ITEM 15

REPORT TO: **WEST OF ENGLAND COMBINED AUTHORITY COMMITTEE**

DATE: **16 JUNE 2023**

REPORT TITLE: **TREASURY MANAGEMENT OUTTURN REPORT 2022/23**

DIRECTOR: **STEPHEN FITZGERALD, INTERIM DIRECTOR OF INVESTMENT AND CORPORATE SERVICES (S73 OFFICER)**

AUTHOR: **STEVE FINNEGAN, FINANCIAL ACCOUNTANT**

Purpose of Report

1 The Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services: Code of Practice requires the Authority to approve a Treasury Management Strategy before the start of each financial year, review performance during the year, and approve an annual report after the end of each financial year. This report provides a review of performance to 31 March 2023.

Recommendations

The West of England Combined Authority Committee is required to:

1. Notes the Treasury Management Outturn Report to 31st March 2023, prepared in accordance with the CIPFA Treasury Code of Practice and the Treasury Management Indicators to 31st March 2023.
2. Approve the allocation of £475k (25% of budget surplus) to the Treasury Management reserve, as set out in paragraph 2.16

Voting Arrangements:

1 For noting purposes.

2 Decision requires majority agreement of Committee Members in attendance, or their substitutes (one vote representing each Authority) and including the West of England Combined Authority Metro Mayor

Background / Issues for Consideration

2 The CIPFA Code of Practice requires that the West of England Combined Authority Committee considers the treasury management outturn report after the end of each financial year.

Summary

2.1 The average rate of investment return for 2022/23 was 1.46%, which is 0.05% above the 2022 average SONIA (Sterling Overnight Index Average) benchmark rate.

2.2 The Authority's Prudential Indicators for 2022/23 were agreed by the Authority at its meeting on 28th January 2022 and performance against the key indicators is shown in **Appendix 1**. All indicators are within target levels.

Summary of Returns

2.3 The Authority's investment position as at 31st March 2023 is detailed in **Appendix 2**. This shows a change in Investment Balances to £354.84m at 31st March 2022 from £401m at 30th October 2022, which reflects a net decrease.

2.4 The Authority is the Accountable Body for the West of England Revolving Investment Fund, (RIF). The balance as at 31st March 2023 was £16.1m and this sum, prior to distribution, is being invested in line with the Authority's Treasury Management Strategy, with the interest earmarked to the RIF.

2.5 Gross interest earned on all investments for April 2022 to March 2023 was £3,738k. Interest earned for RIF is ringfenced to those funds, giving rise to an income outturn for the West of England Combined Authority activities of £3,655k v £1.600k budget, a favourable variance of £2.055k.

Summary of Borrowings

2.6 The Authority does not currently have any underlying need to borrow long term to fund capital expenditure. As part of its approach to liquidity management, the Authority may borrow short term loans to cover any unplanned cash flow shortages as they arrive. As at 31st March 2023 the Authority held £25m of short-term loans, as summarised in **Appendix 3.**

Strategic & Tactical Decisions

2.7 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. The approach, given these are public funds is minimising risk first with return as the second consideration.

2.8 As shown in the charts at **Appendix 2**, the investment portfolio has been diversified across UK Banks and Local Authorities, which totalled £289.9m. The Authority also uses AAA rated Money Market funds (MMF) to maintain very short-term liquidity with £3.9m invested in Money Market Funds as at 31st March 2023. 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, rose by around 3.5% for overnight/7-day maturities and 3.3% for 6–12-month maturities. The return on the Authority's Money Market Funds ranged between 0.9% - 1.1% p.a. in early April and between 3.8% and 3.9% at the end of March.

2.9 The Authority has added a further £5m to the pooled fund's portfolio with an investment to the Fundamentum Real Estate Investment Trust. The Authority retains units invested in the CCLA Property Fund of £9.9m, Investec £10m, Kames £10m, Royal London £10m, M & G £3.5m and Columbia Threadneedle £3.5m. The Authority has a total of £52m invested across the funds. These investments seek to enhance yields, provide diversification and are intended to be held for higher returns over a long period of time.

