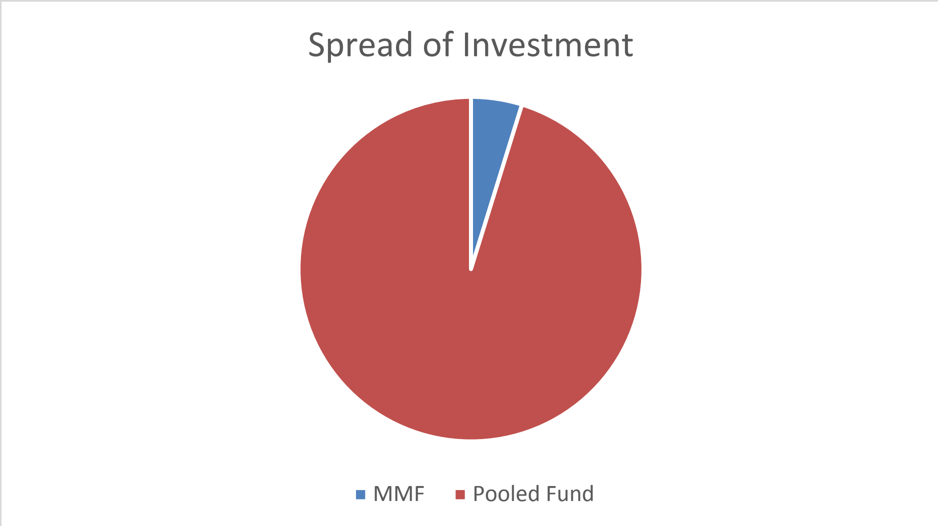
5.4 During August 2022, the Council commissioned Arlingclose to review and advise upon a strategy for borrowing going forward. They advised that a strategic allocation to short-term borrowing of around £60m for the Council to take advantage of the lower interest rates available and that borrowing in excess of this figure should at long-term fixed rates to limit the Council's interest rate risk. The Council is in the process of creating a structured approach to moving some of the short-term debt to long-term.

6 INVESTMENT ACTIVITY IN 2022/23

6.1 The Council holds significant invested funds. During the year, the Council's investment position is shown in table 4 below.

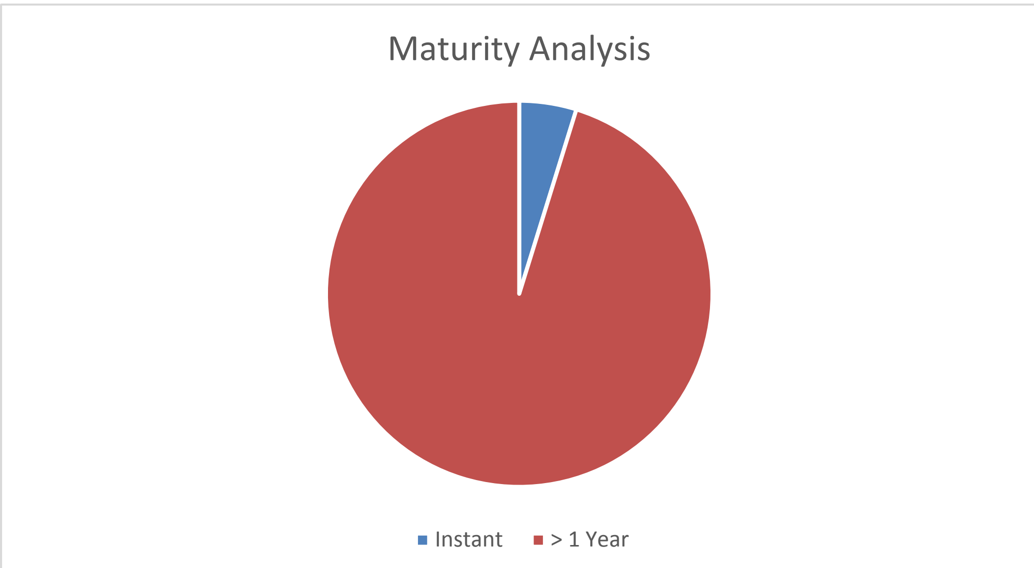
	31-Mar-22 Balance £m	Movement £m	31-Mar-23 Balance £m	31-Mar-23 Rate %
Managed In-house				
Money Market Funds	14.5	(13.4)	1.1	2.11%
Managed Externally				
Pooled Funds				
CCLA LAMIT Property Fund	3.9	0.5	4.4	7.52%
Aegon Strategic Corporate Bond	2.0	(0.2)	1.8	5.41%
M&G Investments Strategic Corporate Bond Fund	4.0	(0.6)	3.4	2.21%
Schroder Income Maximiser Fund	5.0	(0.6)	4.4	3.05%
UBS Multi Asset Fund	5.0	(1.5)	3.5	2.53%
Threadneedle Investments	2.0	(0.2)	1.8	2.69%
Total Investments	**36.4**	**(16.0)**	**20.4**	

