TREASURY MANAGEMENT ACTIVITY DURING 2022/23

BORROWING REQUIREMENT AND DEBT MANAGEMENT

1. On the 31st March 2023, the Authority had an increase in its net borrowing need of £35M 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 useable reserves and working capital are the underlying resources available for investments. These are the core drivers of TM Activity and the year-on-year change is summarised in table 1 below.

2. The Authority's current strategy, given the increasing borrowing requirement, is to minimise both external borrowing and investments and to only borrow to the level of the net borrowing requirement. The reasons for this are to reduce credit risk, take pressure off the Council's lending list and also to avoid the cost of carry (i.e borrowing cash and paying interest on it before it is needed) existing in the current interest rate environment. This has resulted in a decrease in our internal borrowing of £34.82M during 2022/23 from £191.96M to £157.14M.

Table 1 – Balance Sheet Summary

	31-Mar-22 Actual £M	31-Mar-23 Strategy £M	31-Mar-23 Actual £M	31-Mar-23 Actual Movement in year £M
General Fund CFR	339.15	352.27	342.57	3.42
Housing CFR	168.73	181.70	174.88	6.15
Total CFR	**507.88**	**533.97**	**517.45**	**9.57**
Less Other Debt Liabilities*	(60.62)	(57.10)	(57.11)	3.51
Loans CFR	**447.26**	**476.87**	**460.34**	**13.08**
Less External Borrowing**	(255.30)	(288.65)	(303.20)	(47.90)
Internal (over) Borrowing	**191.96**	**188.22**	**157.14**	**(34.82)**
Balance sheet Resources	(303.08)	(217.92)	(211.70)	91.38
Treasury Investments	111.12	48.01	54.56	(56.56)
New Borrowing or (Investments)	**(0.00)**	**18.31**	**0.00**	**0.00**

** finance leases, PFI liabilities and Transferred debt that form part of the authority's total debt*
*** See Table 3 below*

NB – table includes rounded figures

3. The forecast movement in coming years is one of the Prudential Indicators (PIs). When the strategy was updated in February 2023, the CFR for 31 March 2023 was estimated at £533.97M, the Council's actual CFR at the end of the year was £517.45M, a decrease of £16.52M. This was mainly as a result of slippage in borrowing on the capital programme, £10.02M for the General Fund and £6.82M for HRA, as shown in table 2 below.

	Table 2 – Capital Financing Requirement Movement in year

Capital Financing Requirement	31/03/2022 Actual £M	31/03/2023 Forecast Revised Strategy £M	31/03/2023 Actual £M	Movement since last reported position £M
Balance Brought forward	337.18	339.15	339.15	0.00
New Borrowing	12.68	24.55	14.53	(10.02)
MRP	(6.89)	(7.93)	(7.61)	0.32
Movement in Other Liabilities	(3.82)	(3.50)	(3.50)	0.00
Total General Fund Debt	**339.15**	**352.27**	**342.57**	**(9.70)**
HRA	168.73	181.70	174.88	(6.82)
Total CFR	**507.88**	**533.97**	**517.45**	**(16.52)**
Estimated Debt (*see below for breakdown*)	316.28	364.43	360.29	(4.14)
Under / (Over) Borrowed	**191.60**	**169.54**	**157.16**	**(12.38)**

4. The movement in actual external debt and usable reserves combine to identify the Authority's borrowing requirement and potential investment strategy in the current and future years.

Replacement of maturing debt was, in line with the council's strategy, deferred due to the increase in reserves and a corresponding reduction in our net borrowing need.

This is shown in tables 3 and 4 below together with activity in the year.