2.10 For fixed income bond investors, 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. These investments are made in the knowledge that capital values will move both up and down on months and quarters, but with the confidence that over a three to five-year period, total returns will exceed interest rates. They provide regular revenue income and in 2021-22 provided an average total return of 3.66%. Considering their performance over the medium-long term, investment in these funds has been maintained.

2.11 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 medium- to long-term investment objectives are regularly reviewed. These investments are made in the knowledge that capital values will move both up and down on months and quarters, but with the confidence that over a three to five-year period, total returns will exceed interest rates. They provide regular revenue income and in 2021-22 provided an average total return of 3.66%. In light of their performance over the medium-long term, investment in these funds has been maintained. The change in the Authority's funds capital values and income earned over the 12-month period is shown in **Appendix 2**.

2.12 Environmental, Social and Governance (ESG) and responsible investing has gained further momentum in 2022. Investors in physical and financial assets are increasingly being expected to be on the frontline of combating climate change and committing to sustainability goals. In its recent consultation on the Treasury Management Code of Practice, CIPFA has proposed a new Treasury Management Practice on ESG Risk Management. The Authority will continue to work with its treasury advisors Arlingclose for support and advice through its ESG, and responsible investment service.

Future Strategic & Tactical Issues

2.13 The Authority's treasury management advisors have provided an economic and market review for 2022/23 – attached at **Appendix 4**.

2.14 Following the increase in Bank rates during 2022-23, the Authority will expect to receive higher income (4% - 4.5% from its cash and short-dated investments, including money market funds in 2023/24).

2.15 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.

2.16 Where investment has exceeded budget, the Authority is recommending a £475k (25% of the budget surplus from revenue savings) to be allocated to the earmarked treasury management reserve which will help manage the risk of future volatility and fair value movements. This reserve was £1.1m on 31st March 2022.

Other Options Considered

3 None.

Risk Management/Assessment

4 The Authority's lending & borrowing list is regularly reviewed, and credit ratings are

monitored throughout the year. All lending/borrowing transactions are within approved limits, with approved institutions. Investment and Borrowing advice is provided by our Treasury Management consultants Arlingclose.

The CIPFA Treasury Management in the Public Services: Code of Practice requires the Authority nominate a committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies. The West of England Combined Authority Audit Committee carries out this role.

Public Sector Equality Duties

5 The public sector equality duty created under the Equality Act 2010 means that public authorities must have due regard to the need to:

- Eliminate unlawful discrimination, harassment and victimization and other conduct prohibited by the Act.
- Advance equality of opportunity between people who share a protected characteristic and those who do not.
- Foster good relations between people who share a protected characteristic and those who do not.

5.1 The Act explains that having due regard for advancing equality involves:

- Removing or minimising disadvantages suffered by people due to their protected characteristics.
- Taking steps to meet the needs of people from protected groups where these are different from the needs of other people.
- Encouraging people from protected groups to participate in public life or in other activities where their participation is disproportionately low.

5.2 The general equality duty therefore requires organisations to consider how they could positively contribute to the advancement of equality and good relations. It requires equality considerations to be reflected in the design of policies and the delivery of services, including policies, and for these issues to be kept under review.

Climate Change Implications

6 The climate implications are contained within the body of the report - reference section 2.12.

Advice given by: Roger Hoare, Head of Environment

Finance Implications, including economic impact assessment where appropriate:

7 A breakdown of the revenue budget that was set for interest income and the year-end outturn position is included in **Appendix 5**. The budget for 2022-23 investment income was £1.6m and following the Authority's successful treasury strategy and investment decisions, have achieved an outturn position of £3.65m which is a positive variance of £2.05m. This surplus can be utilised in the support of the Authority's priorities on delivering for the region.

Advice given by: Stephen Fitzgerald, Interim Director of Investment & Corporate

Services

Legal Implications:

8 The Prudential Code and CIPFA's Code of Practice on Treasury Management requires regular monitoring and reporting of Treasury Management activities.