6.2 The following chart illustrates the spread of investment by type of investment.



The table and chart below illustrate the maturity analysis of investments.

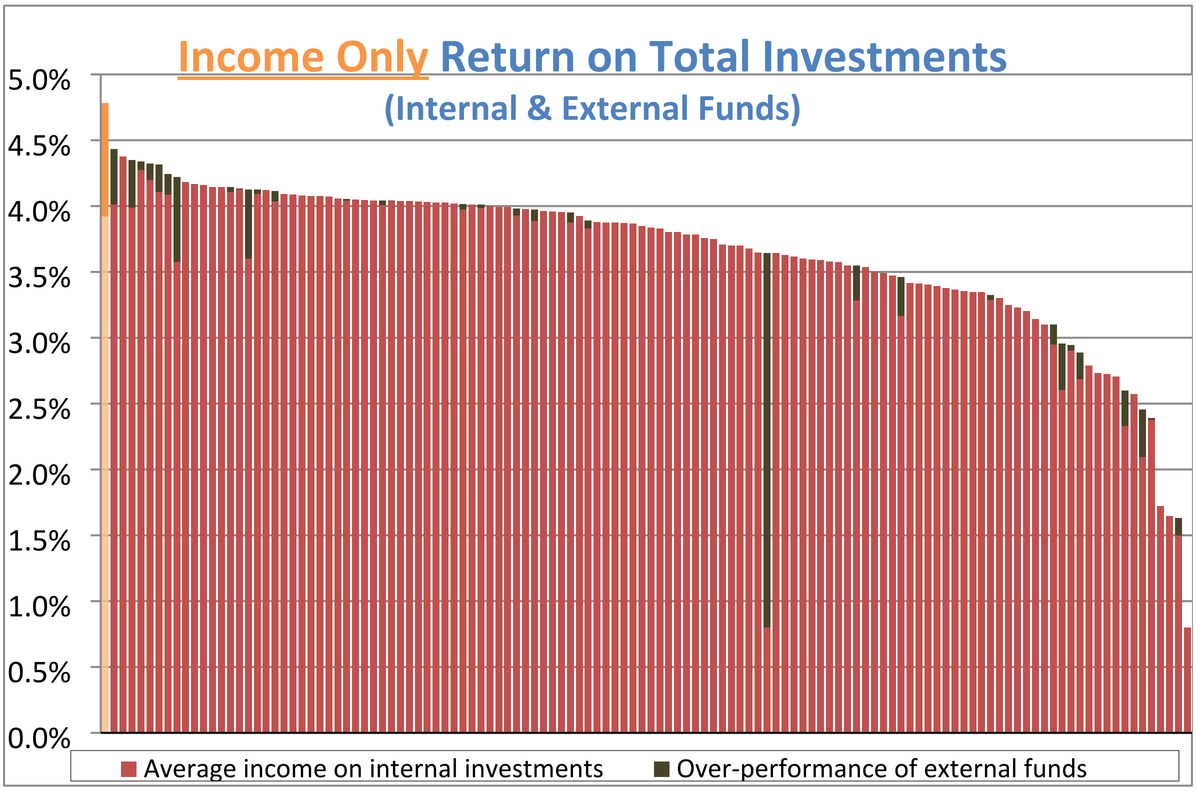
Maturity Analysis for all Investments	Type of Counter Party	Amount Invested	%of Total Investments
Instant	MMF	1.1	5%
> 1 Year	Pooled Fund	21.9	95%
Total for all duration periods		**23**	**100%**



6.3 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.

