From:	Peter Oakford, Deputy Leader and Cabinet Member for Finance, Corporate and Traded Services Zena Cooke, Corporate Director Finance
To:	County Council – 21 September 2023
Subject:	Treasury Management full year report
Classification:	Unrestricted

Summary: This report provides an overview of Treasury Management activity in 2022-23 and developments in 2023-24.

Recommendation: Members are asked to note this report.

1. Introduction

1.1 This report covers Treasury Management activity in 2022-23.

1.2 The Council's Treasury Management Strategy for 2022-23 was approved by the County Council on 10 February 2022.

1.3 The Council has both 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 are therefore central to the Council's treasury management strategy. This report covers treasury activity and the associated monitoring and control of risk.

1.4 Treasury risk management at the Council is conducted within the framework of CIPFA's Treasury Management in the Public Services: Code of Practice (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 fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

1.5 The Council has nominated the Governance & Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies. The Governance & Audit Committee endorsed this report at its meeting on 11 July 2023.

2. External context

2.1 **Economic background:** The following economic commentary has been provided by the Council's treasury advisor during the reporting period, Arlingclose.

a) *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 2023 period continued to be characterised by high energy and commodity prices, high inflation, and the associated impact on household budgets and spending.*

b) *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.*

c) *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 2023. 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.*

d) *Following the decision by the UK government to reverse some of the support to household energy bills announced under the Liz Truss-led administration, further support in the form of a cap on what energy suppliers could charge households was announced in the March Budget to run from April until June 2023. Before the announcement, typical household bills had been due to rise to £3,000 a year from April.*

e) *The labour market remained tight albeit with some ongoing evidence of potential loosening at the end of the period. The unemployment rate 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%.*

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

g) *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%). The annual growth rate in Q4 was 0.6%.*

h) *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.*

i) *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.*

j) *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%.*

k) *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.*

l) *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. Local context

3.1 At 31 March 2023 the Council had borrowings of £802.5m and investments of £492.4m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These are shown in the following table.

	31 Mar 2023 Actual £m
Loans CFR	1,070.0
External borrowing	-802.5
Internal borrowing	**267.5**
Less: balance sheet resources	-759.9
Treasury investments	**492.4**

3.2 The Council followed its strategy to maintain borrowing and investments below their underlying levels, known as internal borrowing, in order to reduce risk and keep interest costs low. This strategy is regularly reviewed with the Council's treasury advisors taking account of capital spending plans and available cash resources.

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

	31-Mar-22 Balance £m	2022-23 Movement £m	31-Mar-23 Balance £m	31-Mar-23 Average Rate %
Long-term borrowing	826.0	-23.5	802.5	4.48
Total borrowing	**826.0**	**-23.5**	**802.5**	**4.48**
Long-term investments	296.4	15.6	312.0	3.88
Short-term investments	36.5	9.2	45.7	3.92
Cash and cash equivalents	130.9	3.8	134.7	3.91
Total investments	**463.8**	**28.6**	**492.4**	**3.97**
Net borrowing	**362.2**	**-52.1**	**310.1**	

4 Borrowing Update

4.1 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.

5 Borrowing Strategy During the Period

5.1 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.

5.2 At 31 March 2023 the Council held £802.5m of loans as part of its strategy for funding previous capital programmes. No net new borrowing was undertaken in the year (although a portion of the borrowing portfolio was restructured, see para. 5.4 below) and £23.5m of existing loans were allowed to mature without replacement.

5.3 Interest rates rose markedly over the year in both the long and short term, with rates at the end of March around 2% - 4% higher than those at the beginning of April. The PWLB 10-year maturity certainty rate stood at 4.33% at 31st March 2023, 20 years at 4.70% and 30 years at 4.66%.

