Agenda item: 9

Cabinet – 21 June 2023

Treasury Management Annual Report 2022/23

Portfolio: Councillor Ferguson, Internal Services

Related portfolios: N/A

Service: Finance

Wards: All

Key decision: No

Forward plan: Yes

1. Aim

1.1 The council is required through regulations issued under the Local Government Act 2003 to produce a year end position statement reviewing treasury management activities and prudential and treasury indicator performance. The Annual Treasury Management Report at Appendix A provides Cabinet with these details, and meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2 The council is required to note the Annual Treasury Management Report is presented to provide assurance that Treasury Management performance is in line with budgeted expectations and within the above regulations and Codes that the authority is required to comply with.

2. Summary

2.1 This report sets out the council's 2022/23 year end position for treasury management activities (Appendix A).

2.2 The council achieved an average interest rate across all investments of 2.11% compared to a budget of 0.74% during 2022/23. In monetary terms this equates to an overachievement against budget of £2.504m. At the point of budget setting interest rate forecasts were suggesting gradual rises over a long period of time, however as inflation continued to rise the Bank of England engaged in monetary policy tightening by raising bank rate 0.25% or 0.50% at each Monetary Policy Committee meeting during the year which had a direct impact on investment returns.

2.3 In such a high interest rate environment the borrowing strategy during 2022/23 has been to delay approved long-term borrowing until needed to minimise interest costs, and this has been managed through careful cashflow forecasting and planning.

2.4 Capital expenditure for 2022/23 was £96.314m of which £28.524m will be funded from approved borrowing (Table 2, Appendix A).

2.5 The actual debt position for the Council as at 31 March 2023 is £265.592m, which is within both the operational and authorised limits for external debt approved by Council on 24/02/22.

3. Recommendations

3.1 To note and forward to Council, for consideration and noting (in line with the requirements of the Treasury Management Code of Practice (2021)), the Annual Treasury Management Report 2022/23 including prudential and local indicators (Appendix A).

4. Report detail - know

Context

4.1 The Annual Treasury Management Report at Appendix A provides Cabinet with a summary of the year end position for 2022/23 and prudential and treasury indicator performance, and meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

The following key points of interest have been extracted from the report:

- The annual report meets the requirement of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities.

- Capital expenditure was £96.314m of which £28.524m will be funded from approved borrowing (Table 2, Appendix A).

- The Bank of England base rate increased from 0.25% to 4.25% between December 2022 and March 2023, this led to improved investment returns by year end.

- The authority has continued to identify appropriate new areas of investment opportunity, reviewed counterparties and limits to reduce exposure to counterparty risk. Together these actions have led to an overachievement of investment income of £2.504m for the 2022/23 financial year.

- Given the high and rising interest rate environment during 2022/23 the Council took an opportunity to reschedule some long-term debt as premium levels were at reduced levels. On 25 August 2022 the Council elected to make an early repayment of £20m of long-term loans leading to an ongoing annual saving on interest payments of £897k per year.

- To note within the local indicators (Table 11) that the net borrowing cost as a percentage of net council tax requirement of 10.64% (3a) and the net borrowing cost as percentage of tax revenue of 7.21% (3b) are both within their target upper limits of 20% and 12.50% respectively.

Council Corporate Plan priorities

4.2 Sound financial management of the council's cash balances supports the delivery of council priorities within council's available resources.

Risk management

4.3 Treasury management activity takes place within a robust risk management environment, which enables the council to effectively maximise investment income and minimise interest payments without undue or inappropriate exposure to financial risk. It is recognised that the management of risk is as important as maximisation of performance and it is essential that the council has the right balance of risk and reward when making investment decisions. This is supported by treasury management policies which seek to manage the risk of adverse fluctuations in interest rates and safeguard the financial interests of the council.

Financial implications

4.5 Treasury management activity forms part of the council's financial framework and supports delivery of the medium term financial strategy. The review of treasury management performance and activity is reviewed through both the annual treasury management report and the mid-year performance review report.

Legal implications

4.6 The council is required to have regard to the Prudential Code under the duties outlined by the Local Government Act 2003. One requirement of the Prudential Code is that the council should comply with the CIPFA Code of Practice for Treasury Management. The council adopted the original treasury management code in 1992 and further revisions to the Code in 2002, 2010, 2017 and 2021.

Procurement Implications/Social Value

4.7 None directly relating to this report.

Property implications

4.8 None directly relating to this report.

Health and wellbeing implications

4.9 None directly relating to this report.

Staffing implications

4.10 None directly relating to this report.

Reducing Inequalities

4.11 None directly relating to this report.

Climate Change

4.12 None directly relating to this report.

Consultation

4.13 The report has been approved by the finance treasury management panel, an internal governance arrangement comprising the Director of Finance, Corporate Landlord and Assurance (S151 Officer) and Head of Finance – Technical and Transactional.