6.4 Treasury management total investment income return during 2022-23 was 3.65% as compared with 4.19% in 2021-22

6.5 Investment Income Benchmarking: The graph below has been produced by Arlingclose and demonstrates that the Council income only returns on total investment portfolio for the last 12 months up to March 2022 was 4.83%.



	Credit Score	Credit Rating	Bail-in [1]Exposure
31-Mar-22	4.97	A+	40%
31-Mar-23	4.89	A+	5%

[1] Requirement to invest to ensure the entity remains solvent

Similar LA's	4.74	A+	63%
All LA's	4.71	A+	59%

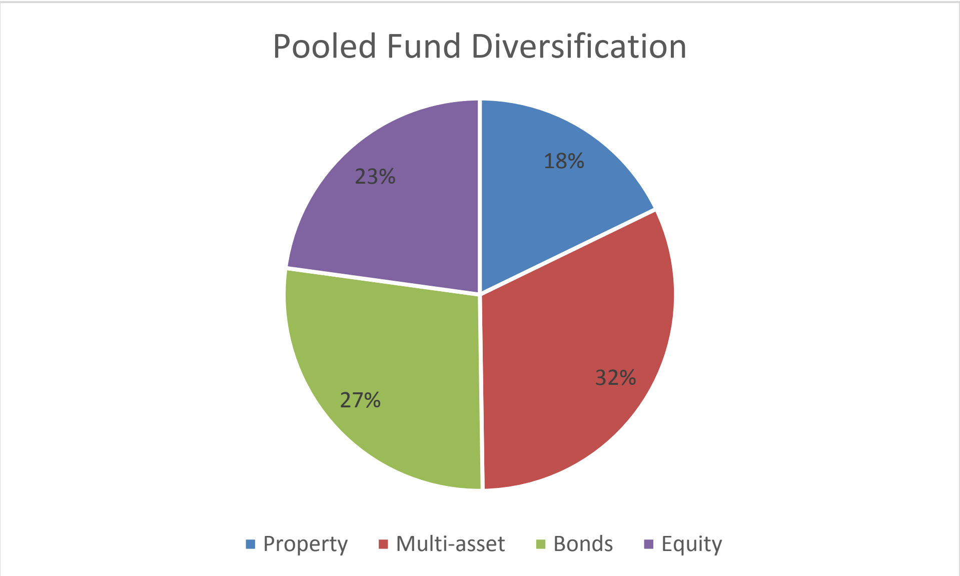
6.6 The benchmarking relating to treasury investments managed in-house, from Arlingclose’s quarterly investment benchmarking report, is detailed in the table below.

<u>External Strategic Pooled Funds</u>

6.7 £21.9m of the Council's investments are held in externally managed strategic pooled equity funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. During 2022/23 these funds generated an average total return of £1.7m (7.5%), comprising a £1.0m (4.19%) income return which is used to support services in year, and £0.7m (3.28%) of unrealised capital gain.

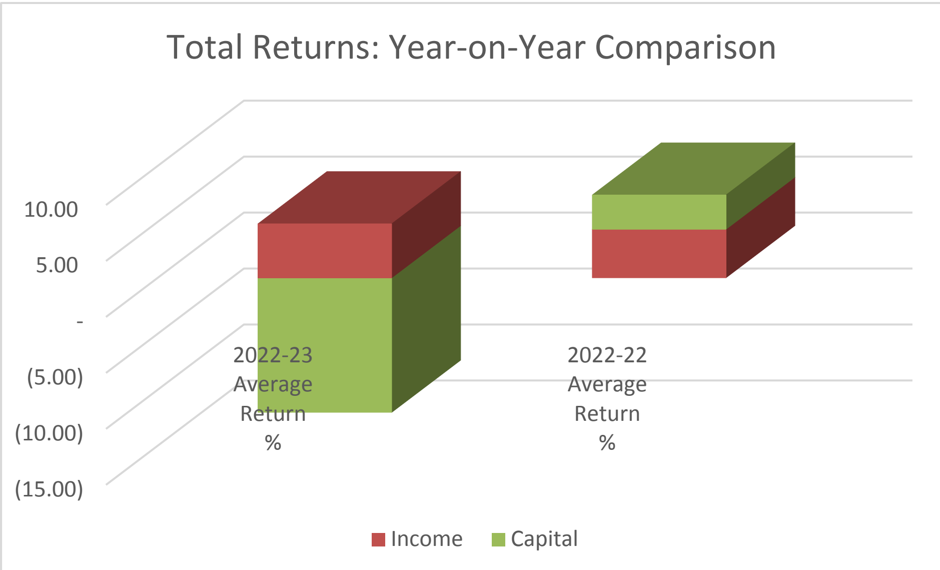
6.8 A summary the diversification of pooled funds is set out in the table and chart below.