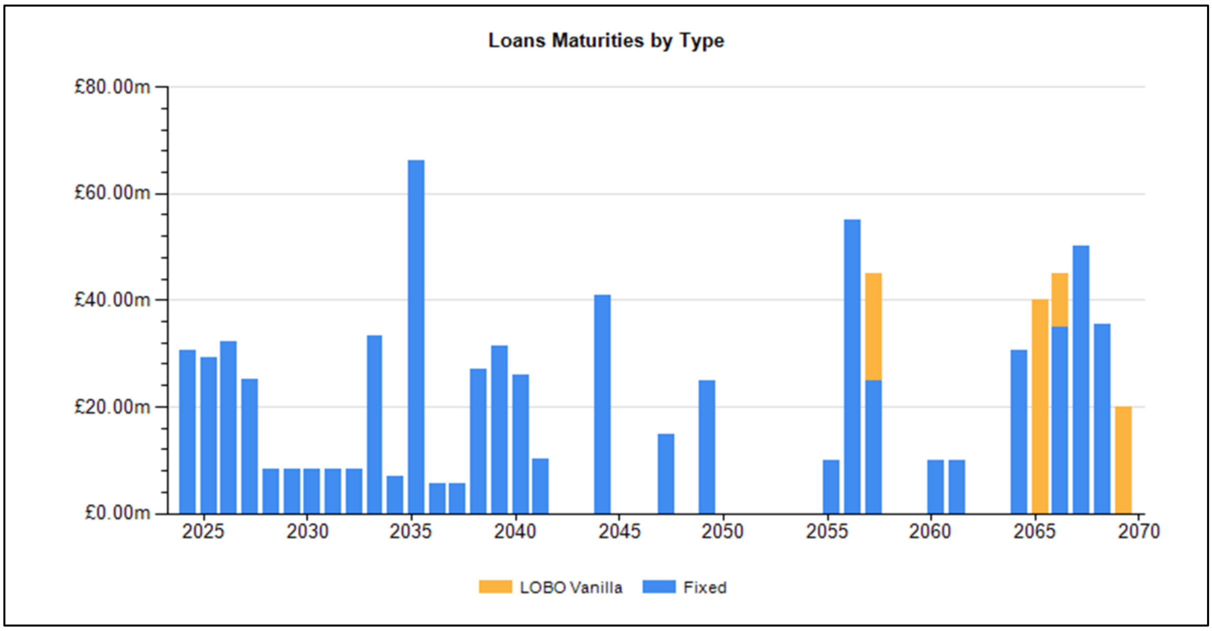
5.4 Officers rescheduled a portion of the Council's long dated market debt in December 2022 with a view to reducing overall financing costs. £75.7m worth of market loans (held by Barclays) was repaid/replaced with new PWLB borrowing undertaken in accordance with the Council's approved borrowing strategy for the year.

5.5 The Council continues to hold LOBO (Lender's Option Borrower's Option) 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. Rising interest rates increases the likelihood of a lender exercising their option although no banks exercised their option during the period.

5.6 The Council's borrowing activity in 2022-23 is as follows:

	31/03/2022	**2022-23**	**31/03/2023**	**31/03/2023**	**31/03/2023**
	Balance	**Movement**	**Balance**	**Average Rate**	**Value Weighted Average Life**
	£m	**£m**	**£m**	**%**	**yrs.**
Public Works Loan Board	426.9	57.0	484.0	4.52%	12.91
Banks (LOBO)	90.0	0.0	90.0	4.15%	40.88
Banks (Fixed Term)	291.8	-75.7	216.1	4.54%	39.23
Streetlighting project	17.2	-4.8	12.4	2.08%	12.88
Total borrowing	**826.0**	**-23.5**	**802.5**		**23.14**

5.7 The maturity profile of the Council's outstanding debt at 31 March 2023 was as follows:



6 Treasury Investment Activity

6.1 CIPFA published a revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes on 20th December 2021. These define treasury management investments as investments that arise from the organisation's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

6.2 The Council holds significant invested funds representing income received in advance of expenditure plus balances and reserves held. During the year the Council's investment balance ranged between £376.8m and £579.7m due to timing differences between income and expenditure.

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 highest 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 Bank Rate increased from 0.75% at the beginning of the year to 4.25% at the end of March 2023. Short-dated cash rates, which had ranged between 0.7% - 1.5% at the beginning of April, rose by around 3.5% for overnight/7-day maturities and 3.3% for 6-12 month maturities.

6.5 The Council continues to hold significant cash balances in money market funds as well as in bank call accounts which have same day availability. This liquid cash was diversified over several counterparties and money market funds to manage both credit and liquidity risks.

6.6 During the year the Council loaned £7.4m to the no use empty loans programme. At 31 March 2023 the Council had made loans totalling £22.0m to the programme now achieving a return of 4.0% which is available to fund general services. A £25.7m net increase in covered bonds in the year brings the total bond portfolio up to £116.7m. These instruments are negotiable, have the benefit of collateral cover and pay an above base rate return.

