Room151's

TREASURY INVESTMENT & CURRENT AFFAIRS SURVEY 2023

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GOOD INVESTMENT

Foreword

Local government impacts everybody, every single day.

Throughout our lives we interact with the sector in numerous ways, often without stopping to recognise the contribution made from our core public services. The work undertaken by the sector is vital, necessary and can be taken for granted.

The sector is now facing some of its most significant challenges for a generation – the scale and complexity of which must not be underestimated. Local government works tirelessly to deliver services to the public which support individuals, families and communities, and which benefit people's lives.

Local government is said to be facing a perfect storm, but does that truly describe the scale of the challenges? Like climate change, with an increasing number of extreme weather events, how can local government manage through this current level of extreme challenges?

Climate change is making it harder to forecast weather and patterns of weather events. Surveys are used to improve the chances of forecasting weather and improve the outcomes.

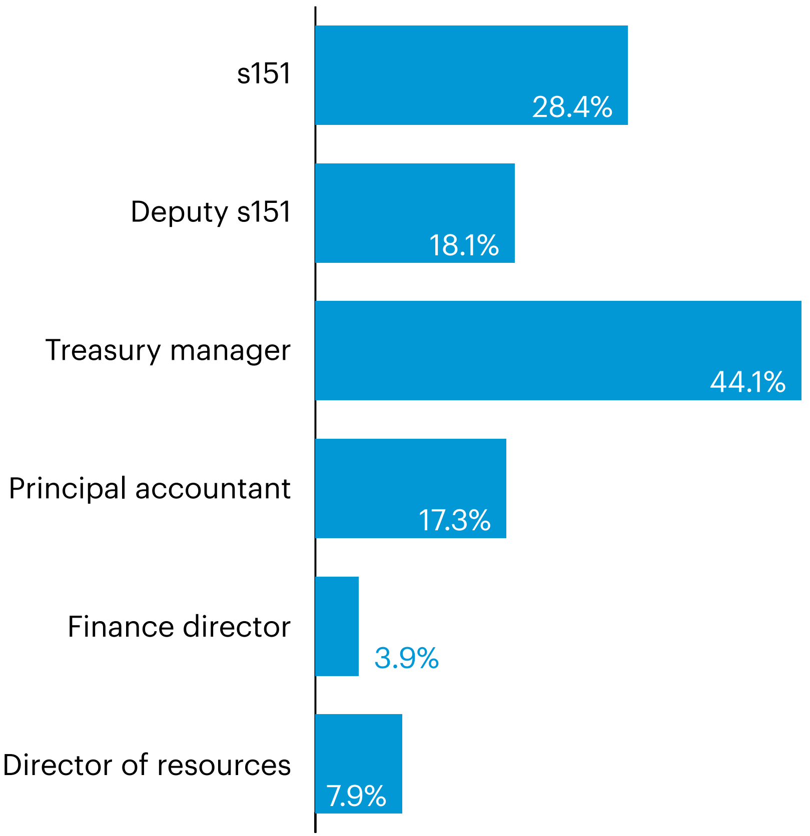
A survey such as this one also collects data which can support learning, understand decision making and provide collective insights – and in this case offers an influential snapshot of senior finance sentiment across the local government sector. It examines the views of local government, macroeconomic trends and threats to local government funding. It may not be able to forecast outcomes for local government but it can help us to determine a collective view.

KELLY WATSON
head of local government relationships, **CCLA Investment Management**

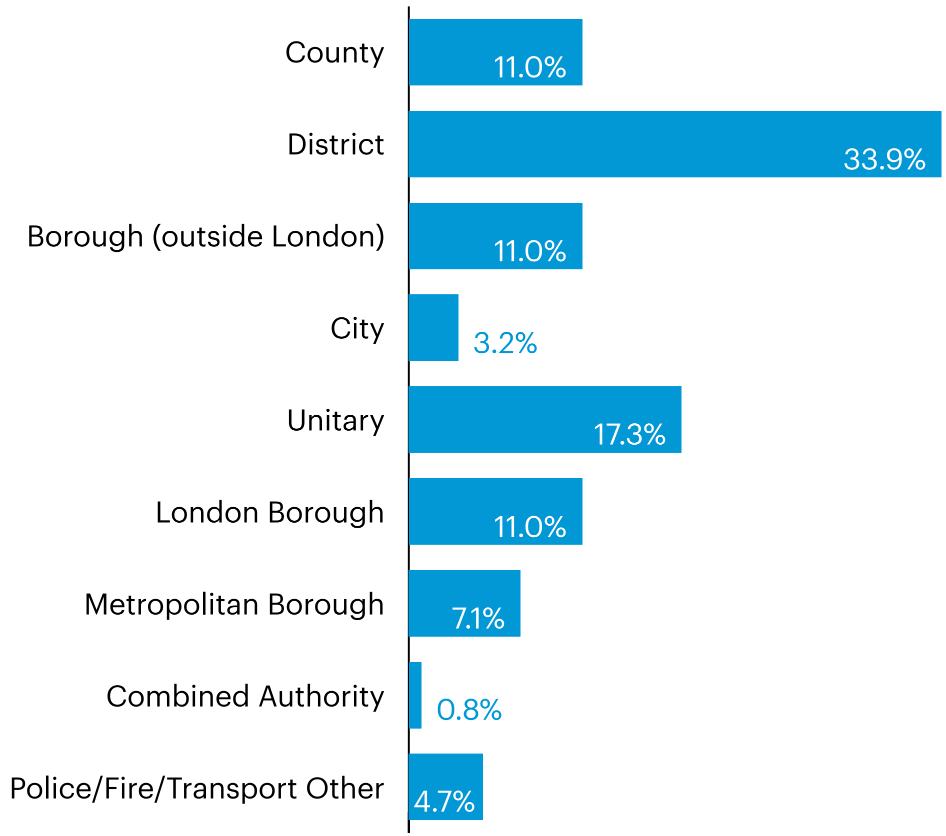
Survey demographics

Total number of respondents: 127

What is your role? (you can choose up to two relevant titles)

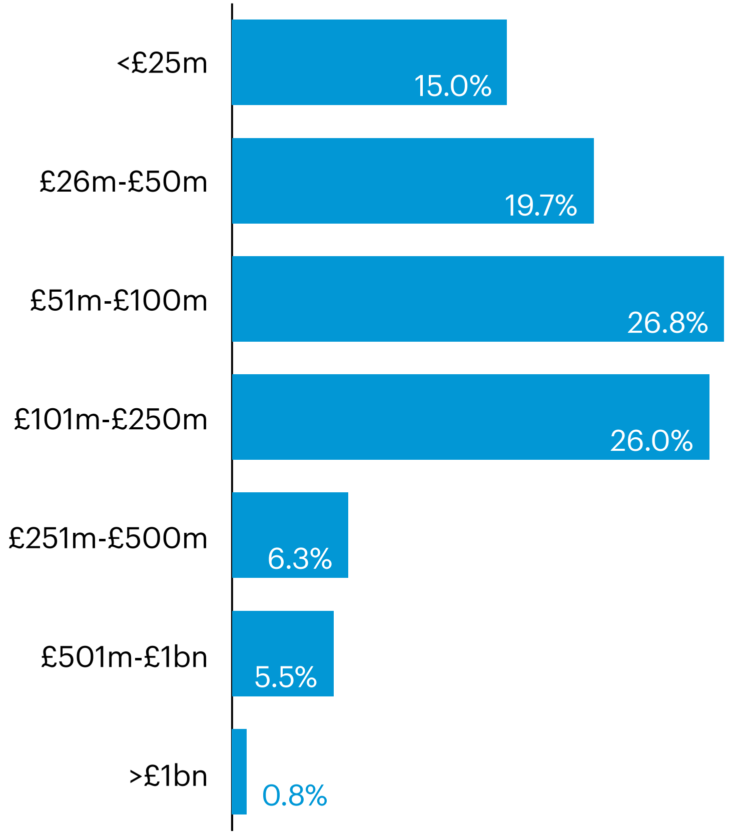


What type of council do you work for?