Type of Pooled Fund	Amt invested £m	% of Total Investments
Property	3.9	18%
Multi-asset	7.0	32%
Bonds	6.0	27%
Equity	5.0	23%
Total	**21.9**	**100%**



6.9 Average Return Breakdown

Type of Return	2022-23 Average Return %	2022-22 Average Return %
Income	4.83	4.33
Capital	(12.02)	3.07
Total Returns	**(7.19)**	**7.40**



The Council is using the alternative fair value through profit and loss (FVPL) accounting and must defer the funds' fair value losses to the Pooled Investment Fund Adjustment Account until 2023/24.

6.10 As these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives is regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three to five-year period total returns will exceed cash interest rates. In light of their performance over the medium-/long-term and the Council's latest cash flow forecasts, investment in these funds has been maintained.

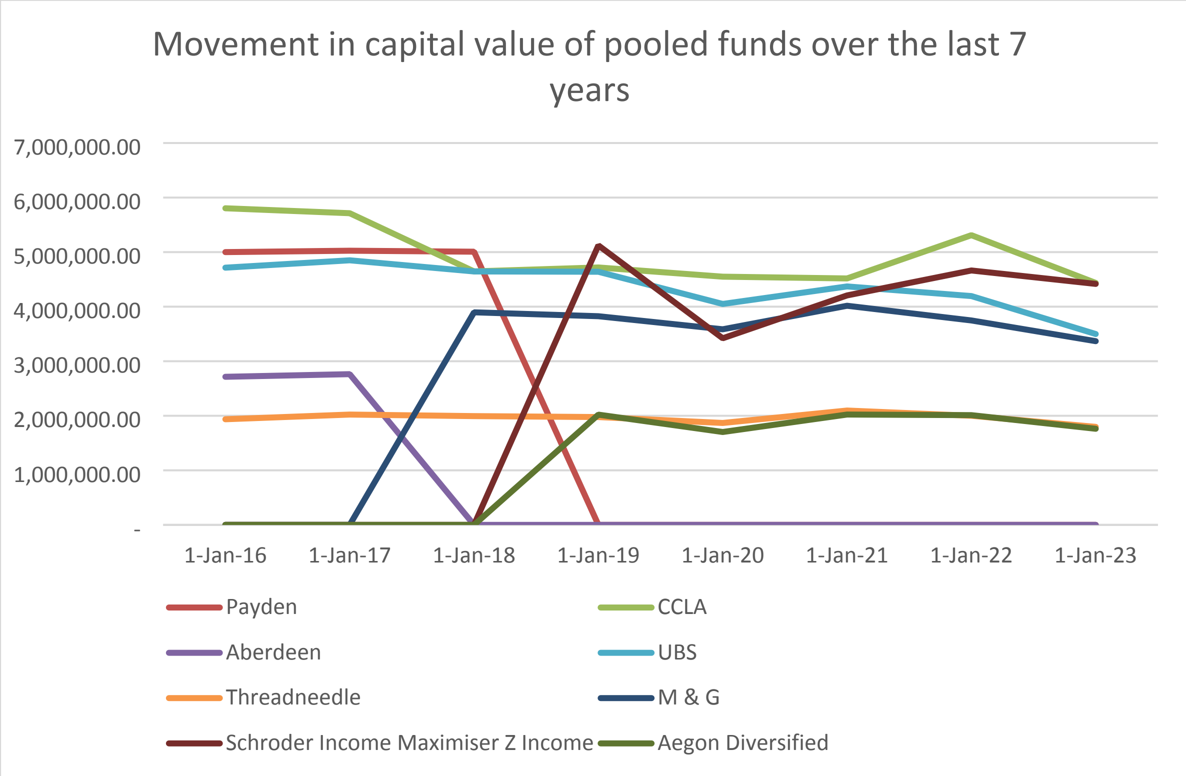
6.12 Details of the Council’s investment activity together with returns generated during 2022/23 are outlined as follows:

6.13 **Capital returns** – the Council’s pooled funds continued to experience some variations in performance during the year 2022/23 and property values had a significant impact on the UK economy during 2022/23. Against this background the Council’s pooled funds have performed in line with other local authorities returning an overall net decrease in fair value for the year 2022/23 of £2.59m (an aggregate decrease of 12.02% of overall pooled funds invested).