Advice given by: Stephen Gerrard, Interim Director of Law and Governance

Appendices & Background papers:

Appendix 1 – Performance Against Prudential Indicators
Appendix 2 – The Authority's Investment Position at 31 March 2023
Appendix 3 – The Authority's External Borrowing Position at 31 March 2023
Appendix 4 – Arlingclose's Economic & Market Review for 2022/23
Appendix 5 – Interest & Capital Financing Budget Monitoring 2022/23
Appendix 6 – Summary Guide to Credit Ratings

Background Papers: Treasury Management Strategy Statement & Investment Strategy 2022/23 – As reported to West of England Combined Authority Committee on 28th January 2022.

APPENDIX 1

Performance against Treasury Management Indicators (as approved in the Treasury Management Strategy Statement)

The Authority measures and manages its exposure to treasury management risks using the following indicators.

1. Security

The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

Credit risk indicator	Target	Actual
Minimum portfolio average credit rating	A-	A+

2. Liquidity

The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount it can borrow each quarter without giving prior notice.

Liquidity risk indicator	Target	Actual
Total sum borrowed in past 3 months without prior notice	£30m	£25m

3. Interest Rate Exposure

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

Interest rate risk indicator	Limit	Actual
Upper limit on one-year revenue impact of a 1% fall in interest rates	£1m	£1m

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

4. Principal sums invested for periods longer than a year:

The purpose of this indicator is to control the Authority'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 will be:

Price risk indicator	2022/23 Target	2022/23 Actual	2023/24 Target	2023/24 Actual	2024/25 Target	2024/25 Actual	+3 Years Target	+3 Years Actual
Limit on principal invested beyond 364 days as % of total cash balance	50%	21%	30%	18%	20%	17%	20%	13%

APPENDIX 2

The Authority's Investment position as at 31st March 2023

Table: 1 Investments by Type

	31-Mar-23 Actual Portfolio £m	31-Mar-23 Average Rate %
Treasury investments by type:		
Banks & building societies (unsecured)	16.9	1.56
Covered bonds & repo (secured)	0	0
Government (incl. local authorities)	272.0	0.79
Registered Providers	10.0	1.25
Money Market Funds	3.9	3.86
Social Housing Real Estate Investment Trust	5.00	2.56
Other pooled funds:		
CCLA Property Fund	10.0	3.70
Investec	10.0	3.69
Kames	10.0	5.05
Threadneedle	3.5	3.20
M & G	3.5	4.92
Royal London Enhanced Cash Plus Fund	10.0	1.65
Total treasury investments	354.8	1.46

Table: 2 Term of investments

	Balance at 31st March 2023 £000s
Notice (instant access funds)	**10,700**
Up to 1 month	**44,000**
1 month to 3 months	**109,187**
4 to 6 months	**60,000**
6 to 12 months	**60,000**
More than 12 months	**19,000**
Pooled Funds *	**51,957**
Total	**354,844**

The Authority had a total average net positive balance of £340m during the period April 2022 to March 2023

* Notice period 4 days except property fund which is 90 days

Table 3: Pooled Funds

Fund Name	Asset Class	Purchase Value £000s	Fair Value as at 31/3/23 £000s	Capital Growth/(Loss) £000s	Income Return One Year	Income Return Since Purchase
CCLA Property Fund	Property	9,956	9,043	-913	3.70%	20.81%
Ninety One Diversified Income Fund (Investec)	Multi Asset	10,000	9,039	-961	3.69%	12.30%
Aegon Diversified Monthly Income Fund (Kames)	Multi Asset	10,000	8,505	-1,495	5.05%	13.25%
Threadneedle Strategic Bond Fund	Bond	3,500	2,974	-526	3.20%	5.32%
M&G UK Income Distribution Fund	Equity - UK	3,500	3,509	9	4.92%	10.48%
Royal London Short Term Enhanced Cash Fund	Cash Plus	10,000	9,854	-146	1.65%	1.09%
Fundamentum Social Housing REIT	Property	5,000	4,700	-300	2.56%	2.56%
		51,956	47,624	-4,332	3.97%	12.65%

