Treasury Management Half Year Report 2022-23

Audit Committee Meeting	
Meeting Date	15 November 2022
Report Title	Treasury Management Half Year Report 2022/23
EMT Lead	Lisa Fillery, Director of Resources
Head of Service	Duncan Ellis, Head of Finance and Procurement (interim)
Lead Officer	Duncan Ellis, Head of Finance and Procurement (interim) & Olga Cole, Management Accountant
Classification	**Open**
Recommendations	1. To note the performance information in this report. 2. To note the prudential and treasury management indicators within the report.

1 Purpose of Report and Executive Summary

1.1 The purpose of this report is to review the mid-year position on treasury management transactions for 2022/23, including compliance with treasury limits and Prudential and Treasury Performance Indicators. This report will be going to Council on 7 December 2022.

1.2 The Treasury Management Strategy is underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in the Public Services, which requires the Council to approve treasury management half-year and annual reports.

1.3 The Council's Treasury Management Strategy for 2022/23 was approved at a meeting on 23 February 2022. The Council has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk is therefore central to the Council's Treasury Management Strategy.

1.4 In conclusion the Council can confirm that it has complied with its Prudential Indicators for 2022/23 which were set in February 2022 as part of the Council's Treasury Management Strategy Statement. The Council is required to report on the highly technical Prudential Indicators. There are no issues of concern to highlight with Members. The indicators are based on approved commitments and the current budget.

2 Background

<u>Market Environment</u>

2.1 Economic background: The ongoing conflict in Ukraine has continued to put pressure on global inflation and the economic outlook for UK and world growth remains weak. The UK political situation towards the end of the period following the 'fiscal event' increased uncertainty further.

2.2 The economic backdrop during the April to September period continued to be characterised by high oil, gas and commodity prices, ongoing high inflation and its impact on consumers' cost of living, no imminent end in sight to the Russia-Ukraine hostilities and its associated impact on the supply chain, and China's zero-Covid policy.

2.3 UK inflation remained extremely high. Annual headline CPI hit 10.1% in July, the highest rate for 40 years, before falling modestly to 9.9% in August. RPI registered 12.3% in both July and August. The energy regulator, Ofgem, increased the energy price cap by 54% in April, while a further increase in the cap from October, which would have seen households with average energy consumption pay over £3,500 per annum, was dampened by the UK government stepping in to provide around £150 billion of support to limit bills to £2,500 annually until 2024.

2.4 The Bank of England increased the official Bank Rate to 2.25% over the period. From 0.75% in March, the Monetary Policy Committee (MPC) pushed through rises of 0.25% in each of the following two MPC meetings, before hiking by 0.50% in August and again in September. August's rise was voted by a majority of 8-1, with one MPC member preferring a more modest rise of 0.25%. the September vote was 5-4, with five votes for an 0.5% increase, three for an 0.75% increase and one for an 0.25% increase. The Committee noted that domestic inflationary pressures are expected to remain strong and so given ongoing strong rhetoric around tackling inflation further Bank Rate rises should be expected.

2.5 Arlingclose's Economic Outlook for the remainder of 2022/23 (based on 26th September 2022 interest rate forecast).

	Current	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
Official Bank Rate													
Upside risk	0.00	0.50	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	2.25	4.25	5.00	5.00	5.00	5.00	5.00	5.00	5.00	4.75	4.25	3.75	3.25
Downside risk	0.00	-1.00	-1.00	-0.75	-0.50	-0.50	-0.50	-0.75	-1.25	-1.50	-1.75	-1.75	-1.75

Arlingclose expects Bank Rate to rise further during 2022/23 to reach 5% by the end of the year.

Borrowing

2.6 CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the Authority

2.7 On 1 April 2022, the Council had two loans from other local authorities, totalling £10m. During the first half of the financial year the Council has not repaid or taken out any additional loans. On 30 September 2022, the Council's external borrowing stood at £10m and further details can be found within appendix I below.

Investments

2.8 The Council may invest its surplus funds with any of the counterparty types in the table below, subject to the cash limits (per counterparty) and the time limits shown. These counterparties were agreed by Cabinet and Council earlier this year when the 2022/23 Treasury Strategy was approved.

