Report to Audit Committee

12 July 2023
By the Director of Resources
INFORMATION REPORT

Not exempt

Treasury Management Activity and Prudential Indicators 2022/23

Executive Summary

This report covers treasury activity and prudential indicators for 2022/23. At 31 March 2023, the Council's investments totalled £75.0m (£83.3m 2021/22) with no external debt.

During 2022/23, the Council's cash balances were invested in accordance with the Council's treasury management strategy and its associated indicators apart from one indicator where the actual interest rate sensitivity exceeded the estimate and two instances where the Council's operational bank account exceeded the single bank limit. These instances have previously been reported to this Committee.

Interest of £2.285m (£0.942m in 2021/22) was earned on investments, an average return of 2.6% (1.2% in 2021/22). This was £1.320m over the budget of £0.965m. Investment property income was £3.74m (£3.47m 2021/22), in line with the estimate in the strategy.

Investment income from treasury operations has been stronger than expected as interest rates climbed throughout the year. Income from investment properties has largely recovered from the pandemic lows.

Recommendations

The Committee is recommended to:

i) Note the Treasury Management stewardship report for 2022/23.
ii) Note the actual prudential indicators for 2022/23.

Reasons for Recommendations

i) The annual treasury report is a requirement of the Council's reporting procedures.
ii) This report also covers the actual Prudential Indicators for 2022/23 in accordance with the requirements of the relevant CIPFA Codes of Practice.

Background Papers

"Capital Strategy 2022/23 incorporating Investment and Treasury Management Strategy" - Audit Committee 1 December 2021
"Budget for 2022/23" - Cabinet 27 January 2022; Council 9 February 2022
"Treasury Management and Prudential Indicators mid-year report 2022/23" Audit Committee 7 December 2022
Consultation: Arlingclose Ltd – the Council's Treasury Management advisers
Wards affected: All
Contact: Julian Olszowka, Group Accountant (Technical), 01403 215310

Background Information

1 Introduction

1.1 This report covers treasury management activity and prudential indicators for 2022/23. It meets the requirements of the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003.

1.2 In line with the CIPFA Codes, the Council adopts prudential indicators for each financial year and reports on performance relative to those indicators. This requirement is designed to demonstrate that capital spending is prudent, affordable and sustainable and that treasury management decisions are taken in accordance with good professional practices. This report compares the approved indicators with the outturn position for 2022/23. Actual figures have been taken from or prepared on a basis consistent with the Council's Statement of Accounts. It should be noted that those statements are not yet signed off by the auditor.

1.3 The original prudential indicators for 2022/23, together with a Capital Strategy and Treasury Management Strategy 2022/23, were agreed by Council on 9 February 2022 having been approved by this Committee on 1 December 2021.

1.4 These indicators were the first incorporating a revision to the Prudential Code for Capital Finance and Treasury Management Code published by CIPFA on 20 December 2021.

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

2.1 This is one of the required prudential indicators and shows total capital expenditure for the year and how this was financed. The estimates include revisions to the original indicators approved by the Council on 9 February 2022 as a part of the budget report.

2022/23	Actual £m	Estimate £m	Variance £m
Services capital expenditure*	4.7	5.5	(0.8)
Capital Investments*	0.5	0.6	(0.1)
Resourced by:			
External resources	2.7	2.4	0.3
Internal Resources	2.5	3.7	(1.2)
Debt (unfinanced capital spend)	0.0	0.0	0.0
Total financing	**5.2**	**6.1**	(0.9)

*Capital expenditure here differs from capital outturn report by capitalised salaries

2.2 The services capital spend in 2022/23 was slightly under the budget as revised in the 2023/24 budget report. The capital investments, which covers the Housing Subsidiary loans and equity was slightly below estimate.

3 The Council's Overall Borrowing Need

3.1 The Council's underlying need to borrow is termed the Capital Financing Requirement (CFR). It represents the accumulated net capital expenditure which has not been financed by revenue or other resources. Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources.

3.2 The Council is required to make an annual revenue charge, the Minimum Revenue Provision (MRP), to reduce the CFR – effectively a repayment of the borrowing need. The Council's 2022/23 MRP Policy, as required by the Department for Levelling Up, Housing and Communities (DLUHC) Guidance, was approved on 9 February 2022 as a part of the 2022/23 Budget report.