Chart 1 : CA Investments by Funding Source (£354.84m) at 31st March 2023

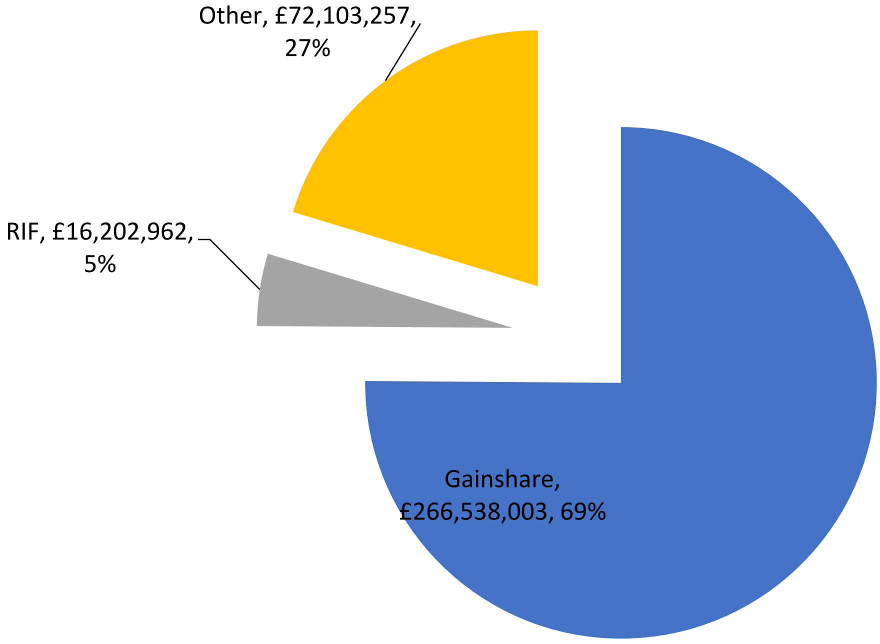


Chart 2 : CA Investments by Funding Source (£401.14m) at 31st October 2022

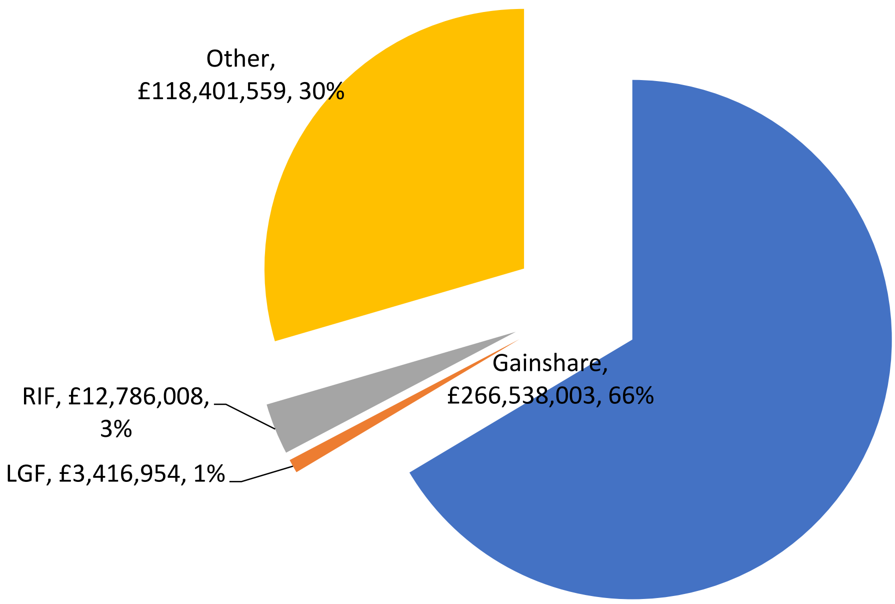


Chart 3: CA Investments per lowest equivalent Long Term credit rating (£354.84m) at 31st March 2023