5. Decide

5.1 In line with the Treasury Management Code of Practice (2021) there are a number of reports that are required to be produced and reported publicly each year. The Annual Treasury Management Report forms one of these requirements and as such is being reported to Cabinet for noting and forwarding onto Council for consideration.

6. Respond

6.1 This report is not seeking approval of a decision, in line with the Treasury Management Code of Practice (2021) it is required to be reported for noting and forwarding to Council for consideration.

7. Review

7.1 In line with Treasury Management Code of Practice (2021) this is a backward looking document looking at performance over the previous.

Background papers

Various financial working papers.

Corporate budget plan and treasury management and investment strategy 2022/23 – Council 24/02/22.

Author

Anna Bignell
Interim Senior Treasury and Banking Manager
01922 652352

anna.bignell@walsall.gov.uk

Richard Walley
Technical Accounting, Treasury Management & Education Finance Manager
01922 650708
richard.walley@walsall.gov.uk

Judith Greenhalgh
Interim Executive Director – Resources

21 June 2023

Shaun Darcy
Director – Finance / Corporate Landlord & Assurance / Section 151 Officer

21 June 2023

Councillor Ferguson
Portfolio Holder – Internal Services

21 June 2023

Appendix A

Annual Treasury Management Report 2022/23

Walsall Council
June 2023

Annual Treasury Management Report 2022/23

Purpose

This council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and prudential and treasury indicator performance. This document therefore reports this position for the 2022/23 financial year. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

During 2022/23 the following reports were produced:

- an annual treasury strategy in advance of the year (Council 24 February 2022)
- a mid-year (minimum) treasury update report (Cabinet 14 December 2022)
- an annual review of treasury management policies in advance of the year (Council 24 February 2022)
- an annual report following the year describing the activity compared to the strategy (this report to Cabinet)

In addition, this council's treasury management panel has received regular treasury management update reports throughout 2022/23.

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

This council also confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by Cabinet before they were reported to the full Council. Member training on treasury management issues was undertaken during the year on 8 November 2022 in order to support members' scrutiny role.

Summary

During 2022/23, the council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Table 1 **Actual prudential and treasury indicators**	**2021/22 Actual £m**	**2022/23 Original £m**	**2022/23 Revised £m**	**2022/23 Actual £m**
Capital expenditure	78.385	121.000	235.510	96.314
Capital Financing Requirement:				
Including PFI and finance leases	374.499			390.185
Excluding PFI and finance leases	370.709			387.252
External Borrowing	328.971			265.592
Investments	256.925			140.771
Net borrowing	**72.046**			**124.821**

Other prudential and treasury indicators are to be found in the main body of this report. The Director for Finance, Corporate Landlord & Assurance (S151 Officer) confirms that borrowing is only undertaken for capital purposes or to support required in year cash-flow requirements, however no new borrowing was undertaken in 2022/23.

Following a period of high and rising inflation the Bank of England engaged in monetary policy tightening at every Monetary Policy Committee meeting during 2022, and into 2023, either by increasing Bank Rate by 0.25% or 0.50% each time. From December 2021 to March 2023 Bank Rate has increased from 0.25% to 4.25%, and this has had a direct impact on investment returns. Counterparty risk has been continually reviewed throughout the financial year to ensure credit ratings exceed the minimum requirements set in Treasury Management policies, and cash was invested primarily in At-Call and Short Term accounts to ensure the council was taking account of a rising interest rate environment.

The original capital expenditure target of £121.000m for 2022/23 is based on the figure for the 2022/23 capital programme reported in the budget report presented to full Council on the 24 February 2022, and was revised within the financial year to a £235.510m. The actual spend for 2022/23 is lower than the target due to slippage, and amendments to the original capital programme agreed during the year, of which spend will now be incurred in 2023/24.

1. Introduction and background

To set the context of the treasury management environment it is first necessary to provide a review of the economy and interest rates.

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

2. The Council's Capital Expenditure and Financing 2022/23

The council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc., which has no resultant impact on the council's borrowing need); or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed. The amount to be funded from borrowing for 2022/23 will be £28.524m. It shows a variance to budget due to slippage on some capital projects.

Table 2	2021/22 Actual £m	2022/23 Original £m	2022/23 Actual £m
Total capital expenditure	**79.586**	**121.000**	**96.314**
Resourced by:			
• Capital receipts	3.301	1.500	3.314
• Capital grants	57.884	87.350	61.697
• Capital Reserves and Revenue	2.555	0.020	2.779
• Approved Borrowing	15.846	32.130	28.524
	79.586	**121.00**	**96.314**

3. The Council's Overall Borrowing Need

The council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the council's debt position. The CFR results from the capital activity of the council and which resources have been used to pay for the capital spend. It represents the 2022/23 capital expenditure funded by borrowing (see table 2), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the council.