Comparison of other local authorities decrease in fair value is detailed in the table below.

	% decrease
Rushmoor	12.02
Similar LA's	11.14
All LA's	11.85

6.14 There is variation in performance across the portfolio as shown graphs below



Where an investment drops to zero, this is because the council divested during the last 7 years. Where investment commences at zero, this is because the council invested during the last 7 years.

6.15 **Income Returns** – The income returned by fund for the period to 31 March 2023 is analysed below:

- <u>CCLA's Local Authorities' Mutual Investment Trust</u> - £3.9 million investment at commencement of the year. The Property Fund is designed to achieve long-term capital growth and income from investments in the commercial property sector. The fund has returned 7.52% annualised income during 2022/23.

- <u>UBS Multi-Asset Income Fund</u> - £5 million investment. This fund follows a strategy of reducing volatility exposure levels by spreading investments across a diversified range of asset classes. This fund has returned 2.53% annualised income during 2022/23.

- <u>Threadneedle Strategic Bond Fund</u> - £2 million investment. The fund aims to provide income and capital appreciation through investment grade and high yield bonds. This fund has returned 2.69% annualised income during 2022/23

- M & G Corporate Bond Fund - £4m investment. This fund aims for a target total return of 2.45% from a combination of investment income or capital appreciation. This fund has returned 2.21% annualised income during 2022/23.

- Schroder Income Maximiser Fund - £5m investment made in December 2018. The fund aims to provide both income and capital growth, delivering a target income of 3.05% per annum. The fund has returned 5.99% annualised during 2022/23.

- Aegon Strategic Corporate Bond (formerly known as Kames Diversified Monthly Income Fund) - £2m investment made in February 2019. The fund aims is to provide income with the potential for capital growth over the medium term. The fund has returned 5.41% annualised during 2022/23.

7 TREASURY MANGEMENT COMPLIANCE PERFORMANCE

7.1 The Council measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates.

7.2 **Compliance -** The Chief Finance Officer reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy with the exception of current account balance limits.

7.3 Compliance with specific investment limits is demonstrated in the table below.

	2022-23 Actual £m	2022-23 Limit £m	Complied
Any group of pooled funds under the same management	21.9	25.0	Yes
Money Market Funds	1.1	25.0	Yes

8 TREASURY MANAGEMENT INDICATORS

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

8.2 **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	2022-23 Actual	2022-23 Target	Complied
Portfolio average credit rating	A+	A-	Yes

8.3 **Liquidity:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount it can borrow each period without giving prior notice.

	2022-23 Actual £m	2022-23 Target £m	Complied
Total sum borrowed in past 3 months without prior notice	-	1.0	Yes

8.4 **Interest Rate Exposures**: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

	2022-23 Actual £m	2022-23 Limit £m	Complied
Upper Limit on one-year impact of 1% rise in interest rates	0.2	0.5	Yes

Upper limit on one-year impact of 1% fall in interest rates	0.4	0.5	Yes

8.5 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

8.6 **Maturity Structure of Borrowing:** This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	2022-23 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	96%	100%	0%	Yes
12 months & within 24 months	4%	100%	0%	Yes
24 months & within 5 years	0%	100%	0%	Yes
5 years & within 10 years	0%	100%	0%	Yes
10 years & above	0%	100%	0%	Yes

8.7 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.

8.8 **Principal Sums Invested for Periods Longer than a year:** 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 to final maturities beyond the period end were:

	2022-23 £m	2023-24 £m	2024-25 £m
Actual principal invested beyond year end	21.9	21.9	21.9
Limit on principal invested beyond year end	90.0	90.0	90.0
Complied	Yes	Yes	Yes

8.9 **Total Investment Yield:** The Council's revised estimates regarding investment yields and costs compared to the actual outturn for 2022/23 is shown in the table below.