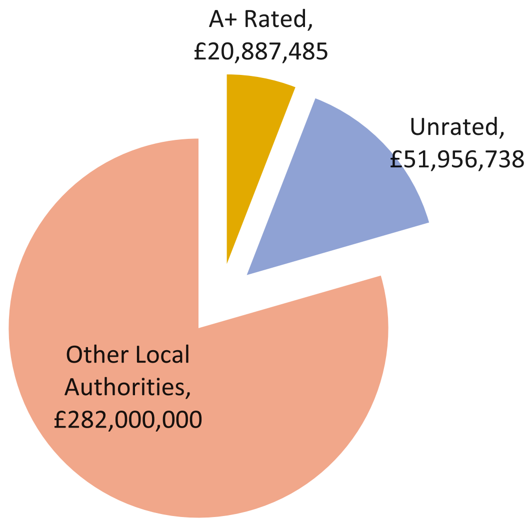
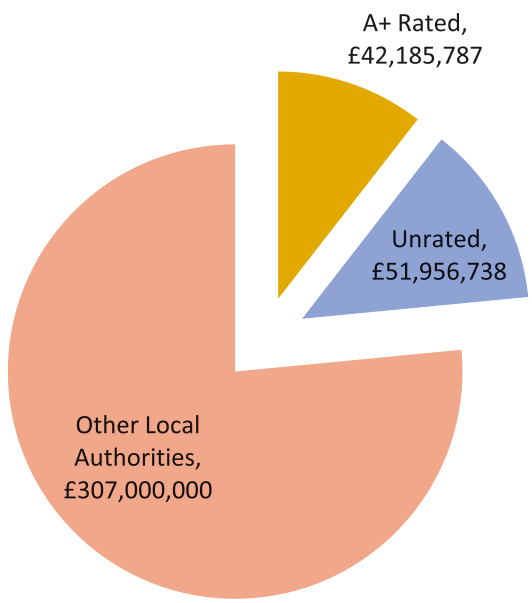


Chart 4: CA Investments per lowest equivalent Long Term credit rating (£401.14m) at 31st October 2022