3.3 The Council's CFR for the year is shown below, and represents a key prudential indicator because it is a measure of the Council's underlying indebtedness. As there was no additional unfinanced expenditure the only movement in the CFR is its reduction by the Minimum Revenue Provision.

Capital Financing Requirement	Actual £m	Estimate £m	Variance £m
Opening balance 1 April 2022	33.6	33.6	0.0
Debt/unfinanced capital expenditure	0.0	0.0	0.0
less Minimum Revenue Provision	(0.9)	(0.9)	0.0
Closing balance 31 March 2023	**32.7**	**32.7**	**0.0**

4 Treasury Position at 31 March 2023

4.1 Whilst the Council's gauge of its underlying need to borrow is the CFR, the Director of Resources can manage the Council's actual borrowing position by either borrowing to the level of the CFR or choosing to utilise other available funds instead, sometimes termed under-borrowing. The Council is under-borrowed as it has no external debt.

4.2 Although the Council is under-borrowed relative to its CFR, it also holds investments and the summary treasury position on the 31 March 2023 compared with the previous year is shown below. This is a snapshot of investments on the date and the rates will not necessarily be equal to the whole year average figures.

Treasury position	31 March 2023		31 March 2022	
	Principal £m	Average Rate	Principal £m	Average Rate
Fixed Interest Rate Debt	-	-	-	-
Investments	75.0	3.4%	83.3	1.5%

4.3 Returns for shorter term cash has increased markedly as inflation surged and central banks reacted with rate rises. This has resulted in income greatly exceeding the budget.

4.4 The Council's cash levels were down on last year as some of the various unused Covid-19 related grants were repaid but still remained close to historically high levels.

4.5 The increasing rates meant the budget, which was set when interest rates had not started their rise, was exceeded by £1.3m.

5 Prudential Indicators

5.1 **Gross Debt and the Capital Financing Requirement CFR** - In order to ensure that borrowing levels are prudent over the medium term the Council's external debt must only be for a capital purpose. Gross debt should not, therefore, except in the short term, exceed the CFR for 2022/23 plus the expected CFR movement over 2023/24 and 2024/25. As there is no external debt planned and the CFR is over £32m and in the budget plans of the Council it is not projected to decrease significantly over the relevant future period, the Council has complied with this prudential indicator.

5.2 The **Authorised Limit** is the "Affordable Borrowing Limit" required by section 3 of the Local Government Act 2003. The Council set the Authorised Limit at £15m for 2022/23. The table below demonstrates that during 2022/23 the Council has maintained gross borrowing within its Authorised Limit.

5.3 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. This indicator was set at £0m. There was no gross borrowing in the year.

	2022/23
Authorised Limit	£15m
Operational Boundary	£0m
Maximum gross borrowing position in the year	£0m
Minimum gross borrowing position in the year	£0m

5.4 **Actual financing costs as a proportion of net revenue stream** - This indicator shows the cost of capital (borrowing and other long term obligation costs) against the net revenue stream. This is a gauge of the affordability of capital spend and as the Council has no borrowing is purely the MRP charge. The actuals are in line with estimate.

	2022/23 actual	2022/23 forecast
Financing costs (£m)	0.9	0.9
Proportion of net revenue stream	7%	7%

5.5 **Interest rate exposure** – This indicator is set to control interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates are shown in the table below. The impact of change in interest rates is calculated on the assumption that maturing investment will be replaced at current rates.

	Actual	Limit
Limit one-year revenue impact of a 1% rise in interest rates	£0.175m	£0.250m
Limit one-year revenue impact of a 1% fall in interest rates	-£0.175m	-£0.250m

5.6 **Maturity structures of fixed borrowing -** These gross limits are set to reduce the Council's exposure to large fixed rate loans falling due for refinancing. Although the Council has no borrowing this indicator is required by the CIPFA code.