Reducing the CFR – the council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The council is required to make an annual revenue charge, called the minimum revenue provision (MRP) to reduce the CFR. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a voluntary revenue provision (VRP).

The Council's 2022/23 MRP Policy, (as required by DLUHC Guidance), was approved as part of the Treasury Management Strategy Report for 2022/23 on 24 February 2022.

The council's CFR for the year 2022/23 is shown below in Table 3, and represents a key prudential indicator (PrI4). It includes Private Finance Initiative (PFI) and leasing schemes from the balance sheet which increase the council's borrowing need – although no borrowing is normally required against these schemes as a borrowing facility is included in the contract (if applicable). It shows that in 2022/23 the council's CFR has increased by £15.686m from £374.499m to £390.185m.

Table 3 CFR (£m)	31 March 2022 Actual £m	31 March 2023 Actual £m
Opening balance	**370.108**	**374.499**
Add capital expenditure funded from approved borrowing (as above)	15.846	28.524
Less MRP	(11.455)	(12.838)
Closing balance	**374.499**	**390.185**

The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term the council's external borrowing, net of investments, must only be for a capital purpose, or to fund expected in year cash-flow requirements. This essentially means that the council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR. Table 4 below highlights the council's net borrowing position £124.821m against the CFR excluding PFIs and Finance leases £387.252m because the debt liability for these are not in the net borrowing position of the council. The council has complied with this prudential indicator.

Table 4 Gross borrowing and the CFR (£m)	31 March 2022 Actual £m	31 March 2023 Actual £m
Gross Borrowing	**332.390**	**268.273**
Net borrowing position	**72.046**	**124.821**
CFR – excluding PFIs and Finance Leases	**370.709**	**387.252**
Long term Assets	**629.599**	**657.389**
Net Borrowing % of Long term Assets	**11.44%**	**18.99%**

Another measure of prudency is the proportion of net borrowing to long term assets. Table 4 shows that the net borrowing position of the council as at 31 March 2023 is £124.821m which represents 18.99% of the value of the council's long term assets which are valued on the council's balance sheet at that date.

Other key Prudential Indicators are shown in Table 5 below:

Table 5 Prudential and Borrowing Limits	31 March 2022 Actual £m	31 March 2023 Actual £m
1. Authorised limit	**498.300**	**474.380**
2. Maximum gross borrowing in year	**351.454**	**328.971**
3. Operational boundary	**453.000**	**431.250**
4. Average gross borrowing	**341.922**	**300.332**
5. Financing costs as proportion of net revenue stream	**7.23%**	**4.10%**

1. **The authorised limit** - the authorised limit is the "affordable borrowing limit" set by the council as required by section 3 of the Local Government Act 2003. The council does not have the power to borrow above this level without the prior approval of full Council. Table 5 demonstrates that during 2022/23 the council's maximum gross borrowing was within its authorised limit.

2. **Maximum Gross borrowing** – is the peak level of borrowing in year.

3. **The operational boundary** – the operational boundary is the expected borrowing position of the council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached. In 2022/23 the council's average borrowing position was less than the operational boundary.

4. **Average Gross Borrowing** – is an estimate of the borrowing level in the year (see Table 7 for analysis of Borrowing).

5. **Actual financing costs as a proportion of net revenue stream** - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream. Net revenue stream is defined as Net Council Tax Requirement plus Standard Spending Assessment (previously Formula Grant).

4. Prudential Indicators

The following tables show performance against statutorily required prudential and local indicators.