Budgeted Income and Outturn	**2022-23 Actual £m**	**2022-23 Budget £m**	**Variance £m**
Interest Receivable	(1.5)	(1.5)	-
Interest Payable	1.2	1.0	(0.2)
Net Amount	**(0.3)**	**(0.5)**	**(0.2)**

APPENDIX B

NON-TREASURY INVESTMENT OPERATIONS FOR 2022/23

1 INTRODUCTION

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

1.2 The purpose of non-treasury investment management operations is to ensure that all investment decisions that are made primarily to generate a profit have a suitable level of security and liquidity. Ensuring risks and rewards are monitored regularly.

1.3 The second main function of investment management is to generate potential returns and monitor performance of returns on a regular basis.

1.4 The Council also holds £133.9m of such investments at as 31 March 2023 in:

- directly owned property £125.9m
- loans to local businesses and landlords £6.7m
- loans to subsidiaries £1.3m

2 PROPORTIONALITY

2.1 The Council is becoming increasingly dependent on profit generating investment activity to achieve a balanced revenue budget. Table 1 below shows the forecast proportion of gross service expenditure funded by investment activity.

Table 1: Proportionality of Investments

	2022/23 Estimate	2022/23 Outturn
Proportion	14.3%	

3 SERVICE IMPROVEMENT LOANS

3.1 The Council lends money to its subsidiaries, local businesses, and its employees to support local public services and stimulate local economic growth. The Council is a funding partner of Farnborough International Limited. The loans have enables to development of the Farnborough International exhibition and conference centre. Expanding the exhibition and conferencing capabilities in Farnborough brings increased economic capacity to the Borough and is a reinvestment in local business.

3.2 The Council performance and upper limits on the outstanding loans to each category of borrower have been set as follows:

Category of Borrower	2022-23 Approved Limit £m	2022-23 Actual £m
Local businesses	6.7	6.7
Subsidiaries & Partnerships	3.5	1.0
Employees	0.1	0.1
Total	**10.3**	**7.8**

Service loans have generated 5.5% rate of return for the Council during 2022/23 financial year. The rate of return on Service loans is lower than estimated due to follow two events:

- delays in issuing loans to Rushmoor Housing Company – two loans were made during 2022/23 totalling £0.6m
- funding consortium partnership agreeing to defer interest payments on loans to provide cashflow support to by Farnborough International Limited (FIL) following the cancellation of the 2020 Air show. Further detail is given in report FN2115

4 COMMERCIAL INVESTMENT: PROPERTY

4.1 The Council invests in local and regional commercial and residential property with the intention of making a profit that will be spent on local public services. Transactions during 2022/23 increased the overall portfolio to £125.2m as outline in the table below.

Property by Type	31-Mar-2022 Carry Forward	2022-23 Purchase Cost	Year end value
Mixed Use	5.2	-	5.2
Industrial Units	26.9	-	26.9
Retail	20.0	23.0	43.0
Offices	46.3	4.5	50.8
Total	**98.4**	**27.5**	**125.9**

<u>Return on Commercial investment</u>

4.2 Commercial property investments generated £4.7m of net investment income for the Council after taking account of direct costs, cost of borrowing and Minimum Revenue Provision (MRP). This represents a rate of return of 3.7%.

5 NON-TREASURY INVESTMENT INDICATORS

5.1 The Council measures and manages its exposures to non-treasury investment risks using the following indicators.

5.2 **Total risk exposure:** This indicator shows the Council's total exposure to potential investment losses. This includes amounts the Council is contractually committed to lend but have yet to be drawn down and guarantees the Council has issued over third-party loans.

Total Investment Exposure	31-Mar-23 Estimate £m	31-Mar-23 Actual £m
Treasury Management Investments	23.9	20.4
Service Investments: Loans	13.0	8.1
Service Investments: Shares	0.6	-
Commercial Investments: Property	124.4	125.9
Total Exposure	**161.9**	**154.4**

5.3 **How investments are funded:** Government guidance is that these indicators should include how investments are funded. Since the Council does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as being funded by borrowing. The remainder of the Council's investments are funded by usable reserves and income received in advance of expenditure.

