2022/23 Mid-Year Treasury Management Review

1. Background

1.1 Capital Strategy

In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2022/23, all local authorities have been required to prepare a Capital Strategy which is to provide the following: -

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services.
- an overview of how the associated risk is managed.
- the implications for future financial sustainability.

This report has been written in accordance with the requirements of the CIPFA TM Code.

1.2 Treasury management

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low-risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer-term cash may involve arranging long or short-term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly, treasury management is defined as:

> "The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2. Introduction

This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the way the Council will seek to achieve those policies and objectives.
3. Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy -

for the year ahead, a Mid-year Review Report and an Annual Report, (stewardship report), covering activities during the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Audit and Governance Committee

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first part of the 2022/23.
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy.
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators.
- A review of the Council's investment portfolio for as at 30th September 2022.
- A review of the Council's borrowing strategy for 2022/23.
- A review of any debt rescheduling undertaken during 2022/23.
- A review of compliance with Treasury and Prudential Limits for 2022/23.

3. Treasury Management Summary as at 30th September 2022.

Investment Activity

The Council's investments at 30th September 2022 was £115.6m as below.

Investments	Balance at 01.04.2022 £m	Movement £m	Balance at 30.9.2022 £m	Ave Rates/ Return %
Building Societies	10.0	2.0	12.0	1.82
UK Banks	10.0	5.0	15.0	2.04
Local Authorities	8.0	7.0	15.0	1.23
Call Account	21.4	12.2	33.6	1.75
Money Market Fund	25.0	15.0	40.0	1.63
Total Investments	**74.4**	**41.2**	**115.6**	**1.68**

No investment was made for more than 364 days. The Treasury team want to take advantages of long -term investment opportunities with duration of (1-3 years) with UK banks as specified in the treasury management strategy.

Borrowing Position

The Council's borrowing position as at 30th September 2022 was £415.7m below:

Loans	Balance as at 01.4.2022 £m	Raised £m	Repaid £m	Balance as at 30.9.2022 £m	Rate/Return %
PWLB	236.3	96.7		333.0	3.79
Market Loan	60.6		(15.1)	45.5	4.37
Temp Loans	84.0		(47.0)	37.0	1.42
Salix loan	0.2			0.2	0.00
Total Loans	**381.1**	**96.7**	**(62.1)**	**415.7**	**3.64**

On the 11th May 2022 the Council executed £50m PWLB fixed long-term loan at maturity (£25m for 42 year @ 2.71% and £25m for 46 years @ 2.68%).
On the 15th September 2022 executed £50m PWLB medium-term loan at maturity for 6 years at 3.73%.

The purpose of the loan is to replace some of the temporary borrowing done for less than 364 days and to finance historic capital expenditure.

The Council's capital financing requirement (CFR) for 2022/23 is forecasted at £601m. The CFR denotes the Council's underlying need to borrow for capital purposes. The council can borrow up to the CFR from PWLB or Financial Market.

For new borrowing affordability and the "cost of carry" remained important influences on the Authority's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing. Link (the Council Treasury Advisers) have forecasted an interest rate increase to December 2023, this will reduce the cost of carry (net cost between the borrowing and investment).

3.2 Debt Rescheduling

The possibility of debt rescheduling is regularly discussed with our treasury adviser and is a regular agenda item at the quarterly treasury meeting held between the treasury officers, LAS, the Strategic Director of Finance and Governance (S151 officer) and the lead Member for Financial Management. However, there have not been recent opportunities to reschedule.

