Committee: Cabinet

Date: 19 June 2023

Wards: All

Subject: London Borough of Merton Treasury Management Strategy Annual Review 2022/23

Lead officer: Roger Kershaw - Finance and Digital

Lead member: Councillor Billy Christie – Corporate Services Lead

Contact officer: Nemashe Sivayogan. - Head of Treasury and Pensions

Recommendations:

A. This is an update on the Merton Treasury management activity during 2022-23 and details any difference in activity from the Treasury management strategy approved in March 2022.

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1 PURPOSE OF REPORT AND EXECUTIVE SUMMARY

1.1. The Council undertakes Treasury Management Activities in accordance with the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management, which requires that the Council receives an annual strategy report by 31 March for the year ahead and an annual review report of the previous year by 30 September. This report is the review of Treasury Management annual activities during 2022/23.

2 DETAILS

2.1 The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2022/23. 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 minimum reporting requirements were that the full Council should receive the following reports:

- an annual Treasury strategy in advance of the year (Council March 2022)
- a mid-year (minimum) treasury update report to the Council- November 2022.
- an annual review following the end of the year describing the activity compared to the strategy (this report)

- plus- monthly Treasury management activity update for the S151/ Deputy S151 officer

2.2 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, 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.

2.3 THE COUNCIL'S CAPITAL EXPENDITURE AND FINANCING

2.3.1 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 internal resources, the capital expenditure will give rise to a borrowing need.

2.3.2 The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

	2022/23 Actual £'000	2023/24 Estimate £'000	2024/25 Estimate £'000
Capital expenditure.	23,892	43,873	41,564
Financed in Year	5,913	10,441	22,729
Unfinanced Capital Expenditure	17,979	33,432	18,835

2.4 THE COUNCIL'S OVERALL BORROWING NEED

2.4.1 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). As at 31 March 2023 the council was 19% under borrowed. This will be higher now after the Council has paid off a significant amount of PWLB loans in April 2023.

2.4.2 **Gross borrowing and the CFR** – in order to ensure that borrowing levels are prudent over the medium term and is only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2021/22), plus the estimates of any additional capital financing requirement for the current (2022/23) and next two financial years. This essentially means that the council is not borrowing to support revenue expenditure.

Capital Financing Requirement(CFR)	2022/23 Actual £'000	2023/24 Estimate £'000	2024/25 Estimate £'000
Total CFR	160,290	165,120	187,144

2.4.3 **The authorised limit –** this is the "affordable borrowing limit" required by S3 of the Local Government Act 2003. Once this has been set, the council does not have the power to borrow above this level. The table below demonstrates that during 2022/23 the Council has maintained gross borrowing within its authorised limit.

2.4.4 **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 are acceptable subject to the authorised limit not being breached.

2.5 THE COUNCIL'S OVERALL TREASURY POSITION AS AT 31 MARCH 2023

2.5.1 At the beginning and the end of 2022/23 the Council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

	Balance as at 31 March 2022	Balance as at 31 March 2023
CFR including PFI & lease	167,460	171,044
CFR excluding PFI & lease	138,653	145,019
External Borrowing	109,010	108,700
Over/Under Borrowing	(28,807)	(36,009)

		Investment		Debt	
		31-Mar-22	31-Mar-23	31-Mar-22	31-Mar-23
Average interest Rate		0.64%	4.17%	5.54%	5.84%
Average period		179 days	207 days	32 Yrs	36 Yrs
Total interest		£0.53m	£4.8m	£6.1m	£6.1m
Balance as at 31 March	Fixed Deposits/loan	£70m	£136.8m	£109m	£108.7m
Balance as at 31 March	MMFs	£50m	£180m	n/a	n/a

2.5.2 In 2022-23 interest rates increased significantly, especially from December 2021 with the Bank of England increasing the base rate on a regular basis.
On the 5th January 2023 London Borough of Merton sold its subsidiary company, CHAS 2013 Ltd. The sales proceeds were placed in Money Market Funds and the DMO in the short term.
This is the reason for the large increase in cash balances and deposit interest income. In the new financial year, it is proposed to invest the CHAS sales proceeds into long-term bonds to secure a stable long-term return.