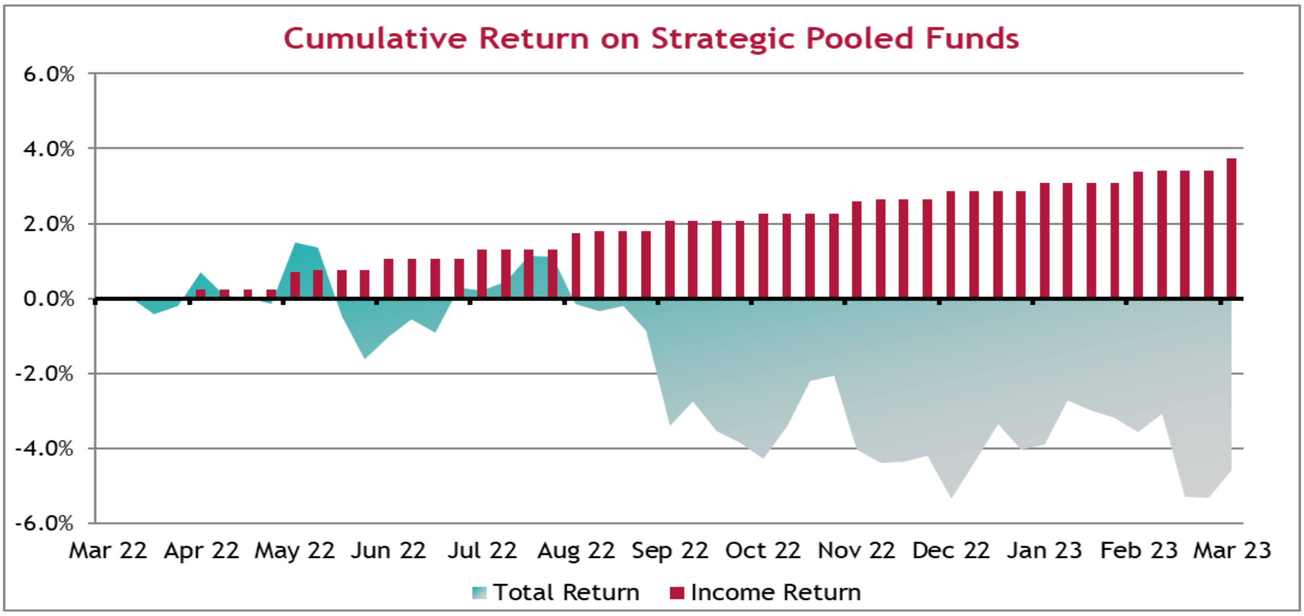
6.7 The Council's investments during the year are summarised in the table below and a detailed schedule of investments as at 31 March 2023 is in Appendix 1.

	31-Mar-22	**2022-23**	**31-Mar-23**	**31-Mar-23**	**31-Mar-23**
	Balance	**Movement**	**Balance**	**Rate of Return**	**Average Credit Rating**
	£m	**£m**	**£m**	**%**	
Bank Call Accounts	5.0	-3.8	1.3	0.80	A+
Money Market Funds	130.9	3.8	134.7	3.91	A+
Covered Bonds	91.0	25.7	116.7	3.92	AAA
DMO Deposits (DMADF)	19.5	15.1	34.6		
Government Bonds	12.0	-2.2	9.8	3.84	AA-
No Use Empty Loans	14.6	7.4	22.0	2.50	
Equity	1.3	0.0	1.3		
Internally managed cash	**274.3**	**46.1**	**320.4**	**3.91**	AA
Strategic Pooled Funds	**189.0**	**-17.1**	**172.0**	**4.06**	
Total	**463.4**	**29.0**	**492.4**	**3.97**	

7 Externally managed investments

7.1 The Council is invested in equity, multi-asset and property funds. Because the pooled 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 are regularly reviewed.

7.2 **Performance YTD**. The value of our holdings decreased to £172.0m at the end of March 2023, showing an unrealised loss of £17.1m (-9.03%) since the end of March 2022. This was partially offset by income earned over the period, and the total return (comprised of both income and capital returns) on the pooled fund investments over the year since 31 March 2022 was -4.97%, as shown in the table below.



7.3 Strong inflationary pressures and the associated increase in interest rates provided strong headwinds for most major investment asset classes in 2022, which was a challenging year for investors generally.