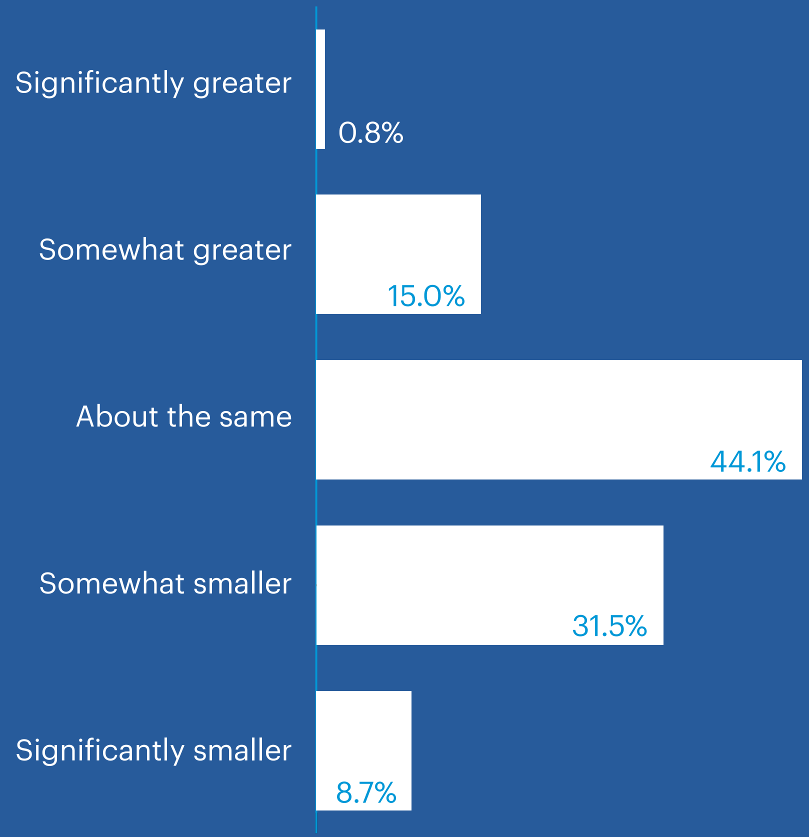


Survey results

Roughly what is the value of your council's total treasury assets under management or AUM (i.e. the total approximate value today of all your council's treasury deposits/treasury investments)?

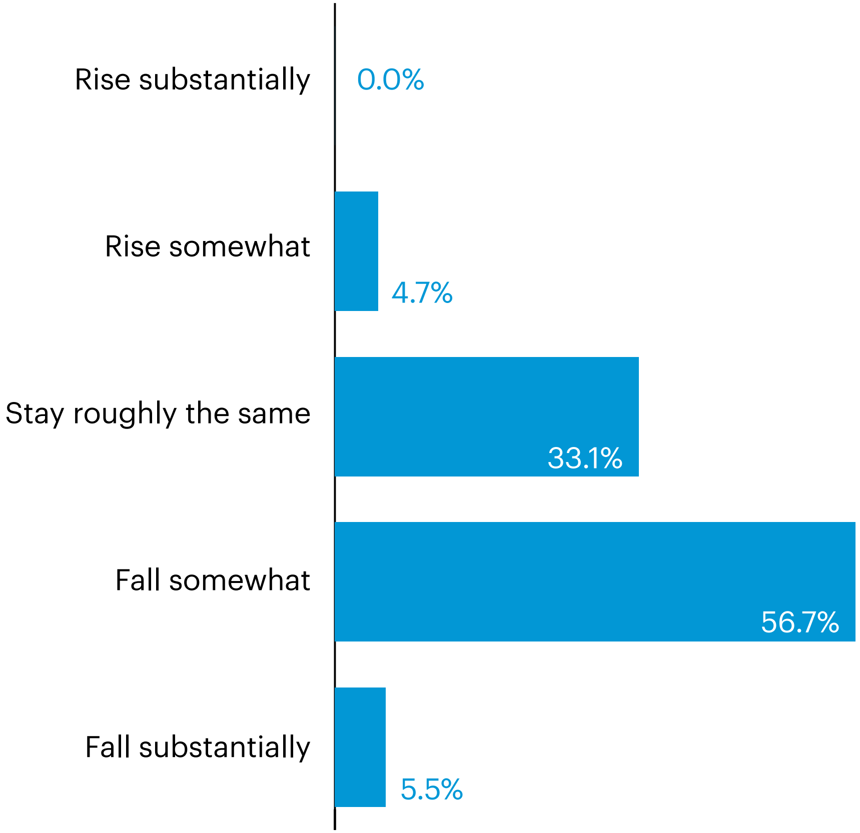


Is that AUM value greater or smaller than it was this time last year?

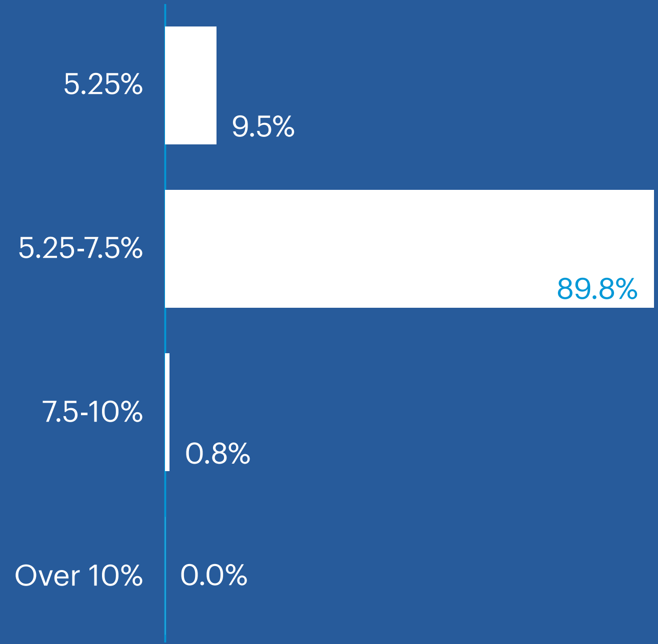


Survey results

Do you expect the value of your treasury assets under management to rise or fall over the next 12 months?



Where do you expect the Official Bank Rate to peak in the next five years?