Counterparty	**Time Limit**	**Cash Limits**
The UK Government	50 years	Unlimited
Local Authorities and other government entities	25 years	£3m
Major UK banks / building societies unsecured deposits*	13 months	£3m
Leeds Building Society unsecured deposits*	As per credit advice	£1.5m
Close Brothers unsecured deposits*	As per credit advice	£1.5m
Money Market Funds*	n/a**	£3m each
Strategic Pooled Funds e.g., Absolute return, Equity income, Corporate Bond Funds, Multi Asset Funds	n/a**	£3m each
CCLA Property Fund	n/a**	£3m
Registered providers (unsecured) *	5 years	£3m in aggregate
Secured Investments*	25 years	£3m in aggregate
Other Investments *	5 years	£3m in aggregate
Non treasury investments	As per credit advice	To be agreed on a case by case basis

* Minimum credit rating: Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than [A-]. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

**These funds have no defined maturity dates but are available for withdrawal after a notice period.

2.9 The Council holds significant investment funds, representing income received in advance of expenditure plus balance and reserves held. During the six months to 30 September 2022 the Council held average daily cash balance of £28.2m (£33.8m September 2021).

2.10 The Council's budgeted investment income for the six months to 30 September 2022 was £83k (£84k September 2021) and the actual income received was £174 (£79k September 2021), of which £58k (£56k September 2021) was from the Council's long-term investment in the Church, Charities and Local Authorities (CCLA) Mutual Investment Property Fund.

2.11 The results for the six months to 30 September 2022 show that the Council achieved 0.23% (0.48% September 2021) average return below the average Sterling Overnight Index Average (SONIA) and 0.29% average return rate below the average Bank of England Base Rate.

2.12 The Council has £3m invested in an externally managed property fund which is the CCLA property fund which generated an average total return of 3.84%, comprising of a £58k (3.72%, £56k September 2021) income return. Since this fund has no defined maturity date but is available for withdrawal after a notice period (due to the current uncertain market conditions this period was extended in October from 3 to 6 months), its performance and continued suitability in meeting the Council's investment objectives are regularly reviewed. Considering its performance and the Council's latest cash flow forecasts, investment in this fund has been maintained.

Compliance with Prudential Indicators

2.13 The Council can confirm that it has complied with its Prudential Indicators for 2022/23 which were set in February 2022 as part of the Council's Treasury Management Strategy Statement. The Council is required to report on the highly technical Prudential Indicators. There are no issues of concern to highlight with Members. The indicators are based on approved commitments and the current budget.

2.14 Prudential and Treasury Management Indicators are set out in Appendix II.

3 Proposals

3.1 No changes are proposed at this stage.

4 Alternative Options Considered and Rejected

4.1 The Director of Resources will consider changes to the counterparty criteria with reference to the Council's agreed policy with regard to risk.

5 Consultation Undertaken or Proposed

5.1 Consultation has been undertaken with the Council's retained treasury management consultants Arlingclose.

6 Implications

Issue	Implications
Corporate Plan	Supports delivery of the Council's objectives.
Financial, Resource and Property	As detailed in the report.

Legal, Statutory and Procurement	CIPFA produce a framework for managing treasury activities, called a 'Code'. Councils are legally required to have regard to this Code and members of CIPFA are expected to comply with its requirements. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the DLUHC Guidance.
Crime and Disorder	Following CIPFA's Treasury Management Code of Practice is important to avoid involvement in potential fraud or money laundering.
Environment and Climate/Ecological Emergency	The Council does not own any shares or corporate bonds so there are no ethical investment considerations to be met.
Health and Wellbeing	Not relevant to this report.
Safeguarding of Children, Young People and Vulnerable Adults	Not relevant to this report.
Risk Management and Health and Safety	Risk is controlled through adherence to specific guidance included in CIPFA's Treasury Management Code of Practice. The principle of security of funds over-rides investment performance.
Equality and Diversity	Not relevant to this report.
Privacy and Data Protection	Not relevant to this report.