Table 6 – Prudential Indicators		Actual 2021/22	Target 2022/23	Position 31-Mar-23	Variance to target	
		£m	£m	£m	£m	%
PrI 1	Capital Expenditure	71.385	235.510	96.314	(139.196)	(59%)
PrI 2	Ratio of financing costs to net revenue stream	7.23%	9.76%	4.05%	(5.71%)	(59%)
PrI 3	Estimates of the incremental impact of new capital investment decisions on Council Tax	£52.43	£43.02	£43.02	0.00	0%
PrI 4	Capital Financing Requirement	374.499	411.850	390.185	(21.665)	(5%)
PrI 5	Authorised Limit for external debt	498.300	474.380	474.380	0.000	0%
PrI 6	Operational Limit for external debt	453.000	431.250	431.250	0.000	0%
Ref	**Prudential Indicator**	**Actual 2021-22 £m**	**Target 2022/23 £m**	**Position 31-Mar-23 £m**		
PrI 7	Gross Borrowing exceeds capital financing requirement	No	No	No		
PrI 8	Authority has adopted CIPFA Code of Practice for Treasury Management	Yes	Yes	Yes		
PrI 9	Total principle sums invested for longer than 365 days must not exceed	5.0	25.0	5.0		
Ref	**Prudential Indicator**	**Upper Limit**	**Lower Limit**	**Actual 2021/22**	**Position 31-Mar-23**	
PrI 10	Fixed Interest Rate Exposure	95%	40%	**89.47%**	**98.14%**	
PrI 11	Variable Interest Rate Exposure	45%	0%	**10.53%**	**1.86%**	
PrI 12	***Maturity Structure of Borrowing:***					
	Under 12 months	25%	0%	**22.94%**	**12.84%**	
	12 months and within 24 months	25%	0%	**10.53%**	**12.24%**	
	24 months and within 5 years	40%	0%	**14.32%**	**20.25%**	
	5 years and within 10 years	50%	5%	**2.07%**	**0%**	
	10 years and above	85%	30%	**50.14%**	**54.67%**	

PRL 5 (authorised limit for external debt) and PRL 6 (operational limit for external debt) were approved by Council on the 24 February 2022 and the CIPFA Code of Practice only allows these limits to be changed by Council and therefore the actual limit and the target remain the same. The actual debt position for the Council as at 31 March 2023 is £268.273m.

Key variances are because of the following reasons:-

<u>Prl 1 Total capital expenditure - variation of £139.196m</u>

The original £121.000m target for 2022/23 is based on the figure for the 2022/23 capital programme reported in the budget report presented to full Council on the 24 February 2022. This was revised within the financial year to a £235.510m target. The actual spend for 2022/23 is lower than the target due to slippage from 2022/23, and amendments to the original capital programme agreed during the year, of which spend will now be incurred in 2023/24.

<u>PRL 4 Capital Financing Requirement – variation of £21.665m</u>

The Capital Financing Requirement is in line with capital expenditure, with the variation linked to capital slippage as above.

<u>Prl 10 Fixed Interest Rate Exposure</u>

Fixed Interest Rate exposure shows an upper limit of 95.00%, the actual position shows a Fixed Interest Rate exposure of 98.14%. All loans outstanding are fixed rate loans, however for the purpose of the indicator the next call date on a LOBO loan is assumed. There is one LOBO call date within the next 12 months, the value of this is £5m which when compared to the loan portfolio it doesn’t achieve the Upper Limit of fixed rate loans of 95.00%. However, it’s worth noting that despite exceeding the Upper-Limit on Fixed Interest Rate Exposure, due to the current market conditions with rising interest rates, it is more favourable to have fixed rate loans.

<u>Prl 12 Maturity Structure of Borrowing</u>

For the purpose of the maturity profile indicator the next call date on a LOBO loan is assumed as it is the right of the lender to require repayment. This Prudential Indicator currently shows 0% of borrowing maturities within periods 5-10years when compared to the lower limit of this indicator of 5.00%. This is due to there being no loan repayments due between 2027-2043 as the council utilised internal borrowing for periods of time where cash flow allowed meaning the maturity profile of debt is not evenly spread. This provided a favourable return at that time between external borrowing rates payable and return on investments that would be deliverable. Whilst there are no scheduled maturities the council will continue to use this period to review options to repay any existing borrowing early.

5. Treasury Position at 31 March 2023

The council's debt and investment position is organised by the treasury management team in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the summary, and through officer activity detailed in the council's treasury management practices. At the beginning and the end of 2022/23 the council's treasury position was as shown below in **Table 7**:

Table 7 Loans and Investments	Opening Balance £m	Average Rate At 31/03/22 %	Movement in Year £m	Closing Balance £m	Average Rate At 31/03/23 %
PWLB loans	195.658	3.38%	(21.293)	174.365	3.55%
Market Loans	95.000	4.70%	(20.000)	75.000	4.75%
Total Borrowing over 12 months excluding WMCC debt	**290.658**	**3.81%**	**(41.293)**	**249.365**	**3.91%**
Temporary Loans	30.961	1.48%	(20.502)	10.459	1.63%
Total borrowing excluding WMCC debt	**321.619**	**3.59%**	**(61.795)**	**259.824**	**3.82%**
WMCC Debt	10.770	5.44%	(2.321)	8.449	5.30%
Gross Borrowing	**332.389**	**3.65%**	**(64.116)**	**268.273**	**3.86%**
Waste Disposal & Cannock Chase Debtor	(3.418)	5.44%	0.736	(2.682)	5.30%
Borrowing	**328.971**	**3.63%**	**(63.380)**	**265.591**	**3.85%**
CFR less PFI finance & leases	370.709		16.543	387.252	
Under/(Over) Borrowing	41.738		(46.837)	121.661	
Debt as % of CFR	**89%**			**69%**	
Call Accounts	47.925	0.09%	(0.154)	47.771	2.05%
Short Term Investments	174.000	0.39%	(116.000)	58.000	1.82%
Long Term Investments	35.000	2.43%	0.000	35.000	2.89%
Total Investments	**256.925**	**0.74%**	**(116.154)**	**140.771**	**2.11%**
Net Borrowing Position	**72.046**		52.774	**124.820**	