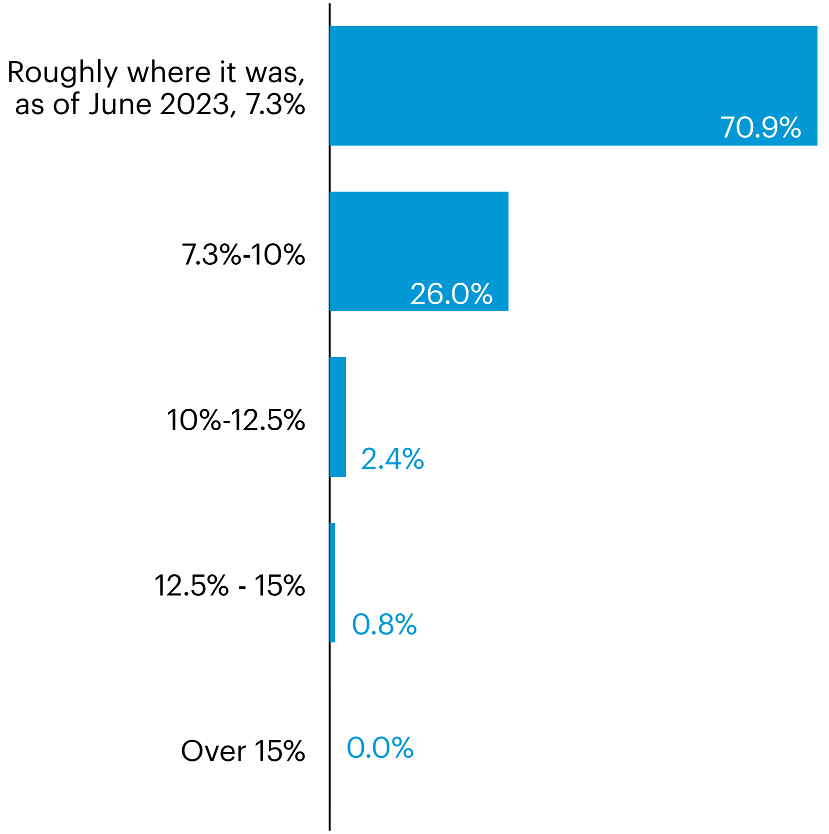
Room151 commentary: There was overwhelming consensus this year among finance officers that the official Bank of England rate would peak within the bracket of 5.25% - 7.5% over the next five years. Some 90% of respondents held this view compared to under 10% in last year's survey. Despite the long-term nature of the question (i.e. forecasting a peak over the coming five years) less than 1% of respondents believe the Bank of England will need to go beyond a 7.5% base rate over the this timeframe.

In the 2021 survey, a mere 7% of finance officers believed the rate would go beyond 2% in the subsequent five years.

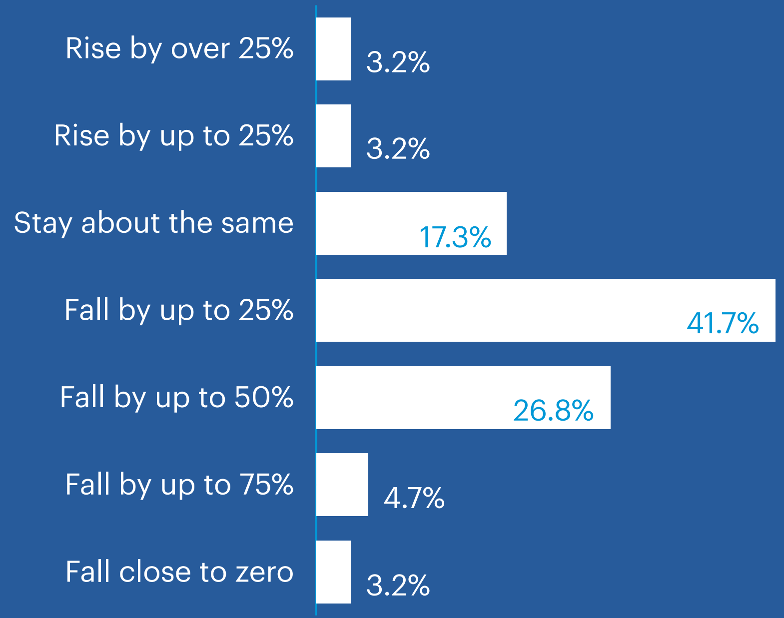
Conclusion: expect the unexpected!

Survey results

Where do you expect the inflation rate (the Consumer Price Index as measured by the ONS) to peak over the next 12 months?



Looking at your medium-term cash flow forecast, how do you expect your investment balance to change over the next five years?

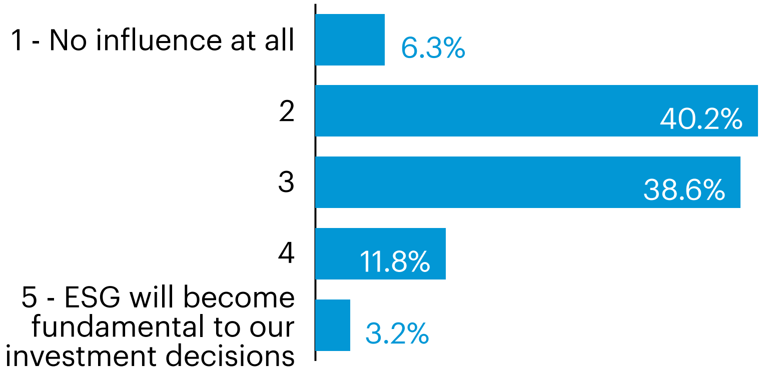


Room151 commentary: Pessimism reigns supreme when it comes to predicting levels of assets under management (AUM). Less than 7% predicted a rise of any kind in 2023, while 76% of practitioners forecast a fall, including a quarter of all respondents expecting a 50% drop in AUM. Anecdotal evidence and news of authorities dipping into reserves certainly supports that narrative. Looking back on recent surveys, however, it was ever thus. Over 65% forecast a fall in January 2021; 60% in September 2021; and 72% in 2022. Despite the bearish outlook, the official local authority investment statistics from MHCLG would suggest a steady rise in aggregate AUM over the same period.

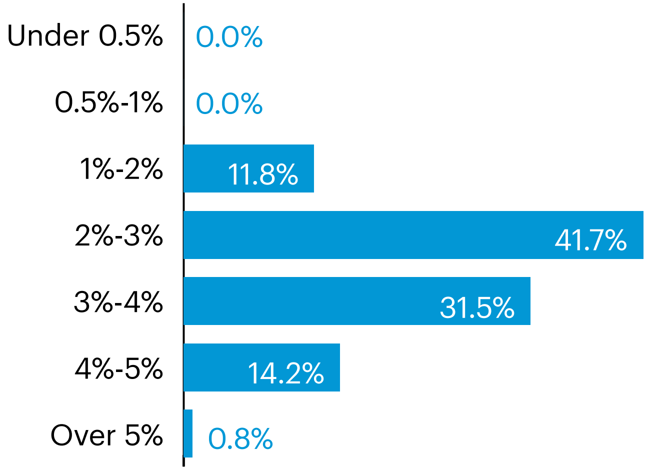
Survey results

To what extent do you expect ESG (environmental, social & governance) factors to influence your investment decisions over the next two years?