Economics update

The Bank of England's MPC hiked Bank Rate for a seventh consecutive meeting in September, hiking Bank Rate by 50bps to 2.25% – the highest since the Great Financial Crisis. The decision to hike interest rates was supported by all nine members of the MPC but the quantum of change was not. One member, newly appointed Swati Dhingra, voted for a 25bps move, five voted for the 50bps move, while 3 (Haskell, Mann and Ramsden) voted for a 75bps move. Adding to the hawkish tone, the accompanying statement was tweaked to say that "...should the outlook suggest more persistent inflationary pressures, including from stronger demand, the Committee will respond forcefully, as necessary". The reference to stronger demand was picked up by analysts as a nod to the fiscal loosening expected at the subsequent mini-Budget, meaning that rates will need to be raised more than previously anticipated to offset the boost to inflation from a rise in public borrowing. Further, while the Committee said that the government's energy support package "will lower and bring forward the expected peak in CPI inflation" and may, therefore, reduce the risk of "more persistent domestic price and wage pressures", it also said that it means "household spending is likely to be less weak than projected" and that "this would add to inflationary pressures in the medium term". These factors, alongside the decision to commence selling gilts (Quantitative Tightening - QT) to the tune of around £80bn over the next 12 months, all left investors in little doubt that the overall meeting was hawkish. The market reaction to this, and in particular, to the largesse of the mini-Budget has been brutal. While the Bank did fall short of announcing an emergency meeting and intra-meeting hike to address the fallout, its statement said that "...it will make a full assessment at its next scheduled meeting of the impact on demand and inflation from the Government’s announcements, and the fall in sterling, and act accordingly. The MPC will not hesitate to change interest rates by as much as needed to return inflation to the 2% target sustainably in the medium term, in line with its remit." Further, it has now commenced a temporary QE programme, with the focus on long-dated yields in order to restore orderly market conditions. In terms of Bank Rate expectations, peak levels next year have eased back from recently hit highs...but not materially so. Markets continue to price in the potential for Bank Rate to be at least 3.75% come the November meeting, with a further 100bps hike at the final meeting of the year in December. For 2023, expectations have reined in, with February levels expected to be 5.25% - 5.5%, compared to 5.75% and 6% previously. However, pricing still shows for Bank Rate to hit 6% in March, but potentially for it to then ease back to 5.75% - 5.5% in May and meetings thereafter. Remember, that even though these levels have come back from recent highs, they are still somewhat elevated to the peak of 4.75% - 5% that was being priced in before last week's events. The table below includes Link's updated forecast, which has been revised in light of recent economic and policy considerations.

Interest rate forecasts

The Council’s treasury adviser, Link Asset Services, has provided the following forecast:

PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1st November 2012.

Link Group Interest Rate View	27.09.22											
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
BANK RATE	4.00	5.00	5.00	5.00	4.50	4.00	3.75	3.25	3.00	2.75	2.75	2.50
3 month ave earnings	4.50	5.00	5.00	5.00	4.50	4.00	3.80	3.30	3.00	2.80	2.80	2.50
6 month ave earnings	4.70	5.20	5.10	5.00	4.60	4.10	3.90	3.40	3.10	3.00	2.90	2.60
12 month ave earnings	5.30	5.30	5.20	5.00	4.70	4.20	4.00	3.50	3.20	3.10	3.00	2.70
5 yr PWLB	5.00	4.90	4.70	4.50	4.20	3.90	3.70	3.50	3.40	3.30	3.20	3.20
10 yr PWLB	4.90	4.70	4.60	4.30	4.10	3.80	3.60	3.50	3.40	3.30	3.20	3.20
25 yr PWLB	5.10	4.90	4.80	4.50	4.30	4.10	3.90	3.70	3.60	3.60	3.50	3.40
50 yr PWLB	4.80	4.60	4.50	4.20	4.00	3.80	3.60	3.40	3.30	3.30	3.20	3.10

Compliance Report Appendix B

The Treasury and Prudential indicators.

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved 2022/23 Treasury and Prudential Indicators (affordability limits) were included and approved by Full Council as part of the TMSS on 3rd March 2022.

During the half year, the Council has operated within the treasury limits and Prudential Indicators set out in the Council's TMSS and in compliance with the Council's Treasury Management Practices. An update on indicators and limits are reported below.

Interest Rate Exposures:

This indicator is set to control the Council's exposure to interest rate risk on its debt portfolio. The upper limits on fixed and variable rate interest rate exposure, expressed as the proportion of gross principal borrowed as below:

	2021/22 Upper	2022/23 Upper	2023/24 Upper
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	25%	25%	25%

Fixed rate borrowings are those borrowings where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

Maturity Structure of Borrowing

This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

30-Sep-22 %	Actual maturity	Upper Limit %	Lower Limit %
18	Under 12 months	50	0
19	1 to 2 years	30	0
6	3 to 5 years	30	0
10	6 to 10 years	30	0
47	more than 10 years	100	0

Currently the Council is temporary borrowing whilst rates remain substantially below long-term interest rates.

Principal Sums invested for Period Longer than 365 days:
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 set in the 2022/23 treasury management strategy in comparison to the half year are set below.