2.5.3 With the reasons explained in point 2.5.2 in 2022-23 the investment income generated from the treasury investments was £4,812m. Although a temporary measure the figure is significantly higher than the budgeted figure.

2.5.4 As rates have increased over the last year the Council has been more active in making deposits given the extra cash while still making prudent decisions and always referring to our Treasury Advisors recommended counterparty list. Diversification has been achieved by placing money with the DMO and utilizing our Treasury Advisors own investment portal, Agency Treasury Services (ATS) to place funds with new counterparties.

2.5.5 The Council approved the opening of two more Money Market Funds in December 2022 and January 2023 bringing the total to 7 and this provided the opportunity to spread our cash balance investments and still maintain liquidity.

2.5.6 In general the Council's uses external borrowing to fund its long-term capital expenditure. Members will note Merton has not taken on any new borrowing since 2007. The debt portfolio was £108.7m as at 31 March 2023 after a PWLB loan of £310k matured during in the year.

2.5.7 In April 2023 the council decided to pay off all its long terms PWLB debts from the one off capital receipt received in Jan 2023. The Council could not pay off the LOBO loans but was able to settle the PWLB loans. Out of £51.7m PWLB loans £38m was paid off in April with the remaining PWLB loans maturing at the end of 2023/24. This cost £41.3m in total with accrued interest and early repayment premium.

2.5.8 The remaining £13.7m will mature on the 31 March 2024. With the redemption of these loans the Council's debt portfolio will be reduced to £57m. This will result in an annual loan interest saving and saving from MRP provision going forward.

Maturity structure of the debt portfolio.	March 2023 £'000	2022/23 %	April 2023 £000	30 April 2023 %
Under 12 months	13,700	12.6	13,700	19.38
12 months and within 24	12,500	11.5	0	
24 months and within 5 years	4,500	4.14	4,500	6.36
5 years and within 10 years	1,000	0.92	0	
10 years and within 15 years	11,500	10.58	9,000	12.73
15 years and over	65,500	60.26	43,500	61.53
Total Debt	**108,700**	**100**	**70,700**	**100**

2.6 BORROWING OUTTURN FOR 2022/23

2.6.1 An analysis of movements at nominal values on loans during the year is shown below:

	Balance at	Loans raised	Loans repaid	Balance at	Repaid in 2023/24	Balance at
	March 2022			March 2023		April 2023
	£000's	£000's	£000's	£'000	£'000	£000's
PWLB	52,010		(310)	51,700	(38,000)	13,700
Other loans	57,000	-				57,000
Total Debt	**109,010**		**310**		**(38,000)**	**70,700**

2.6.2 The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

2.7 INVESTMENT OUTTURN FOR 2022/23

2.7.1 The Council's investment policy is governed by DLUHC guidance, which was been implemented in the annual investment strategy approved by the Council on the 03 March 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 additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

2.7.2 The Council manages its investments in-house (with advice from Link Asset Services) with the overall objective to balance risk with return and the overriding consideration being given to the security of the available funds.

2.7.3 The investment activity during the year confirmed to the approved strategy, and the Council had no liquidity difficulties.

2.7.4 the table below shoes the investment breakdown and the movement in 2022/23

	Investment at 31/03/22 £000's	Amount Invested in year £000's	Investments realised in year £000's	Balance at 31/03/23 £000's
Fixed Rate Investments	60,000	192,575	(125,756)	126,819
Money Market Fund	50,000	165,000	(35,000)	180,000
CCLA Investment	10,000			10,000
Total Investments	120,000	357,575	(160,756)	316,819

Please note- £41.3m of the above balance was used pay off the PWLB loans on the 06 April 2023