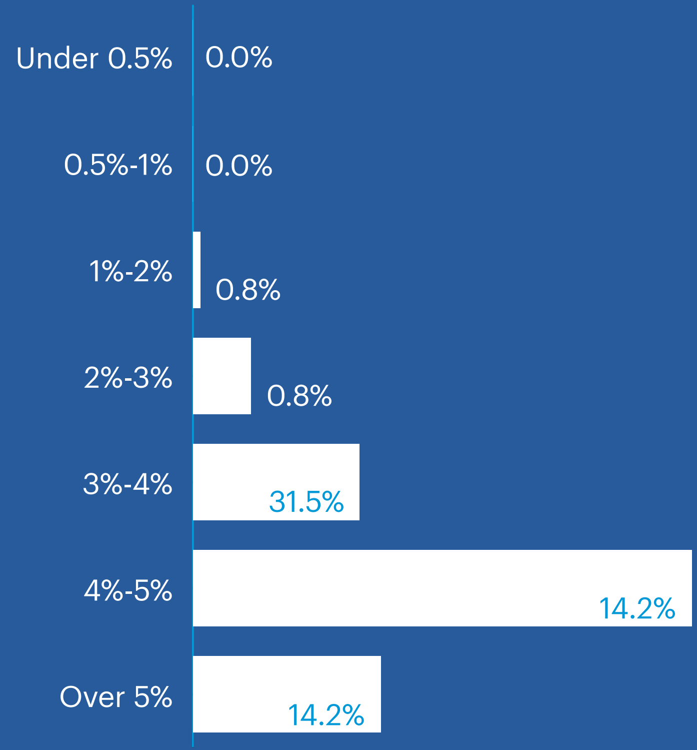
Rate from 1-5 where 1 is no influence at all.



Roughly, what did your entire treasury investment portfolio yield in the last 12 months?



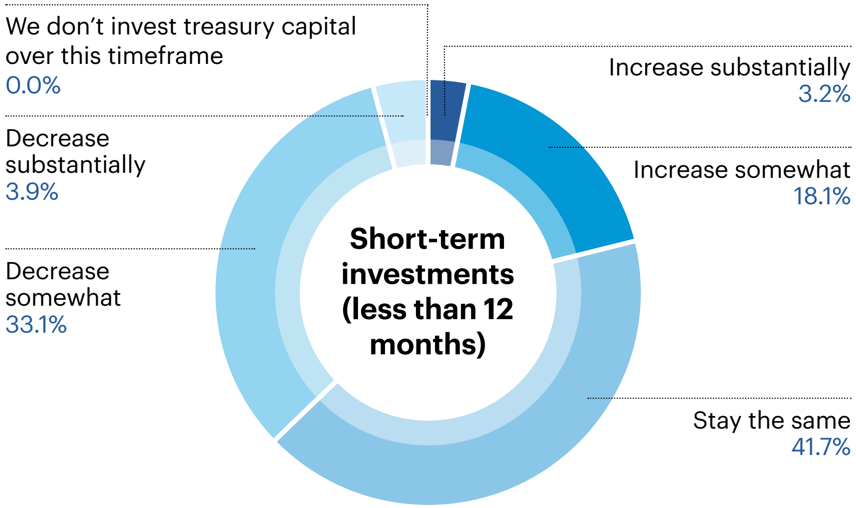
Roughly, what do you expect your entire treasury investment portfolio to yield in the next year?

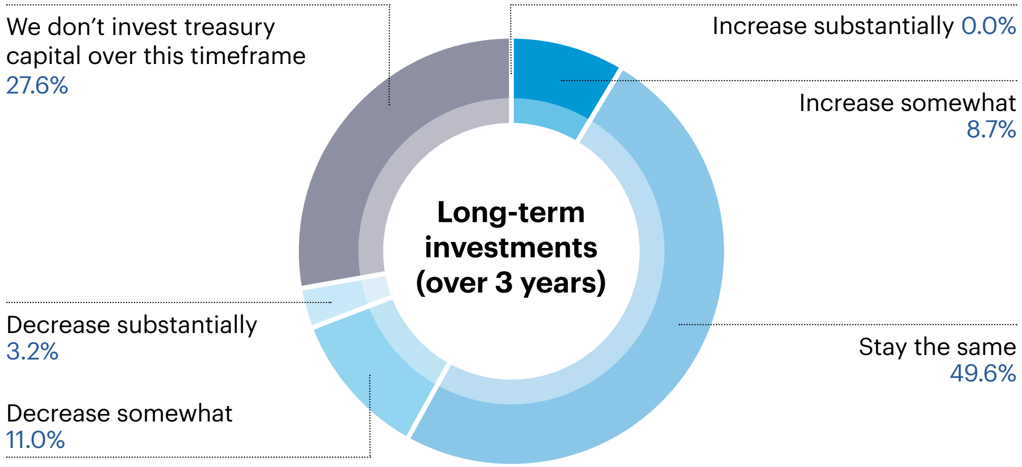


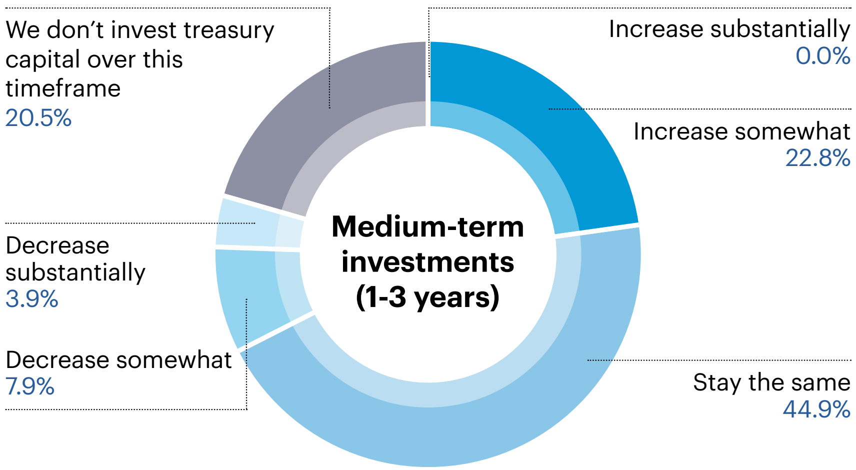
Room151 commentary: Ambitions for yield within the treasury book over the coming year are rightly much higher than they have been since we started the survey in 2017. A fifth of all respondents expect their portfolio to return over 5% with a further 55% expecting a return of 4-5%. Just one respondent felt they could generate a yield of over 7.5%.

Survey results

Thinking now about the length of time you make investments for, from the short to the long term, do you think you will increase or decrease treasury investments within the timeframes below over the next year?







Room151 commentary: As treasury investors with liquidity requirements that span the short to the long term, local authorities have become well versed in a diversified approach to liquidity, where it benefits the overall risk/return dynamic of the portfolio. And in recent years, with short-term rates being so flat, it is no surprise that longer-term risk assets were explored fairly widely.

With short-term rates bouncing back you might expect to see a reallocation of capital towards short-dated assets but the overall picture is actually largely unchanged. Half of investors expect no change to their longer-term (>3yrs) investments, while 9% expect a modest increase. With a quarter of treasurers not invested over this time frame, just 14% are anticipating a fall in their long-term holdings.

Survey results

How likely is it in your opinion that your authority will invest significantly in the following areas over the next five years?