5. *Table 3: Borrowing and Investment Position*

	31-Mar-22 Actual £M	31-Mar-22 Average Yield / Rate %	31-Mar-23 Actual £M	31-Mar-23 Average Yield / Rate %	31-Mar-24 Estimated Balance £M
Long Term Borrowing					
Public Works Loan	246.30	2.88	289.19	3.52	359.60
LOBO Loans from Banks	9.00	4.89	9.00	4.86	9.00
	255.30	**2.95**	**298.19**	**3.63**	**368.60**
Short Term Borrowing					
Other Local Authorities	0.00	0.00	5.00	3.36	10.00
Other	0.36	0.38	0.00	0.00	
Total External Borrowing	**255.66**	**2.83**	**303.19**	**2.96**	**378.60**
Other Long Term Liabilities					
PFI Schemes	47.52	9.01	44.37	9.56	44.37
Deferred Debt Charges (HCC)	13.10	2.66	12.73	3.27	12.73
Total Gross External Debt	**316.28**	**3.87**	**360.29**	**4.08**	**435.71**
Investments:					
Managed In-House					
Government & Local Authority	(24.41)	0.00	(11.06)	4.05	
Cash (Instant access)	(54.50)	0.51	(15.49)	4.08	(10.00)
Long Term Bonds	(1.06)	5.27	(1.01)	5.27	(1.00)
Managed Externally					
Pooled Funds (CCLA)	(27.25)	3.81	(27.00)	4.04	(27.20)
Total Investments	**(107.22)**	**3.46**	**(54.56)**	**4.08**	**(38.20)**
Net Debt	**209.06**		**305.73**		**397.51**

6. ***Table 4: Movement in Borrowing during the year***

Movement during the year	2021/22 Actual £M	31-Mar-23 Movement £M	2022/23 Actual £M	Average Life
Long-term borrowing Carried Forward	231.60		255.30	
Maturities in year	(9.30)		(7.11)	
New borrowing taken in year	33.00		50.00	
Net Long Term Borrowing	**255.30**	**42.89**	**298.19**	**26 Years**
Short-term borrowing Carried Forward	10.36		0.36	
Maturities in year	(10.36)		(0.36)	
New borrowing taken in year	0.36		5.00	
Net Short Term Borrowing	**0.36**	**4.64**	**5.00**	**1 Months**
Total Borrowing at 31st March	**255.66**	**47.53**	**303.19**	

Please note that these figures do not reflect the accounting convention of moving loans maturing in the year from long term to short term so will differ from the maturity analysis.

7. The maturity analysis of the Council's long term debt at 31 March 2023 is further analysed below, in table 5. Debt due in one year includes both short term and long term loans due in year, LOBO loans are shown as uncertain as although they are within the call option, and given the current rising interest environment there is a possibility they could be called in.

8. ***Table 5: Maturity Structure of Borrowing***

Total Financial Liabilities	**Outstanding 31 March 2023**	**% of Total Portfolio**
Source of Loan	**£M**	**%**
Public Works Loan Board	289.19	97
Other Financial Institutions (borrowing)	9.00	3
	298.19	**100**
Analysis of Loans by Maturity		
Less than 1 Year	10.60	118
Between 1 and 2 years	10.60	118
Between 2 and 5 years	31.80	353
Between 5 and 10 years	53.00	589
Between 10 and 20 years	33.35	371
Between 20 and 40 years	149.84	1665
Uncertain Date**	9.00	100
	298.19	**3,313**

Borrowing Update

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

The Authority currently holds £27M in commercial investments that were purchased prior to the change in the CIPFA Prudential Code. Before undertaking further additional borrowing the Authority will review the benefits of retaining these investments against cost of future borrowing.

Borrowing Strategy

10. At 31st March 2023 the Authority held £303.20M of loans, (an increase of £47.90M since 31st March 2022), as part of its strategy for funding previous and current years' capital programmes and the need to externalise borrowing as a result of falling reserves. Outstanding loans are summarised in Table 4 and 5 above.

11. The Authority'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 Authority's long-term plans change being a secondary objective.

12. We have remained under our CFR limit and had internal borrowing of £157.14M at the end of the year compared to £191.60M for 2021/22.