The under borrowing position represents additional external borrowing the council could choose to take if required, however this has currently been financed by internal borrowing (utilising the Council's accumulated cash reserves rather than taking out new external borrowing). This position will continue to be monitored and additional external borrowing may be undertaken if required for cash flow purposes.

The true under borrowed position at the beginning of the year was £71.738m, and at the end of the year was £131.661m. This is because the under/(over) positions in the table above include temporary loans taken to fund upfront pension payments made in April 2020 for the following 3 financial years, which should be removed to show the true under borrowed position.

6. The Borrowing Strategy for 2022/23 and Economic Context provided by Link Asset Services (the council's external Treasury advisor)

During 2022/23, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow was used as an interim measure.

This strategy avoids a cost of carry where any new long-term borrowing that was not immediately used to finance capital expenditure, would have caused a temporary increase in cash balances and would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this has been kept under review to avoid incurring higher borrowing costs in the future when this Authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

Given the high and rising interest rate environment the Council took an opportunity to reschedule some long-term debt as premium levels were at reduced levels. On 25 August 2022 the Council elected to make an early repayment of £20m of long-term loans leading to an ongoing annual saving on interest payments of £897k per year.

7. Borrowing Outturn commentary for 2022/23 provided by Link Asset Services (the council's external Treasury advisor)

PWLB rates are based on gilt (UK Government bonds) yields through HM Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields. Inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation and the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. Indeed, in recent years many bond yields up to 10 years in the Eurozone turned negative on expectations that the EU would struggle to get growth rates and inflation up from low levels. In addition, there has, at times, been an inversion of bond yields in the US whereby 10-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession.

However, since early 2022, yields have risen dramatically in all the major developed economies, first as economies opened post-Covid; then because of the inflationary impact of the war in Ukraine in respect of the supply side of many goods. In particular, rising cost pressures emanating from shortages of energy and some food categories have been central to inflation rising rapidly. Furthermore, at present the Federal Open Market Committee (FOMC), European Central Bank (ECB) and Bank of England are all being challenged by persistent inflation that is exacerbated by very tight labour markets and high wage increases relative to what central banks believe to be sustainable.

Graph of UK gilt yields v. US treasury yields

Gilt yields have been on a continual rise since the start of 2021, peaking in the autumn of 2022. Currently, yields are broadly range bound between 3% and 4.25%.

At the close of the day on 31 March 2023, all gilt yields from 1 to 50 years were between 3.64% and 4.18%, with the 1 year being the highest and 6-7.5 years being the lowest yield.

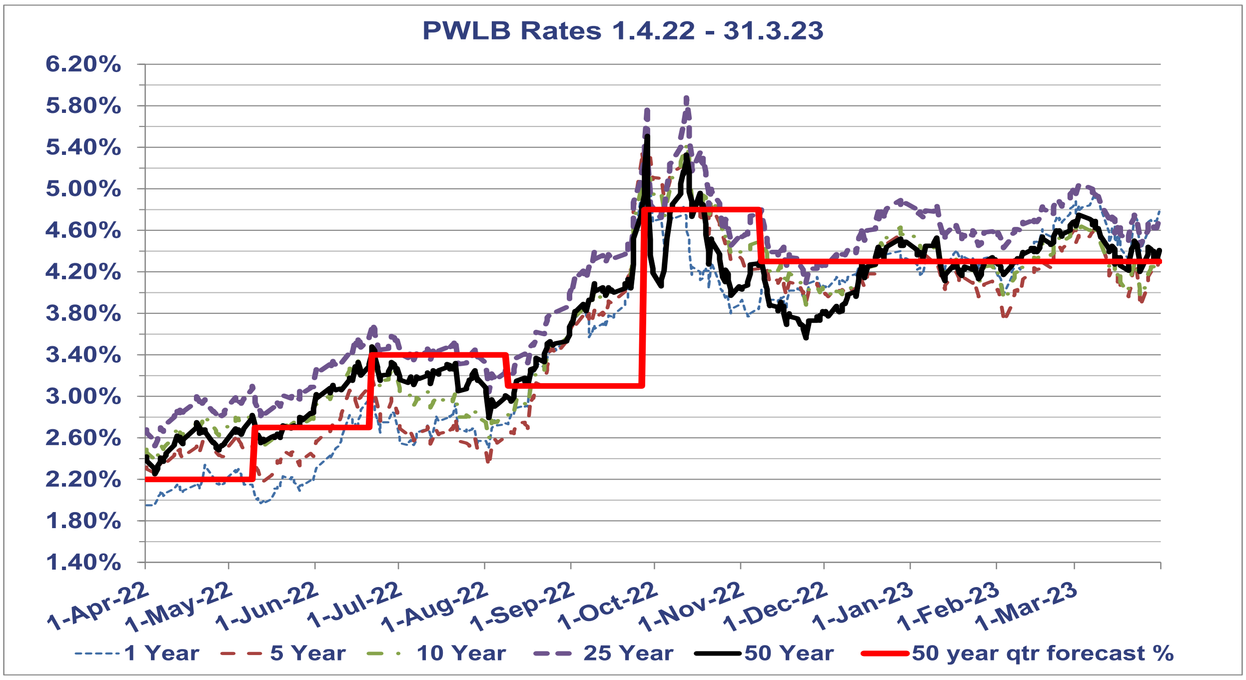
Regarding PWLB borrowing rates, the various margins attributed to their pricing are as follows: -