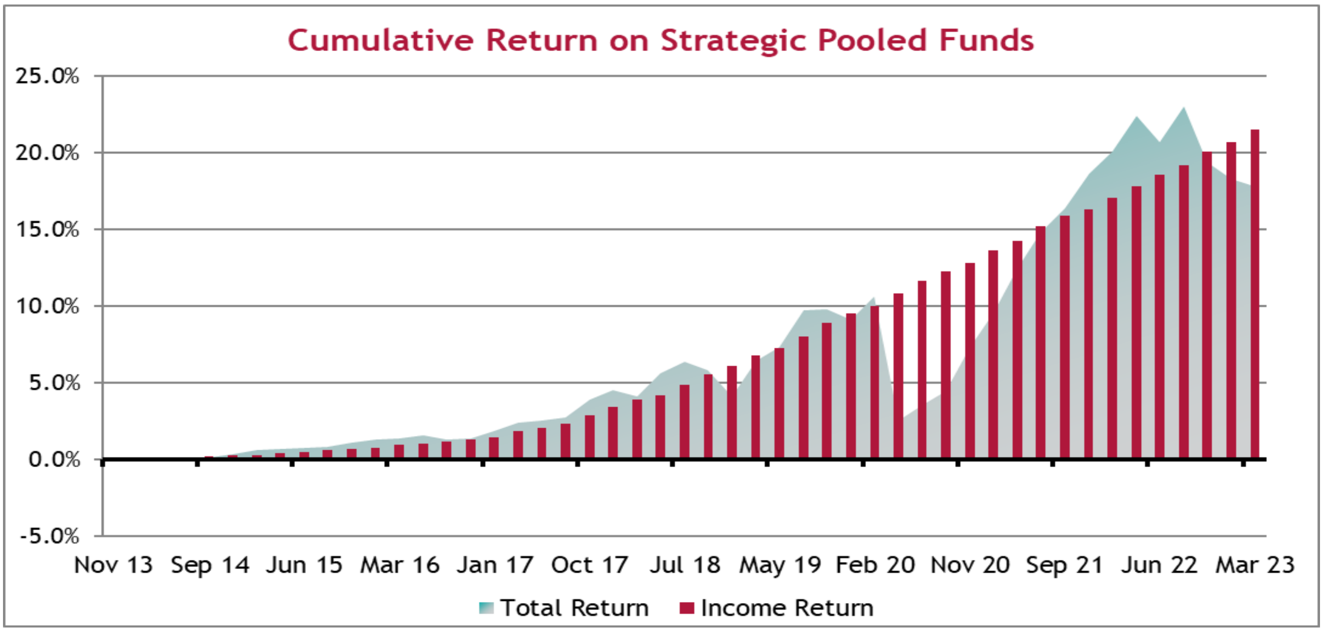
7.4 Strategic pooled fund investments are made in the knowledge that capital values will fluctuate, however the Council is invested in these funds for the long term and with the confidence that over a three-to-five-year period total returns are reasonably expected to exceed cash interest rates.

7.5 The market value of the pooled fund investments as at 31 March 2023 compared to the position as at 31 March 2022 is shown in the table below.

		31-Mar-22	**2022-23**	**31-Mar-23**	**31-Mar-23**	
Investment Fund	**Book cost**	**Market Value**	**Movement**	**Market Value**	**12 months return**	
					Income	**Total**
	£m	**£m**	**£m**	**£m**	**%**	**%**
Aegon (Kames) Diversified Monthly Income Fund	20.0	20.1	-2.4	17.7	5.01%	-6.87%
CCLA - Diversified Income Fund	5.0	5.2	-0.5	4.7	2.75%	-6.13%
CCLA – LAMIT Property Fund	60.0	67.6	-11.1	56.4	3.62%	-12.87%
Fidelity Global Multi Asset Income Fund	25.0	23.9	-1.2	22.7	4.43%	-0.55%
M&G Global Dividend Fund	10.0	14	-0.2	13.8	3.21%	1.52%

Ninety-One (Investec) Diversified Income Fund	10.0	9.6	-0.5	9.1	4.01%	-1.30%
Pyrford Global Total Return Sterling Fund	5.0	5.1	-0.0	5.1	1.20%	0.88%
Schroder Income Maximiser Fund	25.0	21.5	-1.1	20.4	6.96%	1.68%
Threadneedle Global Equity Income Fund	10.0	11.9	-0.1	11.8	2.21%	1.27%
Threadneedle UK Equity Income Fund	10.0	10.2	0.1	10.3	3.60%	4.65%
Total Externally Managed Investments	**180.0**	**189.0**	**-17.1**	**172.0**	**4.06%**	**-4.97%**

7.6 **Performance since inception:** KCC initially invested in pooled funds in 2013. By the end of March 2023 they had achieved a total income return of £44.1m, 21.51%, with a fall in the capital value of the portfolio of £7.7m, -3.75%. Total returns since inception have been far in excess of the returns available from cash and these instruments are an effective way of managing the Council's longer term cash balances. The following chart tracks the returns earned on the pooled funds over the period from inception.