7 Appendices

7.1 The following documents are to be published with this report and form part of the report.

- Appendix I: Investments and Borrowing as at 30 September 2022
- Appendix II: Prudential and Treasury Management Indicators

8 Background Papers

8.1 None.

Investments and Borrowings as at 30 September 2022

Counterparty	**Long-Term Rating**	**Balance Invested & Borrowed at 30 September 2022 £'000**
Fixed Term Deposits		
Debt Management Office	AA-	3,000
Money Market Funds		
Invesco Money Market Fund	AAAmmf	3,000
Deutsche Money Market Fund	AAAmmf	1,670
Goldman Sachs Money Market Fund	AAAmmf	3,000
Aberdeen Money Market Fund	AAAmmf	3,000
Black Rock Money Market Fund	AAAmmf	3,000
JP Morgan Money Market Fund	AAAmmf	2,890
Morgan Stanley Money Market Fund	AAAmmf	3,000
SSGA Money Market Fund	AAAmmf	3,000
CCLA Property Fund		3,000
Total Fixed Term Deposits, Money Market and Property Funds		**28,560**
TOTAL INVESTMENTS	**Maturity Date**	**£'000**
West Midlands Combined Authority	06/04/2023	-5,000
London Borough of Islington	27/02/2023	-5,000
TOTAL BORROWING		**-10,000**

The Ratings above are from Fitch credit rating agency. The Long-Term Rating is the benchmark measure of probability of default. These ratings are shown for illustrative purposes only, as the Council uses the lowest rating across three agencies on which to base its decisions.

AAAmmf: Fund has very strong ability to meet the dual objective of providing liquidity and preserving capital.

AA-: High quality, low default risk.

Investment Activity in 2022/23

Investments	Balance on 01/04/2022 £'000	Investments Made £'000	Investments Repaid £'000	Balance on 30/09/2022 £'000	Average Rate %
Short Term Investments and Cash and Cash Equivalents	23,335	107,650	(105,425)	25,560	0.99
Long Term Investments	3,000	0	0	3,000	3.84
TOTAL INVESTMENTS	**26,335**	**107,650**	**(105,425)**	**28,560**	

Borrowing Activity in 2022/23

Borrowing	Balance on 01/04/2022 £'000	Borrowing Made £'000	Borrowing Repaid £'000	Balance on 30/09/2022 £'000	Average Rate %
External Borrowing	10,000	0	0	10,000	0.73
Total Borrowing	**10,000**	**0**	**0**	**10,000**	

Non-Treasury Investments

The definition of investments in CIPFA's revised 2021 Treasury Management Code covers all the financial assets of the Council, as well as other non-financial assets which the Council holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and/or for commercial purposes (made primarily for financial return).

The Council holds £4.03m (£3.599m September 2021) of a long-standing portfolio of 13 investment properties within the borough. These investments are expected to generate £0.2m (£0.2m September 2021) of investment income for the Council after taking account of direct costs, representing a rate of return of 5.2% (4.5% September 2021).

Prudential and Treasury Management Indicators

Appendix II

1. Background

There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in local authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators.

2. Gross Debt and the Capital Financing Requirement (CFR)

This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for a capital purpose, the local authority should ensure that debt does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional increases to the capital financing requirement for the current and next two financial years.

Capital Financing Requirement	**2021/22 Actual**	**2022/23 Revised Estimate**	**2023/24 Estimate**	**2024/25 Estimate**
	£'000	**£'000**	**£'000**	**£'000**
Capital Financing Requirements	47,774	48,999	59,627	65,768
External Borrowing	(10,000)	(13,000)	(24,700)	(32,700)
Cumulative External Borrowing Requirements	**37,774**	**35,999**	**34,927**	**33,068**

External Borrowing: as at 30 September 2022 the Council had £10 million of external borrowing – please see Appendix I for further details.

3. Capital Expenditure

This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax.