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

There is likely to be a fall in gilt yields and PWLB rates across the whole curve over the next one to two years as Bank Rate first rises to dampen inflationary pressures and a tight labour market, and is then cut as the economy slows, unemployment rises, and inflation (on the Consumer Price Index measure) moves closer to the Bank of England's 2% target.

As a general rule, short-dated gilt yields will reflect expected movements in Bank Rate, whilst medium to long-dated yields are driven primarily by the inflation outlook.

The Bank of England is also embarking on a process of Quantitative Tightening, but the scale and pace of this has already been affected by the Truss/Kwarteng "fiscal experiment" in the autumn of 2022 and more recently by the financial market unease with some US (e.g., Silicon Valley Bank) and European banks (e.g., Credit Suisse). The gradual reduction of the Bank's original £895bn stock of gilt and corporate bonds will be sold back into the market over several years. The impact this policy will have on the market pricing of gilts, while issuance is markedly increasing, is an unknown at the time of writing.



8. Investments in 2022/23 and Economic Context commentary provided by Link Asset Services (the council's external Treasury advisor)

Investment returns picked up throughout the course of 2022/23 as central banks, including the Bank of England, realised that inflationary pressures were not transitory, and that tighter monetary policy was called for.

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

The sea-change in investment rates meant local authorities were faced with the challenge of pro-active investment of surplus cash for the first time in over a decade, and this emphasised the need for a detailed working knowledge of cashflow projections so that the appropriate balance between maintaining cash for liquidity purposes, and "laddering" deposits on a rolling basis to lock in the increase in investment rates as duration was extended, became an on-going feature of the investment landscape.

With bond markets selling off, equity valuations struggling to make progress and, latterly, property funds enduring a wretched Q4 2022, the more traditional investment options, such as specified investments (simple to understand, and less than a year in duration) became more actively used.

Meantime, through the autumn, and then in March 2023, the Bank of England maintained various monetary policy easing measures as required to ensure specific markets, the banking system and the economy had appropriate levels of liquidity at times of stress.

Nonetheless, while the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the Great Financial Crisis of 2008/09. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates as illustrated in the charts shown above and below. Such an approach has also provided benefits in terms of reducing counterparty risk exposure, by having fewer investments placed in the financial markets.