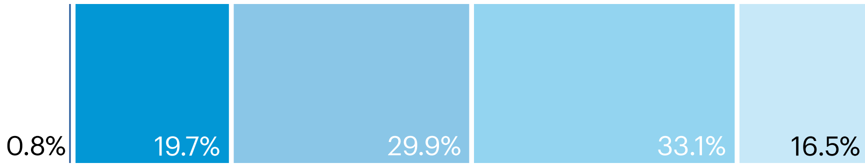
Highly likely | Likely | N/a / don't know | Unlikely | Highly unlikely

Meeting decarbonisation/net-zero pledge

Housing development

Improvements in IT/tech/systems

Commercial enterprises/revenue-generating initiatives



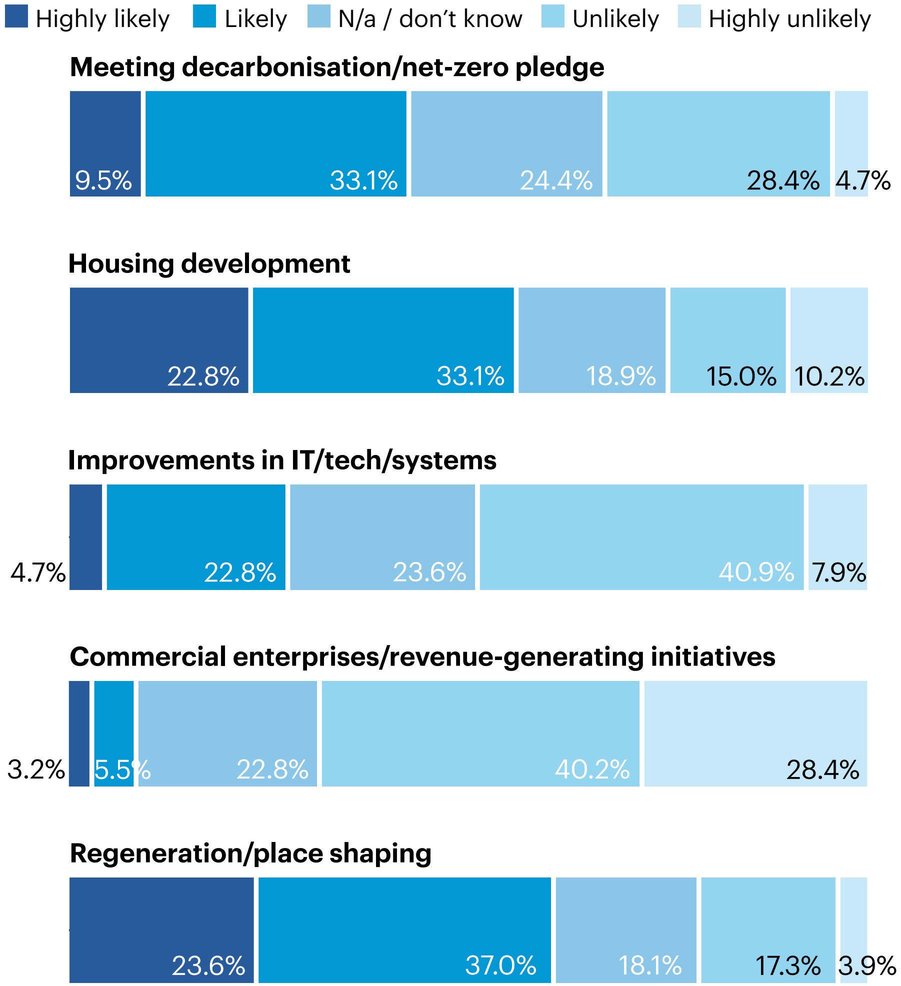
Regeneration/place shaping

Room151 commentary: Some 61% of respondents were "likely" and 18.1% "highly likely" to invest significantly in meeting decarbonisation or net zero pledges over the next five years. Nearly three-quarters of councils stated that they are either "likely" or "highly likely" to significantly invest in improvements in IT and tech systems, with 66% suggesting housing development.

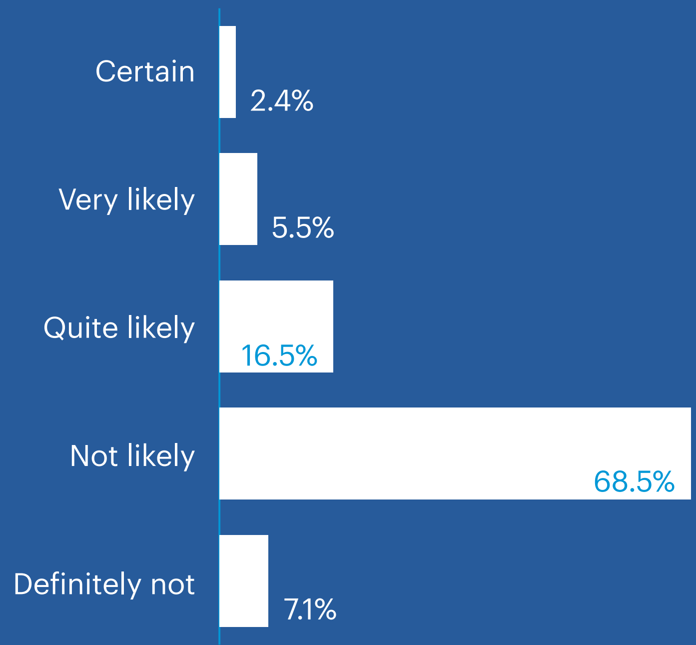
"Decarbonisation, regeneration, technology and housing are key areas in terms of investment and the other one that does feature is climate change. However, it has come down in the agenda, which could be to do with the issues that local government is facing at the moment," said Kelly Watson, head of local government relationships at CCLA Investment Management.

Survey results

In your opinion, how likely is it that your authority will undertake significant borrowing over the next five years to fund the following



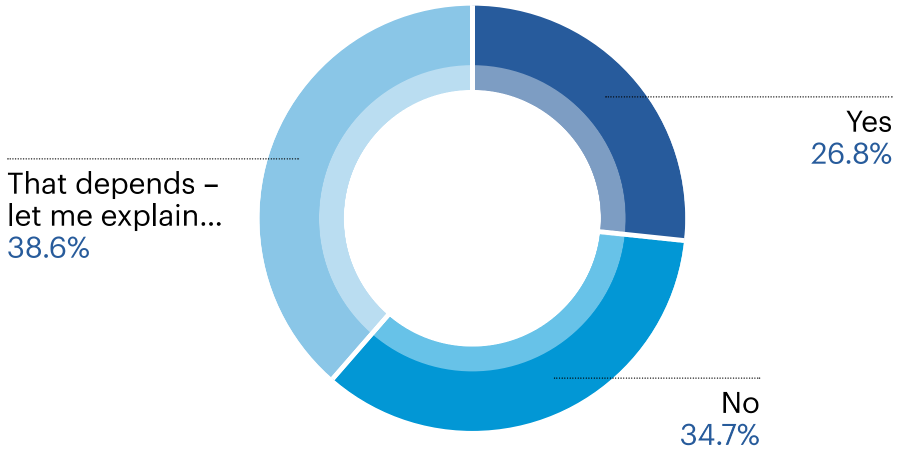
To what extent is it likely that your authority will borrow (long term) from a different source than the PWLB over the next five years?



Room151 commentary: While just over 75% of respondents said they were either “not likely” or “definitely not” looking to borrow long-term loans from a different source to the Public Works Loan Board, this high number perhaps disguises the fact that the rest of the respondents might look to different sources. And that’s a high number – and a definite shift from previous years. Indeed, some 16.5% of participants stated that they were “quite likely” to look for alternative sources, followed by 5.5% voting “very likely” and 2.4% suggesting “certain”.

Survey results

The Bank of England base rate started to move upwards from its historic low of 0.1% in December 2021 and has risen consistently thereafter. During the preceding period of very low interest rates, many councils adopted a borrowing strategy of ‘rolling over’ short-term loans. Was this a prudent strategy?