7.7 The DLUHC published a consultation on the IFRS 9 pooled investment fund statutory override for English authorities for fair value gains and losses on pooled investment funds which was due to expire with effect from 2023/24. The options under evaluation were to allow the override to lapse, to extend it, or to make it permanent. The override will be extended for two years and therefore remain in place for the

2023/24 and 2024/25 financial years. Under the Regulations, gains and losses resulting from unrealised fair value movements relating to treasury pooled investment funds, that otherwise must be recognised in profit or loss under IFRS 9, are not charges to the revenue account, and must be taken into an unusable reserve account.

8 Investment benchmarking at 31 March 2023

8.1 The Council's treasury advisor during the reporting period, Arlingclose, monitors the risk and return of some 160 local authority investment portfolios. The metrics over the 12 months to 31 March 2023 extracted from their quarterly investment benchmarking, per the table below, show that the risk within the Kent internally managed funds has been consistent throughout the 12-month period and in line with that of other local authorities. The income return has risen reflecting increased rates payable on our cash investments.

Internally managed investments	Credit Score	Credit Rating	Bail-in Exposure %	Weighted Average Maturity (days)	Rate of Return %
Kent - 31.03.2022	3.17	AA	53	290	0.62
Kent - 31.03.2023	**3.26**	**AA**	**46**	**315**	**3.91**
Similar LAs	4.37	AA-	42	1,894	3.38
All LAs	4.71	A+	59	12	3.67

8.2 The following table shows that overall KCC's investments in strategic pooled funds are achieving a marginally superior income return compared with that of other local authorities, whilst the income returns for all investments (i.e., including internally managed investments) is meaningfully higher by comparison.

	Rate of Return – Income only %	Total Rate of Return %
Strategic Funds at 31.03.2023		
Kent	**4.06**	**-4.97**
Similar LAs	4.02	n/a
All LAs	3.93	n/a
Total Investments at 31.03.2023		
Kent	**3.98**	**0.67**
Similar LAs	3.48	1.24
All LAs	3.66	1.59

9 Actual and forecast outturn

9.1 Over the 12 months to 31 March 2023 the Council's strategic investments generated an average total return of -4.97%, comprising a 4.06% income return which is used to support services in year, and -9.03% of unrealised capital loss.

9.2 Interest rates have moved higher and the returns on our cash deposits are expected to continue to improve for the foreseeable future.

9.3 Forecast net debt costs are lower than budget as yields from short-term and variable long-term cash investments have increased.

10 Compliance

10.1 The Corporate Director Finance 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.

11 Treasury Management Advisor

11.1 The Council retains an appointed external treasury management advisor to support the delivery of its treasury management activity, and to provide ongoing access to appropriate specialist advice to enable the Council to effectively develop and implement its treasury management strategy.

11.2 Officers carried out a re-procurement exercise for the Council's treasury management advisory contract over the course of Q4 2022/23 and Q1 2023/24, as the contractual arrangements with the incumbent provider, Arlingclose, were due to end by 31 May 2023. Following a competitive tendering exercise, Link Asset Services have been appointed as the Council's treasury management advisor for a period of three years, with an optional extension of a further two years, commencing from 1 June 2023.

12 Treasury Management Indicators

12.1 The Council measures and manages its exposures to treasury management risks using the following indicators:

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

Credit risk indicator	**Actual 31/03/2023**	**Target**
Portfolio average credit rating	AA	AA

12.3 **Liquidity:** The Council 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.

Liquidity risk indicator	Actual 31/03/2023	Target
Total cash available within 3 months	£199.6m	£100m

12.4 **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 was:

Interest rate risk indicator	Actual 31/03/2023	Limit
One-year revenue impact of a 1% rise in interest rates	£1.4m	£10m
One-year revenue impact of a 1% fall in interest rates	-£1.4m	-£10m

12.5 **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 borrowing were:

	Actual 31/03/2023	Upper limit	Lower limit
Under 12 months	2.53%	100%	0%
12 months and within 5 years	8.00%	50%	0%
5 years and within 10 years	3.12%	50%	0%
10 years and within 20 years	32.54%	50%	0%
20 years and within 40 years	26.27%	50%	0%
40 years and longer	27.55%	50%	0%

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.

12.6 **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:

Price risk indicator	Actual 31/03/2023	Limit 2021/22	Limit 2022/23	Limit 2023/24
Principal invested beyond year end	£260.9m	£300m	£300m	£300m

13 Recommendation

Members are asked to note this report.

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August 2023

Appendices:

1. **Investments as at 31 March 2023**

2. **Glossary of local authority treasury management terms**