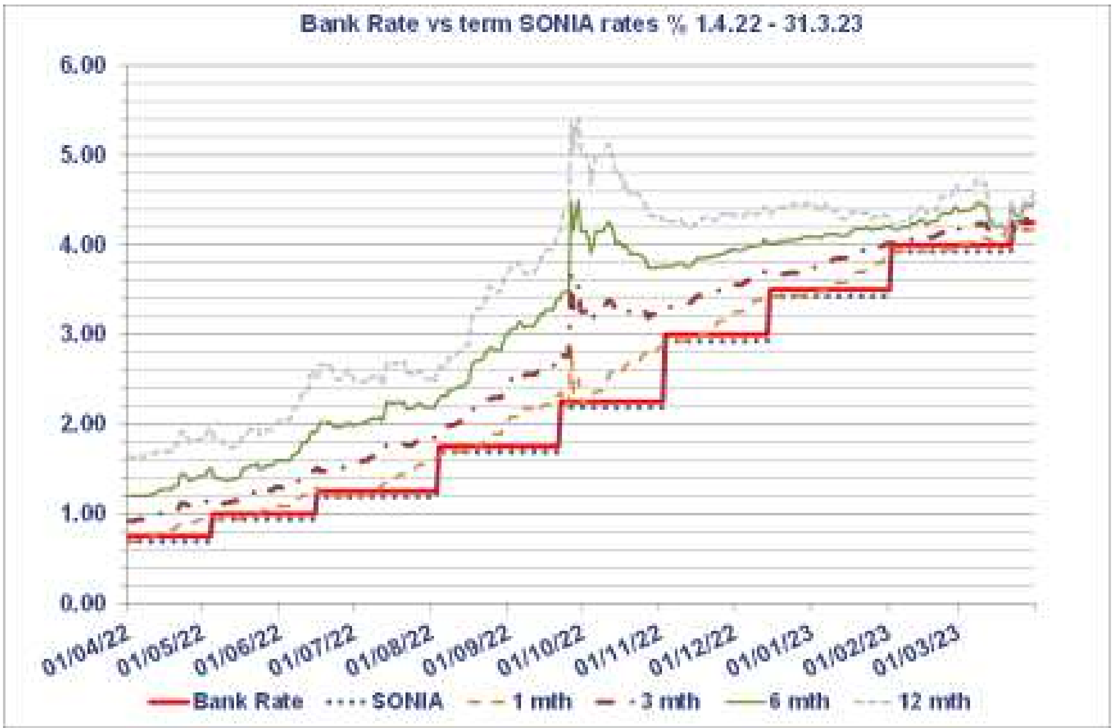


Table 8 within the report details the authority's investments by call, short and long term. The SONIA rate set out in the graph above (average of 2.24% across the year) is a fair comparator for at-call and the 12 month SONIA rate (average of 3.53% across the year) for short term investments.

Resources – the council's longer term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations.

Investment Policy – the council's investment policy is governed by DLUHC investment guidance, which was implemented in the Annual Investment Strategy approved by Council on 24th February 2022. This policy set out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by an analysis of Common Equity Tier (CET1) levels. The investment activity during the year conformed to the approved Strategy, and the council had no liquidity difficulties.

At the end of 2022/23 Walsall's investment balance was £116.154m lower than that at the start of the year.

Table 8 below shows an age profile of the investments.

Table 8: Changes in Investments during 2022/23	Opening Balance £m	Closing Balance £m	Movement in Year £m
At Call accounts	47.925	47.771	(0.154)
Between 31 days and 365 days	174.000	58.000	(116.000)
Over 365 days	35.000	35.000	0.000
Total	**256.925**	**140.771**	**(116.154)**

Investments held by the council - the council maintained an average balance of £209.171m of internally managed funds. The internally managed funds earned an average rate of return of 2.11%.

Recognising the continuation of the stresses on the world banking system, enhanced priority has continued to be given to security and liquidity. To reduce counterparty risk to the maximum possible extent the investment portfolio was spread across a range of appropriately credit rated / analysed institutions. **Table 9** shows the outturn on investment income in 2022/23.

Total investment income was £4.706m compared to a budget of £2.202m, leading to an underspend position of £2.504m. At the point of budget setting, interest rate forecasts were suggesting only gradual rises in short, medium and longer term interest rates during 2022/23, but by August it had become clear that inflation was moving up towards 40-year high, leading to the Monetary Policy Committee increasing Bank Rate by 0.25% and 0.50% each time. This had a direct impact on investment returns, ensuring a significant underspend on investment income.

Table 9 Investments Interest – Gross Income	2022/23 Approved Cash Limit £m	Outturn at 31 March 2023 £m	Over /(under) achieved cash limit £m	% Target Rate	% Average Rate achieved
Call Account investments	0.088	1.069	0.981	0.10%	2.05%
Short Term Investments	0.991	2.443	1.452	0.50%	1.82%
Long Term Investments	0.120	0.026	(0.094)	0.80%	0.83%
Property Fund	1.003	1.168	0.165	3.34%	3.89%
Total	**2.202**	**4.706**	**2.504**	**0.91%**	**2.11%**

9. Performance Measurement

One of the key requirements in the CIPFA Code of Practice on Treasury Management is the formal introduction of performance measurements relating to investments, debt and capital financing activities. **Table 10** below shows that Walsall has consistently achieved a higher average return on it's investments and has reduced it's average rate it pays for its borrowing. The figures for 2011/12 to 2014/15 are derived from the the CIPFA treasury management benchmarking club. For 2015/16 onwards, as a number of authorities no longer participate in this benchmarking exercise, the figures set out are based on a review of reports issued by the authorities statistical neighbours. Comparative figures for 2022/23 are not yet available.