Unrated investments are the Pooled Funds

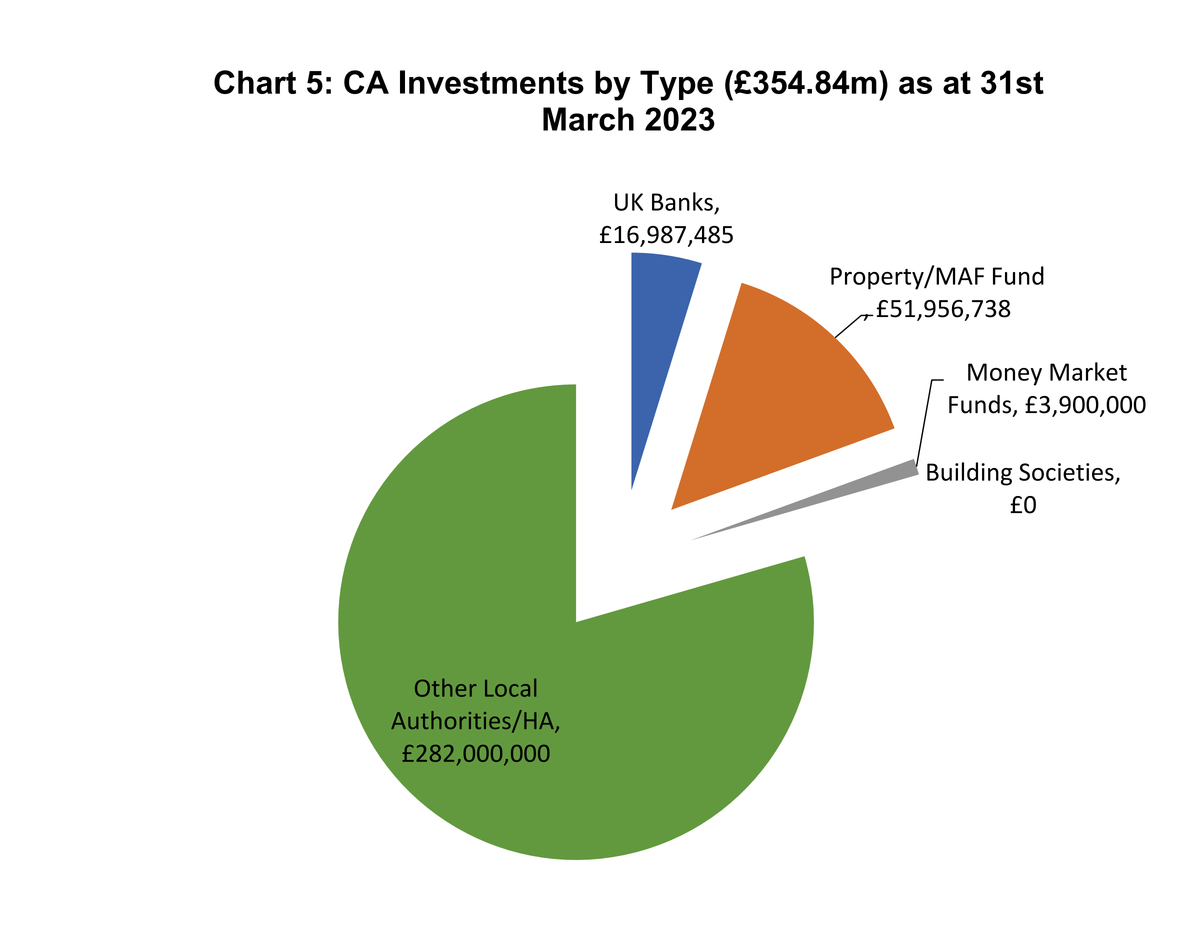


Chart 5: CA Investments by Type (£354.84m) as at 31st March 2023
UK Banks, £16,987,485
Property/MAF Fund £51,956,738
Money Market Funds, £3,900,000
Building Societies, £0
Other Local Authorities/HA, £282,000,000