Room151 commentary: Respondents expressed split opinions on whether borrowing short during the low interest rate period was a “prudent” strategy, with nearly 35% voting that it wasn’t. Some 34.6% of respondents thought that adopting a borrowing strategy of “rolling over” short-term loans was “not prudent”. However, 26.8% of participants voted that the strategy was “prudent”, whilst the remaining 38.6% of respondents suggested that “it depends” and gave a written response.

In the explanations received, many respondents suggested that it wasn’t “prudent” to have a borrowing strategy solely based on short-term loans and instead councils should opt for a mixed borrowing strategy of short-term and long-term loans. One participant said: “It is a risky strategy to rely solely on short-term loans. It is better to have a spread; we adopted a strategy of matching some loans to dates of when we expect to generate capital receipts.”

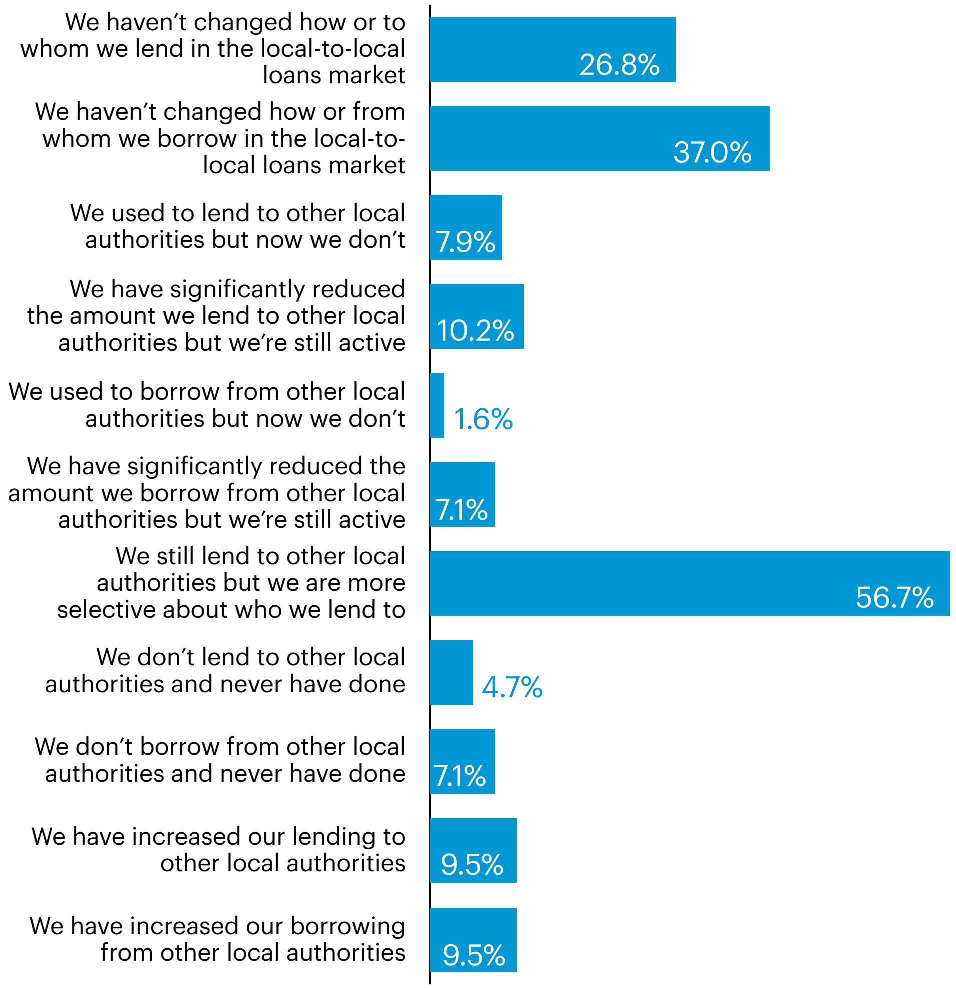
In addition, some participants suggested that whilst borrowing short was a “sensible strategy for a long time”, authorities should have had a greater understanding of the risks and implications of the loans. “[Borrowing short] was the right call until such time as base rate rises became more than a possibility or the risk in the portfolio became excessive in terms of the entire portfolio. At threat point, risk should have been taken off the table to the degree the authority was comfortable with. This of course needs to be balanced within the revenue envelope for treasury management costs and sufficient provision should have existed to enable this swap from short-term to long-term funding,” a participant said.

Many participants also acknowledged that when an authority undertook this borrowing strategy, it should have also focused on an exit strategy or plan if interest rates were to rise. “With hindsight, no, this was not a prudent strategy, however given the foresight of hindsight we would all most likely do things differently, therefore we must look at the information authorities had at the time. At the time, given the very low rates being offered it would have been somewhat illogical to lock into longer term, particularly, higher rates. Equally I don’t think it’s unreasonable to have asked for treasury managers, senior officers and treasury advisors to think a lot more about the question of what to do if rates rise, as it was inevitable that they would do so and indeed have done so,” another participant said.

Some respondents of the survey stated that adopting the borrowing strategy of “rolling over” short-term loans was in line with the advice provided to them by local government treasury advisors.

Survey results

Changes to Bank of England base rates and the financial resilience of some councils have impacted the local-to-local loans market. Which of these apply to you? Select up to 3 responses



Room151 commentary: The way councils utilise the local-to-local loans market has changed in light of section 114 notices and difficult economic conditions. Close to 60% of local authorities said they were now more selective about who they lend to [56.7% of 127 total respondents]. That change is reflected in an overall reduction in the size of the market. At the recent Local Authority Treasurers' Investment Forum (LATIF) and FDs' Summit in London, David Blake, director at Arlingclose, noted that the local-to-local loans market peaked at around £14bn but is now closer to £10bn.

Of the respondents to the survey, 10.24% said they had significantly reduced the amount they lend to other local authorities but are still active, while 7.1% said the same about the amount they borrowed. Some 7.87% said they used to lend to other local authorities but now don't, while 1.57% said they used to borrow from other local authorities but have stopped doing so.

Counter to this, 26.8% of respondents said they hadn't changed how or to whom they lend in the local-to-local loans market, and 37% haven't changed the way they borrow in the market.