This strategy enabled the Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

13. The PWLB remained the Council's preferred source of long term borrowing given the transparency and control that its facilities continue to provide, however PWLB funding margins have lurched quite substantially and there remains a strong argument for diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields + 0.80%. This is kept under constant review, in consultation with our TM advisors.

14. The Council deferred long term borrowing and continued to use internal resources to finance the capital programme to minimise the cost of TM by keeping debt interest payments as low as possible without compromising the longer-term stability of the portfolio.

15. The cost of both long and short-term borrowing rose dramatically over the year, with rates at the end of March 2023 around 2% - 4% higher than those at the beginning of April 2022. Rate rises have been driven primarily by inflation and the need for central banks to control this by raising interest rates. Particularly dramatic rises were seen in September after Liz Truss' 'mini-budget' included unfunded tax cuts and additional borrowing to fund consumer energy price subsidies: over a twenty-four-hour period some PWLB rates increased to 6%. Rates have now fallen from September peaks but remain volatile and well above recent historical norms. 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%.

16. During the year 4 loans have been taken from the PWLB, shown in Table 6 below, to cover borrowing needs. Rates were monitored throughout the year and timing of loans was taken in consultation with our advisors to secure rates when rates dipped in the year. These loans provide some longer-term certainty and stability to the debt portfolio.

Table 6: New loans taken in 2022/23

Long Term Loans	Amount £M	Period (Years)	Rate %
PWLB Maturity Loan	10,000.00	25	2.94%
PWLB EIP Loan	15,000.00	15	3.93%
PWLB EIP Loan (HRA)	10,000.00	10	3.87%
PWLB EIP Loan	15,000.00	10	3.98%
Total Borrowing	**50,000.00**		

17.	This will be kept under review during 2023/24 with the need to resource an increasing capital programme, which will be reported to Council in September and February as part of the capital review. In addition, given the rising costs of materials and of borrowing, the capital programme will be kept under regular review to ensure ongoing Value for Money and the phasing of capital works reviewed to ensure capital financing budgets to accurately reflect the profile of borrowing needed. The Authority with its advisor Arlingclose will evaluate and pursue options for lower cost solutions and opportunities, together with the 'cost of carry' and breakeven analysis.
18.	A new HRA PWLB rate of gilt yield plus 0.4% (0.4% below the currently available certainty rate) was announced on 15th March 2023. This discounted rate is to support local authorities borrowing for Housing Revenue Accounts and the delivery of social housing and became available from June 2023, initially for a period of one year.
19.	The Authority's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short and long term borrowing was maintained.
<u>Lender's Option Borrower's Option Loans (LOBOs)</u>	
20.	The council continues to hold £9M of LOBO loans where the lender has the option to propose an increase in the interest rate at set dates, following which the council has the option to either accept the new rate or to repay the loan at no additional cost. All the LOBOS had options during the year, none of which were exercised by the lender, but if they were it is likely that they would be replaced.
<u>Other Debt Activity</u>	
21.	Although not classed as borrowing the Council has previously raised capital finance via Private Finance Initiative (PFI). The balance at the end of the year, after allowing for repayment in year of £3.14M is £44.38M.
22.	In addition, the Authority holds debt in relation to debt transferred from Hampshire County Council on the 1 April 1997 when we became a unitary authority, of £12.74M. This is being repaid over 50 years at £0.36M per annum.
INVESTMENT ACTIVITY	
23.	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.
24.	The Council maintained its strategy of offsetting investment and borrowing to reduce treasury costs.
25.	The council has held significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2022/23 the council's investment balances have ranged between £47.08M and £109.37M and averaged £83.79M. Movement in year is summarised in Table 7 below:

26. ***Table 7: Investment activity during the year***

	Balance on 01/04/2022 £M	Investments Repaid £M	New Investments £M	Balance on 31/03/2023 £M	(Increase)/ Decrease in Investment for Year £M	Average Life of Investments Life
Multi- National Bonds (not subject to bail in)	(1.06)	(0.05)	0.00	(1.01)	0.05	2 years
Money Market Funds and Call Account	(54.50)	(339.22)	378.13	(15.49)	39.01	on day notice
Government & Local Authority	(24.41)	(232.98)	246.33	(11.06)	13.35	1 Month
Managed Externally (CCLA Pooled funds)	(27.25)	(0.25)		(27.00)	0.25	Unspecified
Total Investments	**(107.22)**	**(572.51)**	**624.46**	**(54.56)**	**52.67**	

27. Both the CIPFA Code and government guidance require the Authority 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 Authority'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.

28. Bank Rate has 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 2022, rose by around 3.5% for overnight/7-day maturities and 3.3% for 6-12 month maturities.

By end March 2023, the rates on DMADF deposits (Debt Management Account Deposit facility) ranged between 4.05% and 4.15%. The return on the Council's sterling Low Volatility Net Asset Value (LVNAV) Money Market Funds ranged between [0.9% - 1.1% p.a.] in early April 2022 and between [4.01% and 4.18%] at the end of March 2023.

29. Security of capital has remained the council's main investment objective. This has been maintained by following the Authority's counterparty policy as set out in its TM Strategy Statement. The council has adopted a voluntary measure of its exposure to credit risk, by monitoring the average credit rating of its investment portfolio, which is supplied by our advisors. 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.

	Target	Actual
Portfolio average credit rating	A	AA+

30. Counterparty credit quality is assessed and monitored with reference to credit ratings across rating agencies Fitch, S&P and Moody's. The Authority's minimum long-term counterparty rating is A-. For financial institutions analysis is of funding structure and susceptibility to bail-in, credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. The authority also used secured investments products that provide collateral in the event that the counterparty cannot meet its obligations for repayment.

31. The table below summarises the Council's investment portfolio as at 31 March 2023 by credit rating and confirms that all investments were made in line with the

Council's approved credit rating criteria. The investment for Pooled funds includes the unrealised estimated gain of £3.89M.

Table 8: Credit ratings of Investments held at 31st March 2023

	Long Term		Short Term	
Credit Rating	**2022 £000**	**2023 £000**	**2022 £000**	**2023 £000**
AAA	1,008	1,006	52	53
AA+			0	0
AA			24,410	0
AA-			0	11,060
A+			46,750	10,080
A			7,753	5,554
A-				
Unrated local authorities	0	0		
Shares in unlisted companies	20	20		
Unrated pooled funds	30,893	25,801	253	281
Total Investments	**31,921**	**26,827**	**79,218**	**27,028**

32. **Benchmarking:** Our advisors produce quarterly benchmarking which shows the breakdown of our investments and how we compare to their other clients and other English Unitary. Details can be seen in Appendix 3. It shows that on average the return on our internal investments at 4.11% is slightly higher than the average of 3.80% and our overall income return including the Local Authority Property Fund is 3.87% compared to the average of 3.77%. This has been achieved without impacting on our average credit rating which at AA+ is higher than the average for both other Local Authorities and Unitary Authorities at A+.

It should be noted that there has been a capital loss on the Local Authority Property Fund as detailed in in paragraphs 35 to 39 below.

Liquidity Management

33. In keeping with the DLUHC's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of Money Market Funds and call accounts. There is no perceived risk that the Council will be unable to raise finance to meet its commitments. The Council also has to manage the risk that it will be exposed to replenishing a significant proportion of its borrowing at a time of unfavourable interest rates. The Council would only borrow in advance of need where there is a clear business case for doing so and will only do so for the current capital programme or to finance future debt maturities.