2.7.5 The table below gives details of the fixed deposits made in year and MMFs.

Counterparty	Start	Matured	Principal
CLOSE BROTHERS	28/09/2020	29/12/2023	5,000,000.00
CLOSE BROTHERS	26/03/2021	28/09/2023	5,000,000.00
DMADF	13/03/2023	12/04/2023	21,818,863.26
DMADF	27/03/2023	03/04/2023	25,000,000.00
GOLDMAN SACHS	29/01/2021	01/08/2023	5,000,000.00
GOLDMAN SACHS	26/02/2021	29/08/2023	5,000,000.00
GOLDMAN SACHS	06/01/2023	06/07/2023	10,000,000.00
N&AN	10/11/2021	10/05/2023	5,000,000.00
NATWEST	20/01/2021	22/01/2024	5,000,000.00
NATWEST	26/01/2022	26/01/2024	5,000,000.00
NATWEST	06/05/2022	09/05/2023	5,000,000.00
NATWEST	04/11/2022	04/08/2023	5,000,000.00
NATWEST	11/11/2022	10/11/2023	5,000,000.00
SANTANDER	06/01/2023	06/07/2023	10,000,000.00
STANDARD CHARTERED	24/11/2022	24/05/2023	5,000,000.00
STANDARD CHARTERED	25/11/2022	24/08/2023	5,000,000.00

3.0 MARKET UPDTE/FORECAST

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, EZ and US 10-year yields all rising by over 200bps in 2022. The table below provides a snapshot of the conundrum facing central banks: inflation is elevated but labour markets are extra-ordinarily tight, making it an issue of fine judgment as to how far monetary policy needs to tighten.

	UK	Eurozone	US
Bank Rate	4.50%	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 GDP deliver growth of +0.1% q/q, 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% q/q. Most recently, January saw a 0.3% m/m 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% q/q 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.

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 MPC will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food (up 18.3% y/y 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 17th of 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, EZ 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 ILO 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.
The Link Group's economic analysts, Capital Economics, expect real GDP to contract by around 0.2% q/q 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 FTSE 100 started 2023 strongly, rising to a record high of 8,014 on 20th February, 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 20th February, 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.

USA. The flurry of comments from Fed officials over recent months suggest there is still an underlying hawkish theme to their outlook for interest rates. Markets are pricing in a further interest rate increases of 25-50bps, on top of the current interest rate range of 4.75% - 5%.
In addition, the Fed is expected to continue to run down its balance sheet once the on-going concerns about some elements of niche banking provision are in the rear-view mirror.
As for inflation, it is currently at c6% but with the economy expected to weaken during 2023, and wage data already falling back, there is the prospect that should the economy slide into a recession of any kind there will be scope for rates to be cut at the backend of 2023 or shortly after.

EU. Although the Euro-zone inflation rate has fallen below 7%, the ECB will still be mindful that it has further work to do to dampen inflation expectations and it seems destined to raise rates to 4% in order to do so. Like the UK, growth has remained more robust than anticipated but a recession in 2023 is still seen as likely by most commentators.

3 ALTERNATIVE OPTIONS

3.1. N/A

4 CONSULTATION UNDERTAKEN OR PROPOSED

4.1. Treasury consultants- LINK Asset Management

5 TIMETABLE

5.1. none

6 FINANCIAL, RESOURCE AND PROPERTY IMPLICATIONS

6.1. Covered in the report

7 LEGAL AND STATUTORY IMPLICATIONS

7.1. none

8 HUMAN RIGHTS, EQUALITIES AND COMMUNITY COHESION IMPLICATIONS

8.1. none

9 CRIME AND DISORDER IMPLICATIONS

9.1. none

10 RISK MANAGEMENT AND HEALTH AND SAFETY IMPLICATIONS

10.1. none

11 APPENDICES – THE FOLLOWING DOCUMENTS ARE TO BE PUBLISHED WITH THIS REPORT AND FORM PART OF THE REPORT

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12 BACKGROUND PAPERS

12.1. Statement of accounts

12.2. The Treasury Management Strategy

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