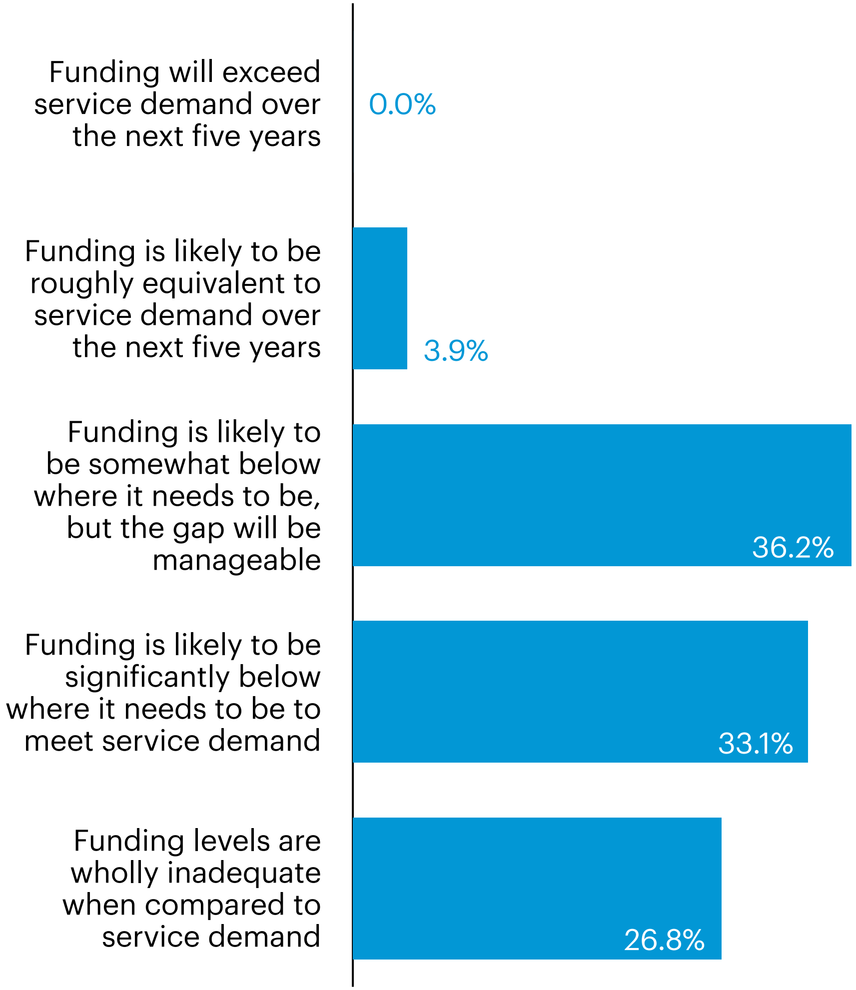
There is currently some "reticence" to lend in the local-to-local loans market because of the potential PR or reputational hit with being involved with councils that are issuing section 114 notices or warnings they are in the territory of doing so.

There is no credit risk but the possibility of a reputational hit is driving this behaviour, with many councillors wary of the impact of being seen to be working with financially struggling councils.

The UK Debt Management Office's Debt Management Account Deposit Facility (DMADF) has also been a viable alternative.

Survey results

As things stand, in your opinion, to what extent will your council's funding levels keep pace with service demand over the next five years?

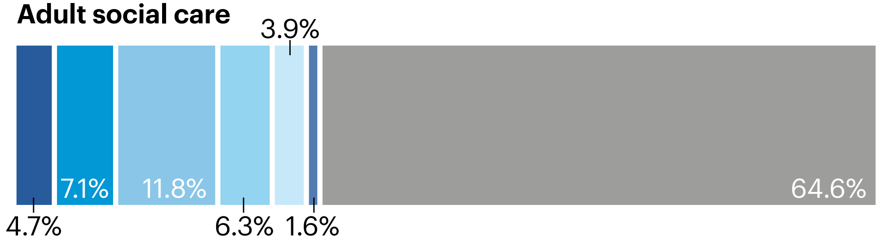


Survey results

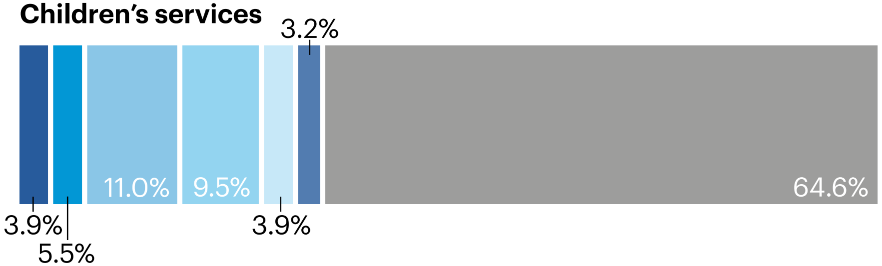
Please estimate to what extent the following areas of service and development will be funded/underfunded at your authority in 2023

Fully funded · 1-5% Underfunded · 6-10% Underfunded
11-20% Underfunded · 21-40% Underfunded · 41-60% Underfunded
Over 60% underfunded · NA/don’t know

Adult social care

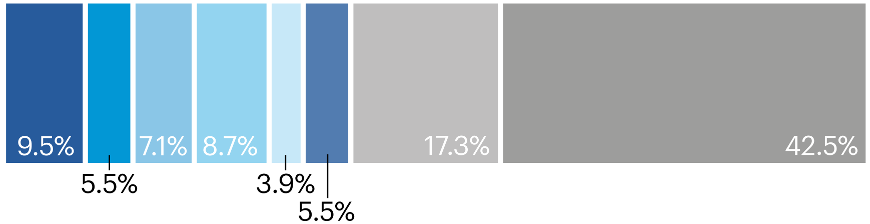


Children’s services

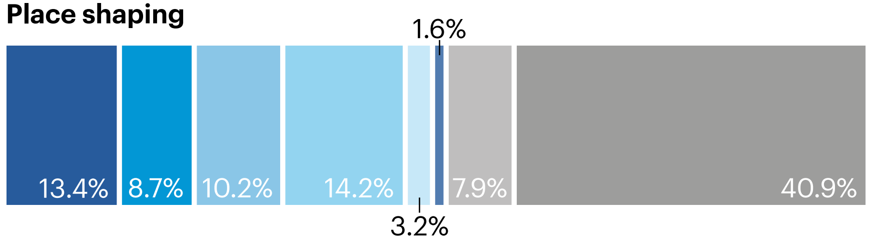


SEND

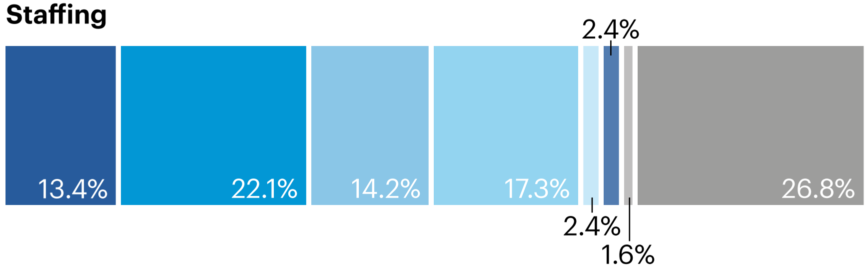
Meeting your decarbonisation/net-zero pledge



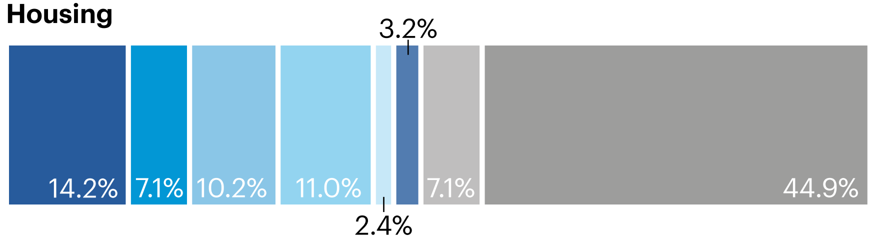
Place shaping



Staffing

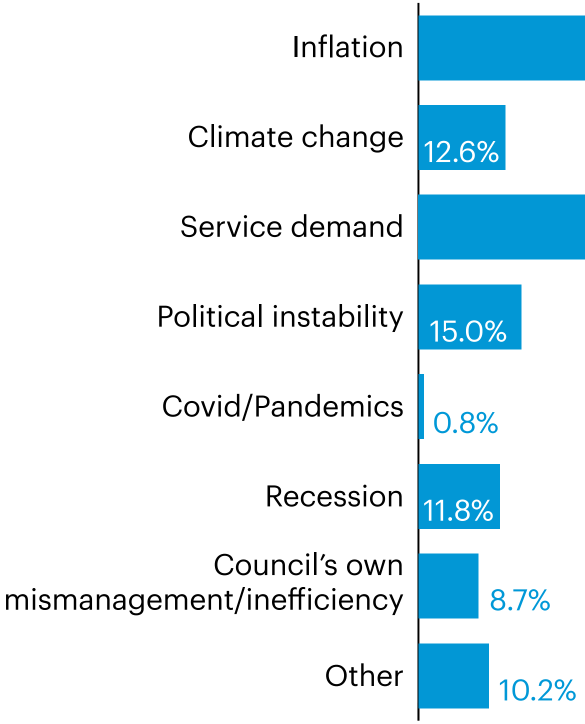


Housing



Survey results

Which of the following do you think presents the greatest risk to local government finances over the next five years? Respondents could select up to two answers