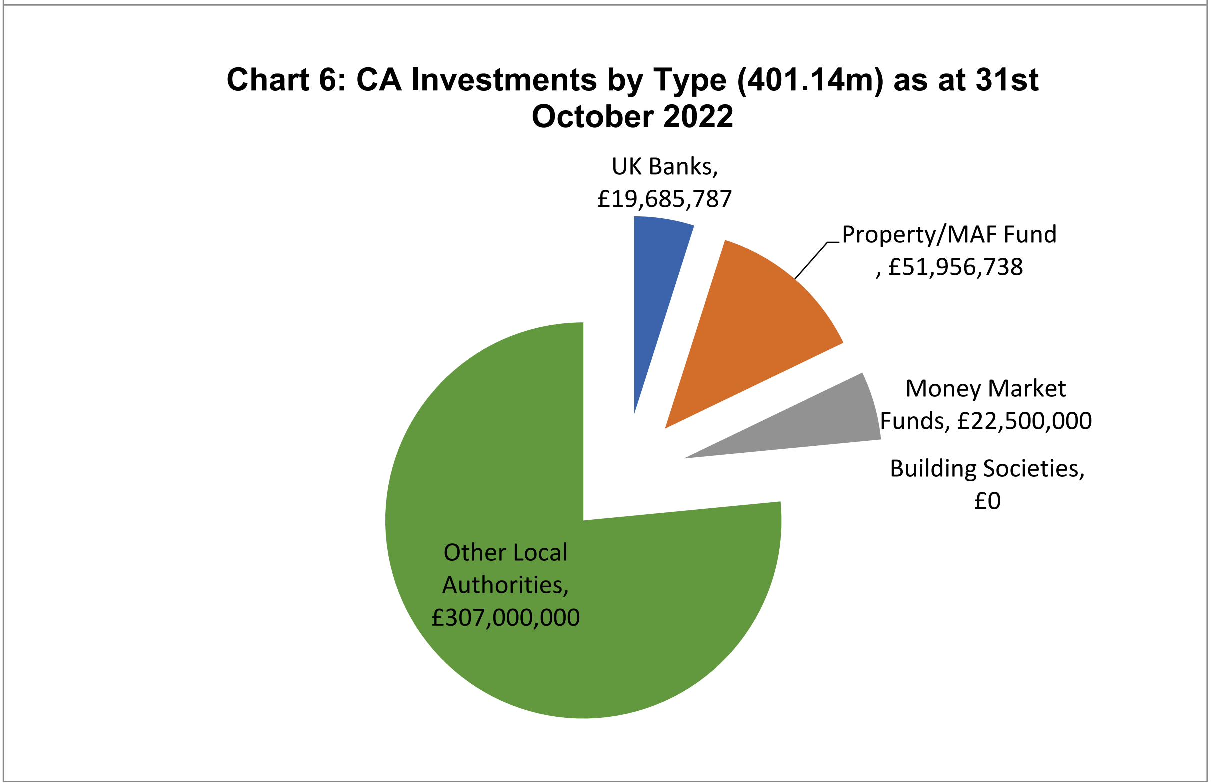


Chart 6: CA Investments by Type (401.14m) as at 31st October 2022
UK Banks, £19,685,787
Property/MAF Fund , £51,956,738
Money Market Funds, £22,500,000
Building Societies, £0
Other Local Authorities, £307,000,000

APPENDIX 3

Authorities External Borrowing at 31st March 2023

	Balance at 31st March 2023 £000s
Public Works Loan Board	**0**
Banks (LOBO)	**0**
Banks (Fixed Term)	**0**
Local Authorities (Long Term)	**0**
Local Authorities (Short Term)	**25,000**
Total	**25,000**

As part of its approach to liquidity management, the Authority may borrow short term loans to cover any unplanned cash flow shortages as they arrive

APPENDIX 4

Economic and Market Review for 2022/23

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

APPENDIX 5

Interest & Capital Financing Costs – Outturn Position for 2022/23

April 2022 to March 2023	Year End Position Budgeted Income £'000	 Outturn Income £'000	 Outturn over or under spend £'000	Adv/Fav
Interest & Capital Financing				
- Debit Costs (Borrowing)	0	(154)	(154)	Adv
- Interest on Balances				
West of England Combined Authority	1,600	3,655	2,055	Fav
Revolving Infrastructure Fund (RIF)	0	83	83	Fav
Total - Interest & Capital Financing	**1,600**	**3,892**	**2,292**	**Fav**

APPENDIX 6

Summary Guide to Credit Ratings

Rating	Details
AAA	Highest credit quality – lowest expectation of default, which is unlikely to be adversely affected by foreseeable events.
AA	Very high credit quality - expectation of very low default risk, which is not likely to be significantly vulnerable to foreseeable events.
A	High credit quality - expectations of low default risk which may be more vulnerable to adverse business or economic conditions than is the case for higher ratings.
BBB	Good credit quality - expectations of default risk are currently low but adverse business or economic conditions are more likely to impair this capacity.
BB	Speculative - indicates an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time.
B	Highly speculative - indicates that material default risk is present, but a limited margin of safety remains. Capacity for continued payment is vulnerable to deterioration in the business and economic environment.
CCC	Substantial credit risk - default is a real possibility.
CC	Very high levels of credit risk - default of some kind appears probable.
C	Exceptionally high levels of credit risk - default is imminent or inevitable.
RD	Restricted default - indicates an issuer that has experienced payment default on a bond, loan or other material financial obligation but which has not entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, and which has not otherwise ceased operating.
D	Default - indicate san issuer that has entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, or which has otherwise ceased business.