Maximum percentage of borrowing in each age category	Upper	Lower	Actual
Under 12 months	100%	0%	0%
12 months to 2 years	100%	0%	0%
2 years to 5 years	100%	0%	0%
5 years to 10 years	100%	0%	0%
10 years and above	100%	0%	0%

5.7 **Total Principal Funds Invested over a year** – These limits cover the Council's exposure to the possibility of loss that might arise as a result of it having to seek early repayment or redemption of investments. The limits and actuals on the long-term principal sums invested to final maturities beyond the period ends are below and the actual values were within the limits.

£m	2022/23	2023/24	2024/25
Actual principal invested beyond year-end	£13.4m	£13.4m	£11.4m
Limit on principal invested beyond year-end	£16m	£14m	£12m

Economic and treasury management context for 2022/23

5.8 The Council's treasury management activities are critically affected by what is happening in the general economy which is subject to continuing uncertainty. The Council has engaged Arlingclose Ltd to advise on various aspects of Treasury Management and a part of that advice, a commentary on the economic background and the finance sector during 2022/23, is included as Appendix A to this report.

Debt management activity during 2022/23

5.9 No new borrowing was undertaken and the Council continues to have no debt. As the CFR shown above is £32.7m the Council is using its internal resources in lieu of borrowing. This lowers overall treasury risk by reducing both external debt and temporary investments and was judged to be the best way of funding capital expenditure. Current borrowing costs have risen markedly from their historic low levels (e.g. PWLB 50 year loan around 5% whereas last year was around1.8%)

6 Investment activity in 2022/23

6.1 In line with both the CIPFA Treasury management Code and government guidance the Council's objectives are to give priority to the security and liquidity of its funds before seeking the best rate of return. The guidance also requires the Council to approve an investment strategy before the start of each financial year and regularly report progress against it.

6.2 The strategy follows the CIPFA and government guidance that require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

6.3 The Council's longer term cash balances comprise revenue and capital reserves and its core cash resources are shown in the table below. The Council is borrowing internally to cover its CFR which reduces the funds to be invested. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. As the resources available exceed the CFR the Council holds net investments as shown below.

Balance Sheet Resources	31 March 2023 £m
General fund CFR	-33
Less Usable reserves	96
Less working capital	12
Total	**75**

6.4 The breakdown of investments held at period end.

	31.3.22 Balance £m	Movement £m	31.3.23 Balance £m	31.3.23 Rate %
Call accounts	4.1	-3.3	0.8	1.0
Money Market Funds – call	10.5	-3.0	7.5	4.1
Money Market Funds – cash plus or short bonds	13.3	-0.2	13.1	1.7
Short-term deposits	29.5	-21.0	8.5	3.0
Short term Bonds	0	2.9	2.9	4.6
Long-term Bonds	0	13.4	13.4	4.5
Pooled Funds - Property	5.6	-0.9	4.7	3.6
Pooled Funds – Multi-Asset	6.9	1.5	8.4	3.9
Pooled Funds – Equity	5.6	3.0	8.6	3.5
Pooled Funds – Bonds	5.7	-0.4	5.3	3.4
REIT	2.1	-0.3	1.8	2.6
Total Investments	**83.3**	**-8.3**	**75**	**3.4**

6.5 **Yield** - The investment income budget for the year 2022/23 was £0.965m (£0.792m in 2021/22). The actual interest received was £2.285m (£0.942m in 2021/22). Cash balances were well above budget throughout the year with the year-end figure being £30m higher than the projections from late 2021 which were used for the budget as cash outflows were overestimated and inflows underestimated. Actual rates far exceeded the budgeted rates which were set in late 2021 when bank rate was 0.25% and although there was the awareness of rising inflation, at the time there was the belief that the increase in inflation would be relatively modest. Overall return was pushed up to 2.6% (1.2% in 2021/22) against a budgeted return of 1.6%.

6.6 **Security** – A benchmark is used as a way of expressing the credit risk of the whole portfolio of counterparties that the Council invests with. The Council has adopted a benchmark of an equivalent credit rating of A against which the portfolio was assessed at the end of each month. The portfolio average credit rating was a minimum of A+ in the year which is one notch above the benchmark.

6.7 **Liquidity benchmark** – The Council needs to ensure it has a sufficient level of liquidity so it has funds available when necessary. To ensure liquidity the Council sets a benchmark of the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing. For 2022/23 the benchmark amount was £3m. The actual funds available were in excess of the benchmark for the whole year; the lowest amount available overnight was £8m.