Room151 commentary: Perhaps unsurprisingly, service demand presents the greatest risk to local government finances over the next five years. This was mentioned by 74% of respondents, followed by inflation (59.8%) and climate change (12.6%). Climate change appears to be bubbling away in the background as a threat to finances.

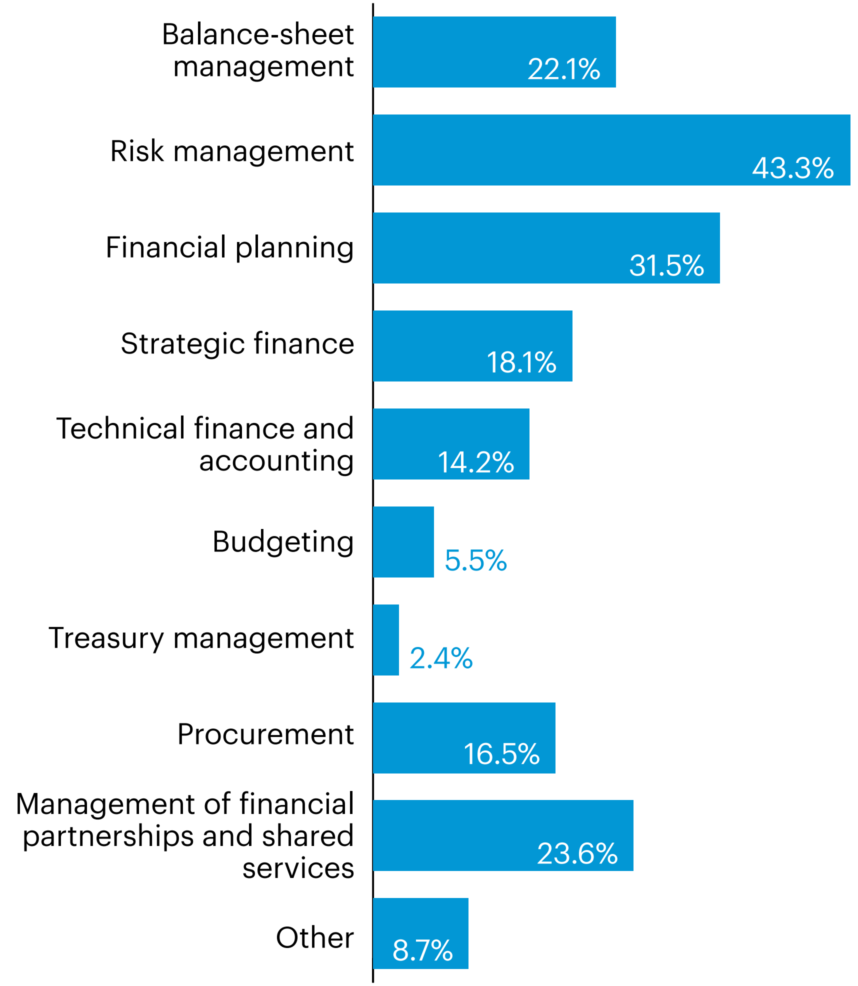
Why do you think so many councils have recently warned of s114 notices? Respondents could choose up to three of the following reasons that they considered most to blame

Room151 commentary: Nearly 90% [87.4%] of respondents think that inadequate funding is the reason why so many authorities have recently warned that they face issuing a section 114 notice. Room151 has reported on the growing number of councils who have issued stark warnings that they are in s114 territory. Some 58.3% and 46.5% of respondents suggested excessive risk-taking by councils and the wider economic environment respectively were factors driving the s114 warnings.

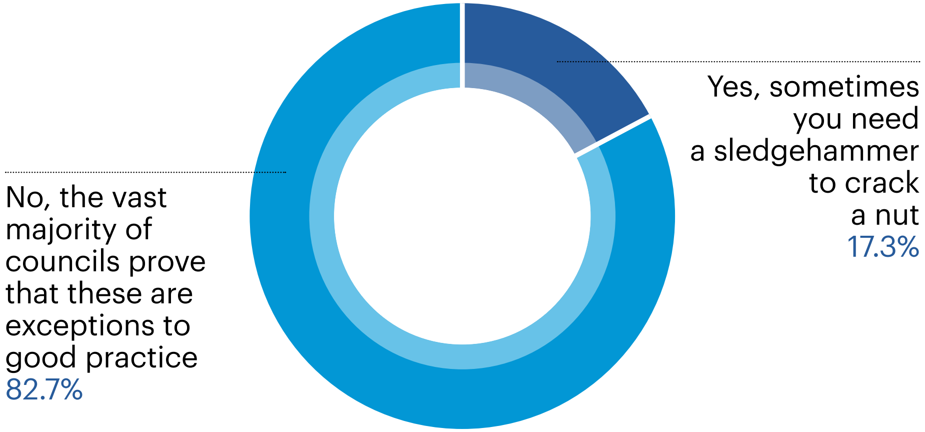
Survey results

In what areas of finance, broadly speaking, do you think local authorities are most in need of improvement?

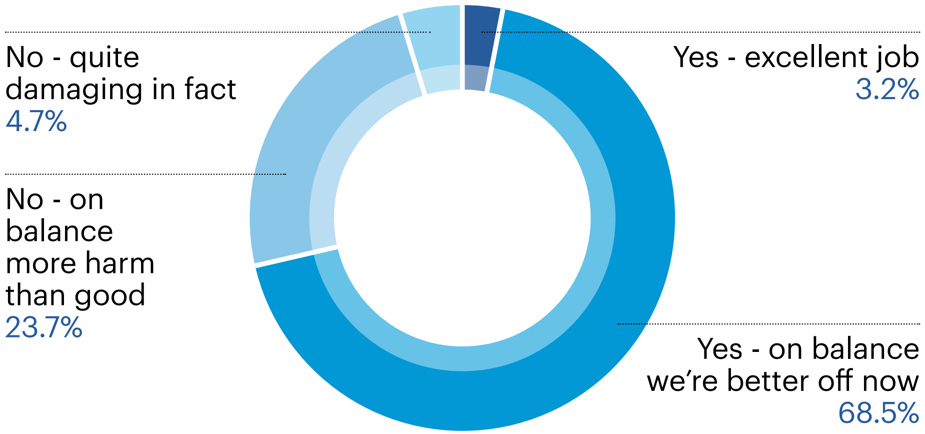
Respondents could select up to two options



Do you think the actions of 'a minority of councils', i.e. those characterised as 'casino councils', should have a bearing on the regulatory environment for all councils?



Has the tightening of the prudential code been a positive development for councils, in general?



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