Table 10 Comparison of Walsall with other councils Average Interest Rates	Walsall Rate Received %	Comparator Average Rate Received %	Walsall Rate Paid %	Comparator Average Rate Paid %
2011/12	1.80	1.20	4.53	4.53
2012/13	2.14	1.11	4.47	4.52
2013/14	1.29	0.85	4.51	4.26
2014/15	1.09	0.77	4.61	4.14
2015/16	1.08	0.76	4.54	4.18
2016/17	0.86	0.76	3.99	4.34
2017/18	1.32	0.73	3.42	4.06
2018/19	1.37	1.10	3.83	4.15
2019/20	1.50	1.00	3.34	4.05
2020/21	0.59	0.24	3.42	3.70
2021/22	0.38	0.16	3.63	4.02
2022/23	2.11		3.87	

Council approved the following local performance indicators, the majority of which were complied with during the year, **Table 11** provides the indicators for March 2023.

		Actual 2021/22	Target 2022/23	Position 31-Mar-23	Variance to target	
Table 11 - Local Indicators		£m	£m	£m	value	%
L1	Full compliance with Prudential Code.	YES	YES	YES	N/A	N/A
L2	Average length of debt. (Years)	16.44	Lower Limit 15 Years, Upper Limit 25 Years	17.13	N/A	N/A
L3a	Net borrowing costs as % of net council tax requirement.	7.15%	20.00%	10.64%	(9.36%)	(47.79%)
3b	Net borrowing costs as % of Tax Revenue.	4.60%	12.50%	7.21%	(5.29%)	(42.28%)
L4	Net actual debt vs. operational debt.	72.62%	85.00%	61.42%	(23.58%)	(27.75%)
L5	Average interest rate of external debt outstanding excluding OLA.	3.59%	3.52%	3.82%	0.30%	8.62%
L6	Average interest rate of external debt outstanding including OLA.	3.65%	3.62%	3.87%	0.25%	6.80%
L7	Gearing effect of 1% increase in interest rate.	3.69%	5.00%	3.81%	(1.19%)	(23.80%)

L8	Average interest rate received on STI vs. At Call rate	280.00%	807.00%	(11.22%)	(818.22%)	(101.39%)
L9	Average interest rate received:					
L9a	At Call investments.	0.10%	0.10%	2.05%	1.95%	1,950.00%
L9b	Short Term Investments.	0.38%	0.50%	1.82%	1.32%	264.00%
L9c	Long Term Investments.	1.11%	0.80%	0.83%	0.03%	3.75%
L9d	Property Fund Investments	3.45%	3.34%	3.89%	0.55%	16.32%
L10	Average interest rate on all ST investments (ST and At Call).	0.29%	0.45%	1.89%	1.44%	320.00%
L11a	Average rate on all investments (excluding property fund)	0.38%	0.48%	1.81%	1.33%	280.29%
L11b	Average Rate on all investments (including property fund)	0.74%	0.91%	2.11%	1.20%	131.58%
L12	% daily bank balances within target range.	100%	99%	99%	0.00%	0.00%

Key variances are because of the following reasons:-

L5 & L6 – The targets set at the beginning of the year factored in borrowing at lower rates for capital expenditure. This borrowing was not required to be taken out during this financial year which has impacted upon this variance adversely as the rate for this year would have included the new borrowing at lower rates.

L8 – Average rate achieved on Short Term Interest vs At Call Rate – The target is to achieve a 50% better rate on short term investments vs the current At Call rate (i.e. do nothing other than leave all cash in overnight At Call accounts). Improvements in At Call rates due to bank rate increases meant that the difference between At Call and Short Term rates was increased, as short term rates were locked in whereas At Call rates increased immediately.

10. The Economy and Interest Rates commentary provided by Link (the council's external Treasury advisor)

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, Eurozone and US 10-year yields all rising by over 200 basis points in 2022. The table below provides a snapshot of the conundrum facing central banks: inflation is elevated but labour markets are extraordinarily 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 Gross Domestic Product (GDP) deliver growth of +0.1% quarter/quarter, 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% quarter/quarter. Most recently, January saw a 0.3% month on month 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% quarter/quarter 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, Consumer Price Index (CPI) inflation picked up to what should be a peak reading of 11.1% in October 2022, 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 Monetary Policy Committee (MPC) will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food (up 18.3% year/year 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 17 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, Eurozone 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 International Labour Organisation 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% quarter/quarter 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 Financial Times Stock Exchange (FTSE) 100 started 2023 strongly, rising to a record high of 8,014 on 20 February 2023, 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 20 February 2023, 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 US.