6.8 **Compliance with strategy** – The strategy was complied with throughout 2022/23 with the exception of two instances when the Council's current bank account balance exceeded £2.5m and the interest sensitivity indicator being exceeded at the

mid-year point. These instances were reported in the mid-year report to this Committee on 7 December 2022.

6.9 **Pooled funds** – The Council holds £26.9m in unrated pooled funds comprising equity, bonds and property. In 2022/23 they yielded £1.07m. These funds are a useful diversifier for the treasury portfolio but are subject to a variable capital value. The value of the investments at the year-end was £0.73m below the initial investment. At the end of last year the capital value was £1.5m above the original value so there is a degree of volatility.

6.10 Many of the pooled funds have a significant bond component and fixed income bond values were hit by rising interest rates. 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 rises to combat inflation. In the next year bond values should recover as interest rates reach their peak and their increased yields will increase dividends.

6.11 The equity element of Pooled funds also suffered as the outlook of sticky inflation, rapid policy rates tightening and an increasing risk of recession damaged confidence. The 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 also fall during the year.

6.12 **Variable Net Asset Value Money Market Funds** – The Council uses Low Volatility Net Asset Value Money Market Funds for day-to-day liquidity. The low volatility refers to the fact that each unit of the fund costs £1 to buy and is redeemed at £1. To facilitate this, the investments within the funds are short term and liquid and so returns are close to Bank of England bank rate. As the Council has cash it can invest over the medium term it has £13.1m in money market funds which can invest in longer term instruments like short term bonds and consequently should have higher yields but where the value of a unit invested can change. At a time of rising rates these type of funds can lag behind the shorter duration money market funds as their overall average rates do not respond as quickly to the new rates. They also suffer a reduction in capital value as they have older bonds with lower rates which will take longer to mature so that the newer higher interest bonds can replace them. The value of these funds on 31 March 2023 was £232,000 lower than the purchase price.

6.13 Although the volatility of capital values is a concern, the Council has sufficient long term funds to avoid crystallising any capital losses. In the Council's accounts these unrealised capital gains or losses will not have an impact on the General Fund as the Council can defer them to a reserve account. The Government has agreed this will remain the case until 2025/26. There is no guarantee this will be extended so the Council will have to consider how to deal with a potential charge to its revenues from 2025/26.

6.14 **Social Housing REIT –** In 2019/20 the Council invested £2m in a REIT specialising in supported social housing. The pandemic had significantly delayed its development of sites so dividends have been lower than expected at 2.7%. The expectation is that the REIT will continue to develop its operations and grow its dividends. There was a small capital loss of £120,000 at the year-end. Any unrealised capital gains or losses will not have an impact on the General Fund as the Council can defer them to a reserve.

6.15 **Covered and Supranational Bonds** During the year a number of covered and supranational bonds were purchased. These are highly secure AAA rated bonds that are covered by collateral or recourse to national governments. They have a variety of maturities over the next 4 years at a fixed rate return.

Non-Treasury investments

6.16 The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in DLUHC's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

6.17 At year end the Council held £58.0m of directly owned property and £0.18m loans to local bodies for service purposes. These investments generated £3.74m of investment income for the Council after taking account of direct costs and making provision for possible losses, representing a rate of return of 6.4%. Income was in line with the estimated income of £3.7m at a return 6.6% in the original 2022/23 strategy.

6.18 **Net income from commercial and service investments to net revenue stream:** This indicator is designed to show the proportion that commercial and service net income forms of the whole Council's net revenue stream and so how far the council relies on the income.

	2022/23 actual	**2022/23 forecast**
Total net income from service and commercial investments	£3.7m	£3.7m
Proportion of net revenue stream	29%	28%

6.19 The income from these non-treasury investments provides an important contribution to financing of the Council's overall service delivery. To ensure stable income flows the Council has a core of longer term leases. The Council's properties have very high occupancy in the high 90% and so can place reasonable reliance on a stable flow of rents. That said, there is a significant retail element which will not be immune from the well-recognised risks to the sector.

6.20 Below is a breakdown of performance grouping assets by type.

Property by type £millions		31.3.2023 actual		2022/23	
	Purchase cost / 31st March 2007 value	Gains or losses	Value in accounts	Capital Gain or loss in year	Income Return In year
Retail – legacy	2.7	1.9	4.6	-0.1	8.1%
Retail – Swan Walk	9.5	-7.5	2.0	0.1	11.1%
Light industrial - legacy	9.3	9.9	19.2	-0.5	6.8%
Healthcare – legacy	6.5	1.6	8.1	-0.3	6.2%
Office - legacy	1.3	0.6	1.9	-0.1	4.5%
Retail - recent	14.7	-6.1	8.6	-1.0	8.1%
Light industrial – recent	6.3	3.8	10.1	0.1	5.2%
Healthcare – recent	0.9	0.0	0.9	-0.3	5.8%
Education -recent	1.8	-0.1	1.7	-0.1	1.3%
Leisure - recent	1.5	-0.6	0.9	0.0	-4.9%
Total properties	**54.5**	**3.5**	**58**	**-2.2**	**6.4%**

6.21 The purchase cost figures above need to be viewed with care as no reliable purchase cost is available for the legacy categories and Swan Walk so the base valuation is the earliest full valuation we have, which is from 2007 when retail was probably at its peak value. Overall capital values are above notional “purchase cost” with the light industrials compensating for retail weakness. In terms of percentage return, care should be taken as the denominator is the valuation at the year-end which is subject to annual revaluation.

6.22 The return for Swan Walk is an estimate as the accounts for the year ending last October have not yet been supplied to the Council. Swan Walk was badly affected by the pandemic with many tenants seeking reductions in their rents and the leasehold was also sold by Aviva in 2021/22. Officers have been pursuing the managing agents for the accounts but the overhang from the pandemic and the transfer of ownership seems to have had a longer lasting effect than expected.

6.23 The category of recent education properties was affected by the departure of Bohunt School leaving the property empty for much of the year. The site requires some work but is currently under offer for a new long term tenant. The recent leisure properties (The Rec) income was impacted by Covid rent arrears being written off because the tenant went into liquidation. The property is now under offer on a new long lease at a significantly enhanced rent (subject to an extended rent free)

6.24 The 2022/23 strategy also set a series of performance indicators shown below.

Indicator	2022/23 Actual	2022/23 Forecast
Commercial investments: Property Overall value	**£58.0m**	**£57m**
Debt to net service expenditure ratio	0%	0%
Commercial income to net service expenditure ratio	34%	34%
Net income return target	6.4%	6.6%
Operating overheads of property section attributable to commercial property as a proportion of net property income	6.1%	6.0%
Average Vacancy levels	4%	3%
Tenant/s over 5% of overall income	5	4
Weighted Average Unexpired Lease Term (WAULT)	14yr 7m	14yr
Bad debts written off	£82,281	£200,000

6.25 The overall value of investment property slightly exceeded the estimate made in December 2021 due to valuations holding up more than projected.

6.26 The Weighted Average Unexpired Lease Term (WAULT) is in line with estimate,

6.27 Overheads as a percentage of income was slightly over estimate. This was because the budgeted income was marginally higher in the forecast.

6.28 Swan Walk income just edged above 5% in the year to make 5 tenants over 5% of overall income.

6.29 Bad debts written off in the year 2022/23 are due to some extent to ongoing effects of the pandemic and the cost of living crisis.

6.30 The valuation figures are based on the unaudited accounts. If there are significant changes for the final audited accounts, the changes in treasury management activity and prudential indicators will be reported to the committee.

7 Resource consequences

7.1 This report provides information only; no staffing or financial resources are required as a result of it.

8 Legal considerations and implications

8.1 There are no legal consequences.

9 Risk assessment

9.1 The framework of indicators and reporting against them provides an effective system of risk control.

10 Procurement implications

10.1 There are no procurement implications.

11 Equalities and Human Rights implications / Public Sector Equality Duty

11.1 There are no impacts on any relevant groups and no Equalities Impact Assessment is required.

12 Environmental implications

12.1 There are no direct environmental impacts from this report.

13 Other considerations

13.1 There are no Data Protection implications or issues concerning Crime & Disorder.

Appendix A Arlingclose Commentary on 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