	2021/22 Forecast £000s	2022/23 Estimate £000s	2023/24 Estimate £000s	2024/25 Estimate £000s
Upper limit for principal sums invested for more than 365 days	£70m or 50% of the outstanding balances			

Gross Debts and the Capital Financing Requirement (CFR)

2020/21 Actual £000s		2021/22 Forecast £000s	2022/23 Estimates £000s	2023/24 Estimates £000s	2024/25 Estimates £000s	2025/26 Estimates £000s	2026/27 Estimates £000s
400,738	Gross Projected Debt	502,889	583,258	562,803	581,529	594,521	614,960
505,768	Capital Financing Requirement	586,726	601,181	584,369	597,524	617,375	650,372
105,030	Under/(Over) borrowing	83,837	17,923	21,566	15,995	22,854	35,412

2020/21 Actual £000s		2021/22 Forecast £000s	2022/23 Estimate £000s	2023/24 Estimate £000s	2024/25 Estimate £000s	2025/26 Estimate £000s	2026/27 Estimate £000s
	CFR as at 31 March						
305,138	General Fund	354,961	350,989	338,833	319,636	299,216	287,222
200,631	HRA	231,765	250,193	245,536	277,889	318,159	363,150
505,768		**586,726**	**601,181**	**584,369**	**597,524**	**617,375**	**650,372**

Overall Borrowing Limits

2020/21 Actual £000s		2021/22 Forecast £000s	2022/23 Estimates £000s	2023/24 Estimates £000s	2024/25 Estimates £000s	2025/26 Estimates £000s	2026/27 Estimates £000s
	Authorised Limit :						
556,345	Borrowing	645,399	661,299	642,806	657,277	679,112	715,409
	Operational Boundary:						
505,768	Borrowing	586,726	601,181	584,369	597,524	617,375	650,372

The prudential indicator ensures that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose*. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2022/23 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

The Strategic Director of Finance and Governance (S151 Officer) reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

The Authorised Limit which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. It is a very difficult the investment market in terms of earning the level of interest rates commonly seen in previous decades as rates were very low. These historic investments which are maturing with the low interest rate has now been replaced with high interest rate investment as the base rate hikes to 2.25%.

Investment Counterparty criteria
The primary principle governing the Council's criteria is the security of its investments, although the yield or return on the investment is also a key consideration.

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' quality criteria where applicable.

	Minimum credit criteria / colour band	Max % of total investments/ £ limit per institution	Max. maturity period
Specified Investments			
DMADF – UK Government	N/A	**100%**	6 months*
Money market funds: CNAV and VNVAV	AAA	100%	Daily Liquidity
Local authorities	N/A	100%	3 years
Barclays Bank plc (the Council's bankers)		£20m £5m	Overnight deposits ** Up to 12 months
Term deposits with banks and rated building societies	Yellow Purple Blue Orange Red Green		Up to 3 years Up to 3 years Up to 3 years Up to l year Up to 6 Months Up to 3 months
Current and Ex - Government Supported banks	Green	50%	Up to 1 year

DMO – is the maximum period offered by the Debt Management Office of H.M.Treasury
** Over £20 million with the explicit agreement of the Strategic Director of Finance and Governance (S151 Officer).

NON-SPECIFIED INVESTMENTS: These are any investments that do not meet the specified investment criteria.
A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made, it will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

	Minimum Credit criteria / colour band	investments/ £ limit per institution	Max. maturity period
Non- Specified Investments			
Term deposits with unrated Building Societies	Assets over £1.0bn	25%	12 mths
UK Banks - Natwest, Santander, Lloyds, HSBC, Barclays and RBS	N/A	£70m or 50% of total investments	1-3 years
Pooled Vehicles: Enhanced Money Market Funds: UK Government and Government Guaranteed Securities Pooled Property Funds Short- Term Investment - graded sterling denominated instruments	N/A	£10m	4 years
UK Treasury Bills, Certificate of Deposits and T-Bills	Yellow Purple blue Orange Red Green No Colour		Up to 3 years Up to 2 years Up to 1 year up to 6 months up to 6 months up to 3 months Not for use
Corporate Bond including Floating Rate Notes(FRNs)	Minimum credit rating: BBB		3 years

Approved Countries for Investments

Lowest available rating	Approved Country
AAA	Australia Denmark Germany Luxembourg Netherlands Norway Singapore Sweden Switzerland
AA+	Canada Finland U.S.A.
AA	Abu Dhabi (UAE) France
AA-	Belgium Hong Kong Qatar United Kingdom

Regulatory changes Appendix D

Consultation on the future of IFRS 9 statutory override

On the 14th September 2022 released the Department for Levelling up, Housing and Communities (DLUHC) released a consultation in advance of the current expiry of the qualifying Pooled Fund override to IFRS 9 accounting requirement.