Capital Expenditure and Financing	2021/22 Actual	2022/23 Revised Estimate	2023/24 Original Estimate	2024/25 Original Estimate
	£'000	£'000	£'000	£'000
Total Expenditure	**6,083**	**12,995**	**21,704**	**23,111**
Revenue contributions	29	2,800	50	509
Capital receipts	201	74	380	0
Grants and other contributions	4,829	7,031	9,574	14,602
Internal/ External borrowing	1,024	3,090	11,700	8,000
Total Financing	**6,083**	**12,995**	**21,704**	**23,111**

4. Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability, highlighting the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs. The definition of financing costs is set out in the Prudential Code. The ratio is based on costs net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2021/22 Actual %	2022/23 Estimate %	2023/24 Estimate %	2024/25 Estimate %
Total	**4.83**	**6.81**	**8.77**	**15.13**

5. Actual External Debt

This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

Actual External Debt as at 30/09/2022	£'000
Borrowing	10,000
Other Long-term Liabilities	0
Total	**10,000**

6. Authorised Limit and Operational Boundary for External Debt

The Authorised Limit sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long- and short-term borrowing, overdrawn bank balances and long-term liabilities). This Prudential Indicator separately identifies borrowing from other long-term liabilities such as finance leases. It is consistent with the Council's existing commitments, its proposals for capital expenditure and financing, and its approved treasury management strategy and practices.

The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

Authorised Limit for External Debt	**2022/23 Estimate £'000**	**2023/24 Estimate £'000**	**2024/25 Estimate £'000**
Borrowing	70,000	70,000	70,000
Other Long-term Liabilities	2,000	2,000	2,000
Total	**72,000**	**72,000**	**72,000**

The Operational Boundary links directly to the Council's estimates of the CFR and estimates of other cash flow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst-case scenario but without the additional headroom included within the Authorised Limit.

Operational Boundary	**2022/23 Estimate £'000**	**2023/24 Estimate £'000**	**2024/25 Estimate £'000**
Borrowing	55,000	55,000	55,000
Other Long-term Liabilities	500	500	500
Total Debt	**55,500**	**55,500**	**55,500**

Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

The Head of Finance and Procurement confirms that there were no breaches to the Authorised Limit and the Operational Boundary during the period to 30 September 2022.

7. Interest Rate Exposure

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.

Upper Limit for Interest Rate Exposure	**Actual level at 30/09/22**	**2022/23 Approved Limit**	**Complied?**
Interest on fixed rate borrowing	100%	100%	✓
Interest on fixed rate investments	-10%	-100%	✓
Interest on variable rate borrowing	0%	100%	✓
Interest on variable rate investments	-90%	-100%	✓

8. Maturity Structure of Borrowing

This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were.

Maturity structure of borrowing	**Existing level at 30/09/22 %**	**Lower Limit for 2022/23 %**	**Upper Limit for 2022/23 %**	**Complied**
Under 12 months	100	0	100	✓
12 months and within 24 months	0	0	100	✓
24 months and within 5 years	0	0	100	✓
5 years and within 10 years	0	0	100	✓
10 years and above	0	0	100	✓

9. Credit Risk

The Council considers security, liquidity and yield, in that order, when making investment decisions. Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Council's assessment of counterparty credit risk.

The Council also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. The following key tools are used to assess credit risk:

- published credit ratings of the financial institution (minimum A- or equivalent) and its sovereign (minimum AA+ or equivalent for non-UK sovereigns);
- sovereign support mechanisms;
- credit default swaps (where quoted);
- share prices (where available);
- economic fundamentals, such as a country's net debt as a percentage of its GDP;
- corporate developments, news, articles, markets sentiment and momentum; and
- subjective overlay.

The only indicators with prescriptive values remain to be credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

The Head of Finance and Procurement confirms that there were no breaches to counterparty limits or credit ratings at the time of placing investments.

10. Principal Sums Invested for Periods Longer than over 364 days

The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested.

Total Principal Sums Invested Over 364 Days	**2022/23** **£'000**
Upper Limit Estimate	10,000
Actual	3,000
Complied?	✓

11. Investment Benchmarking for the six months to 30 September 2022

Average Actual Return on Investments	**Original Estimate Return on Investments**	**Average Bank Base Rate**	**Average Overnight SONIA Rate**
0.99%	0.30%	1.28%	1.22%