Externally Managed Funds

34. For long term investments, 2022 was a very difficult year - bonds had their worst year of performance in several decades; long-term government bonds had their worst year ever as central banks delivered larger interest rates hikes than initially expected and promised more to combat inflation. As policy rates rapidly rose from very low levels, bond investors suffered large crystalised or unrealised losses from rising sovereign and corporate bond yields (i.e. falling prices) as well as from widening credit spreads as concern grew over the risk of defaults in a recessionary environment. The return on the All-Gilts index was -16.3% over the 12 months to March 2023. Negative yielding bonds all but disappeared globally.

UK and global equities remained volatile against a backdrop of high and sticky inflation, rapid policy rates tightening and an increasing risk of recession. There

	was a large sell-off in global equities in April, and again in June and September for both UK and global equities. The total return on the FTSE All Share index for the 12 months ending March 2023 was 2.9% and 5.4% for the FTSE 100. The negative correlation between bonds and equities, which had featured for some years, turned positive in 2022 as both bonds and equities sold off simultaneously against an outlook of sticky inflation and high interest rates. Simultaneously, tighter financial conditions, higher bond yields and challenges in some segments of commercial real estate (e.g. offices post-COVID, high street shops and shopping centres) saw commercial property values fall during 2022, with a large fall in the final calendar quarter.
35.	The Council has invested £27M in property funds which offer the potential for enhanced returns over the longer term but will be more volatile in the shorter term. These funds are managed by professional fund managers which allows the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments.
36.	The change in the Authority's funds' capital values and income earned over the 12-month period is shown in Table 9 below.

Table 9 – Property Fund Performance 2022/23

Quarter Ending	Valuation £M	Movement since Reported in SOA	Divide £M
1st April	30.89		
30th June	32.51	1.61	0.26
30th September	31.13	0.23	0.30
31st December	26.31	(4.58)	0.28
31st March	25.80	(5.09)	0.28
Total			1.12

37.	The market value has decreased further since last reported in December, £26.31M and at March 2023 had a value of £25.80M. This is a decrease of £5.09M since the March 2022 value of £30.89M and is now £1.2M below the initial investment of £27M, so market conditions have proved volatile. The dividend for the year was £1.12M, 4.14% against the original investment. This is higher than 2022/23 (£1.02M 3.78%). The market value of the investment has improved slightly from year end and at May 2023 was £25.88M, an increase of £0.08M since end of year.
38.	Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority'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 long-term and the Authority's latest cash flow forecasts, investment in these funds has been maintained.
39.	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.
Non – Treasury Investments	
40.	The definition of investments in CIPFA's revised 2021 Treasury Management Code covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e., management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).
41.	Investment Guidance issued by the DLUHCalso broadens the definition of investments to include all such assets held partially or wholly for financial return.
42.	Between 2016 and 2017, SCC implemented a strategy to invest in commercial properties with the expected return on investment being used to fund council services, known as the Property investment fund (PIF). To date the authority has purchased 3 properties.
43.	The rate of return on investment in 2022/23 before borrowing costs and other on-costs was 5.74%. Borrowing costs of 3.90% were incurred giving a net rate of return of 1.84%.
44.	All of the properties remain fully let and the tenants are meeting their financial obligations under the leases (although one tenant has vacated the premises but continues to honour the lease) and there are currently no concerns regarding the properties that have currently fallen in value below the debt outstanding on it (by £2.82M) due to the current financial environment and market conditions. Details of the properties purchased are shown in table 10 below. Any loss on investment would only be incurred should the council sell its investments.
45.	**Table 10: Property Investment Fund**

Property	Actual	31.03.2022 Actual		31.03.2023 Actual		Outstanding Debt 31.03.2023
	Purchase Cost £M	Value in Accounts	Gain or (Loss) in Year	Value in Accounts	Gain or (Loss) in Year	£M
Property 1	6.47	4.88	(0.33)	4.79	(0.09)	5.81
Property 2	14.69	11.64	1.32	10.61	(1.03)	13.18
Property 3	8.53	9.16	0.43	8.42	(0.74)	7.65
	29.69	25.68	1.42	23.82	(1.86)	26.64