	31-Mar-23 Estimate £m	31-Mar-23 Actual £m
Treasury Management investment	-	-
Service Investments: Loans	15.0	8.1
Service Investments: Shares	0.6	-
Commercial Investments: Property	112.0	111.9
Total Funded by Borrowing	**127.6**	**120.0**

5.4 **Rate of return received:** This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

	2022-23 Estimate %	2022-23 Actual %
Treasury Management Investments	3.7	3.7
Service Investments: Loans	2.2	0.1
Service Investments: Shares	-	-
Commercial Investments: Property	6.1	6.5
Total Exposure	**12.0**	**10.3**

5.5 The above table shows variable performance across all types of investment. However, in aggregate the total rate of return is in line with the estimate for 2022/23.

5.6 The Council has considered the following additional indicators prudent to report given the investment activities.

	31-Mar-23 Estimate	31-Mar-23 Estimate
Debt to net service expenditure ratio	10.8	9.3
Commercial income to net service expenditure ratio	0.7	0.6

APPENDIX C

PRUDENTIAL INDICATORS

1.1 **Prudential Indicators:** The following indications are required by the CIPFA "Prudential Code" 2017 edition

1.2 **Estimates of Capital Expenditure:** The Council's planned capital expenditure and financing may be summarised as follows.

	2022-23 Budget £m	2022-23 Outturn £m
General Fund Services	37.0	22.5
External Sources	8.6	1.3
Own Resources	1.0	2.1
Debt	27.4	19.1
Total	**37.00**	**22.5**

1.3 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. Planned MRP and use of capital receipts are as follows:

	2022-23 Budget £m	2022-23 Outturn £m
Own Resources	2.7	2.1

1.4 **Estimates of Capital Financing Requirement:** The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose.

	2022-23 Budget £m	2022-23 Outturn £m
General Fund Services	150.0	143.5
MRP	(2.4)	(2.1)
IFRIC 4 Lease Adjustment	(0.3)	(0.3)

1.5 **Gross Debt and the Capital Financing Requirement:** In order to ensure that over the medium-term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of 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 is a key indicator of prudence.

	2022-23 Budget £m	2022-23 Outturn £m
Debt (incl. leases)	125.0	120.0
Capital Financing Requirement	146.1	141.1
Difference	21.1	21.1

6 **Affordable borrowing limit:** The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

	2022-23 Budget £m	2022-23 Outturn £m
Authorised limit - total external debt	134.8	125.0
Operational Boundary - total external debt	129.8	120.0

1.7 **Ratio of Financing Costs to Net Revenue Stream:** This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

	2022-23 Budget	2022-23 Outturn
Financing costs (£m)	1.0	1.2
Proportion of net revenue stream	0.1	0.1

APPENDIX D

Market commentary regarding the year 2022/23 from the Council's treasury management advisors Arlingclose

External Context

Economic background:

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

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

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

Following the decision by the UK government under Rishi Sunak and Jeremy Hunt to reverse some of the support to household energy bills announced under Liz Truss, further support in the form of a cap on what energy suppliers could charge 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%.

Financial markets:

Uncertainty continued to be a key driver of financial market sentiment and bond yields remained relatively volatile due to concerns over elevated inflation and higher interest rates, as well as the likelihood of the UK entering a recession and for how long the Bank of England would continue to tighten monetary policy. Towards the end of the period, fears around the health of the banking system following the collapse of Silicon Valley Bank in the US and purchase of Credit Suisse by UBS caused further volatility.

Over the period the 5-year UK benchmark gilt yield rose from 1.41% to peak at 4.70% in September before ending the financial year at 3.36%. Over the same timeframe the 10-year gilt yield rose from 1.61% to peak at 4.51% before falling back to 3.49%, while the 20-year yield rose from 1.82% to 4.96% and then declined to 3.82%. The Sterling Overnight Rate (SONIA) averaged 2.24% over the period.

Credit review:

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

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

The following month Fitch revised the outlook on the UK sovereign to negative from stable. Moody's made the same revision to the UK sovereign, following swiftly after with a similar move for a number of local authorities and UK banks including Barclays Bank, National Westminster Bank (and related entities) and Santander.

During the last few months of the reporting period there were only a handful of credit changes by the rating agencies, then in March the collapse of Silicon Valley Bank (SVB) in the US quickly spilled over into worries of a wider banking crisis as Credit Suisse encountered further problems and was bought by UBS.

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

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

As market volatility is expected to remain a feature, at least in the near term 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.