The three options included in the consultation are:

- Allow for the statutory override to elapse
- Extend the statutory override on a time-limited basis
- Make the statutory override permanent.

The implementation of IFRS 9 Financial Instrument which removed the use of available for sale (AFS) as a classification available to the preparers of the Statement of Accounts.

Glossary of Terms **Appendix E**

A bond is a debt instrument in which an investor lends money for a specified period of time at a fixed rate of interest. The issuing entity could be corporate, financial or government.

A floating rate note (FRN) is a money market instrument with a Floating/variable rate of interest, which re-fixes over a reference rate, for example 3 month LIBOR.

Bail in is rescuing a financial institution on the brink of failure by making its creditors and depositors take a loss on their holdings. A **bail**-in is the opposite of a **bail**-out, which involves the rescue of a financial institution by external parties, typically governments using taxpayer's money.

Certificates of deposit (CDs) are a negotiable form of fixed deposit, ranked pari passu with fixed deposits. The difference is that you are not obligated to hold the CD to maturity, you can realise the cash by selling in the secondary market.

Coupon is the total amount of interest a security will pay. The coupon period depends on the security. A CD will often pay interest at maturity, while a bond may pay semi annually or annually and an FRN will most likely pay every 3 months.

Covered bond Covered bonds are conventional bonds (fixed or floating) issued by financial institutions, that are backed by a separate group of loans, usually prime residential mortgages. This lowers the creditor's exposure to default risk, enhancing the credit. This is why the issue is usually rated AAA, higher than the rating given to the issuer reduces exposure to bail-in risk.

Credit rating A measure of the credit worthiness of a borrower. A credit rating can be assigned to country, organisation or specific debt issue/ financial obligation. There are a number of credit ratings agencies but the main 3 are Standard & Poor's, Fitch or Moody's.

MIFID is the Markets in Financial Instruments Directive. A European Union Directive.

Principal is the total amount being borrowed or lent.

Spread is the difference between the buy and sell price of a security. It can also be the gap, usually in basis points, between the yield of a security and the benchmark security.
Monetary Policy Committee (**MPC**) is a committee of the Bank of England, which meets for three and a half days, eight times a year, to decide the official interest rate in the United Kingdom (the Bank of England Base Rate).

CPIH (Consumer Prices Index including owner occupiers' housing costs) The new additional measure of consumer price inflation including a measure of owner occupiers' housing costs (OOH).

Treasury bills (T-bills) are UK government rated, short-dated form of Government debt, issued by the Debt Management Office (DMO) via a weekly tender. T-bills are normally issued for one, three or six month duration.

Borrowing Requirements The principal amount the Council requires to borrow to finance capital expenditure and loan redemptions.

Capital Financing Requirement (CFR) Capital Financing Requirement- a measure of the Council's underlying need to borrow to fund capital expenditure.

Counterparties Organisations or Institutions the Council lends money to e.g. Banks; Local Authorities and MMFs.

Credit Default Swap (CDS) A kind of protection that can be purchased by MMF companies from insurance companies (for their investment) in exchange for a payoff if the organisation they have invested in does not repay the loan i.e. they default.

Credit Watch A scoring system issued by credit rating agencies such as Fitch, Moody's and Standard & Poors that indicate the financial strength and other factors of a bank or similar Institution.

Interest Rate Exposures A measure of the proportion of money invested and what impact movements in the financial markets would have on them.

Market Loans Loans from banks available from the London Money Market including LOBOS (Lender Option, Borrowing Option) which enable the authority to take advantage of low fixed interest for a number of years before an agreed variable rate comes into force.

Money Market Fund (MMF) A 'pool' of different types of investments managed by a fund manager that invests in lightly liquid short term financial instruments with high credit rating.

Minimum Revenue Provision (MRP) This is the amount which must be set aside from the revenue budget each year to cover future repayment of loans.

Sterling Overnight Interbank Average Rates (SONIA) –
is based on the actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors.