Appendix 1 - Treasury Management Report Q1 2022/23

1. Introduction

1.1. The Council has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports.

1.2. The Authority's treasury management strategy for 2022/23 was approved at a full Council meeting on 1 March 2022. The Authority has borrowed and 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 remains central to the Authority's treasury management strategy.

1.3. Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report.

1.4. The Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 1 March 2022.

2. External Context (provided by the Council's treasury management advisor, Arlingclose)

Economic background

2.1. Following Russia's invasion of Ukraine in February 2022, global inflationary pressures intensified sharply, leading to a sizeable deterioration in the global economic outlook.

2.2. The economic backdrop in the April-June 2022 quarter was characterised mainly by higher oil, gas and commodity prices, and fears of rising and persistent inflation and its damaging impact on consumers' cost of living. There was little indication of an imminent end to Russia-Ukraine conflict and supply chain bottlenecks were exacerbated by the war in Ukraine and lockdowns in China.

2.3. Added to this was tough rhetoric and action by central bankers globally on fighting inflation through higher interest rates and quantitative tightening even as financial conditions became increasingly difficult for consumers, more so for those whose wages have not kept pace with inflation.

2.4. In the UK inflation remained elevated. Ofgem, the energy regulator, increased the energy price cap by 54% in April, equivalent to around £700 for a household with average energy consumption (the cap had already increased 12% back in October 2021). In May, data showed CPI edging higher to 9.1% while the core CPI rate, which removes energy, fuel and food was 5.9%. RPI rose to 11.7%.

2.5. The labour market continued to show signs of tightness as employers struggled to fill vacancies with workers who have the relevant skill sets matching their requirements. The unemployment rate for April fell to 3.8% and is now below pre-pandemic levels. Pay growth was 6.8% for total pay (including bonuses) and 4.2% for regular pay; however, adjusted for inflation, growth in total pay was just 0.4%, whilst regular pay fell 2.2%.

2.6. Unsurprisingly, with disposable income squeezed and another energy cap increase due in October, consumer confidence plummeted to the level last seen during the 2008/09 financial crisis. Quarterly GDP growth in the first quarter of 2022 was 0.8%.

2.7. Having increased interest rates by 0.25% in April 2022, the Bank of England's Monetary Policy Committee (MPC) increased the official Bank Rate by a further 0.25% to 1.25% in June 2022. This was a split decision with some members of the MPC expressing a preference for a 0.5% increase instead.

2.8. Rises in the input and output producer price measures suggest further inflationary pressure is in the pipeline. The Bank of England is therefore unlikely to become complacent, so further rate rises look likely in the near term.

2.9. In the US, CPI annual inflation rose to 9.1% in June 2022, the highest in nearly 40 years. The Federal Reserve also stepped up its fight against inflation with a 0.5% hike in rates in May followed by a further increase of 0.75% in June, the latter is its most aggressive hike since 1994 and higher than markets expected, taking policy rates to a range of 1.5% - 1.75%.

2.10. In the Eurozone, inflation also pushed higher to 8.1%, with energy price pressures a major contributor. Europe has been heavily impacted by the energy crisis following the Russian invasion of Ukraine, but concerns about the Eurozone's peripheral members and highly indebted member states complicates the European Central Bank's (ECB) response as it seeks to normalise monetary policy. The ECB stated it would end quantitative easing at the beginning of July and then increase interest rates by 0.25% later in the month, the first hike since 2011.

Financial markets

2.11. Heightened uncertainty characterised financial market sentiment and bond yields were similarly volatile but with a general upward trend as concern over higher inflation and higher interest rates continues to dominate.

2.12. Over the quarter the 5-year UK benchmark gilt yield rose from 1.41% to 1.89%, the 10-year gilt yield rose from 1.61% to 2.35% and the 20-year yield from 1.82% to 2.60%. The Sterling Overnight Rate (SONIA) averaged 0.89% over the period.

Credit review

2.13. Arlingclose extended the maximum duration limit for several UK and non-UK banks to 6 months following a full review of its credit advice on unsecured bank deposits. The maximum duration for unsecured deposits with other UK and non-UK banks on Arlingclose's recommended list is 100 days. The Council did not have any unsecured bank deposits placed with any bank as at the end of the reporting period.

2.14. Arlingclose continues to monitor and assess credit default swap levels for signs of credit stress, but no changes have been made to the counterparty list or recommended durations. Nevertheless, increased 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.

3. <u>Local Context</u>

3.1. On 31st March 2022, the Council had net borrowing of £700.4m arising from its revenue and capital income and expenditure. 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. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

Type of Liability	**31.03.22 Actual** £m**
General Fund CFR	598.1
HRA CFR	404.6
**Total CFR ** **	**1,002.7**
Less: *Other debt liabilities	(28.2)
Borrowing CFR – comprised of:	**974.5**
- External borrowing	700.4
- Internal borrowing	274.1

* finance leases, PFI liabilities and transferred debt that form part of the Authority's total debt
** subject to audit

3.2. The treasury management position on 30 June 2022 and the change over the year is shown in Table 2 below.

Table 2: Treasury Management Summary

Type of Borrowing / Investment	**31.03.22 Balance (£m)**	**Movement (£m)**	**30.06.22 Balance (£m)**	**30.06.22 Rate (%)**
Long-term borrowing	600.4	(0.5)	599.9	3.00
Short-term borrowing	100.0	(15.0)	85.0	0.84
Total borrowing	**700.4**	**(15.5)**	**684.9**	**2.73**
Short-term investments	5.0	0.0	5.0	0.12
Cash and cash equivalents	66.2	(33.2)	33.0	1.00
Total investments	71.2	**(33.2)**	38.0	**0.92**
Net borrowing	**629.2**	**17.7**	**646.9**	

4. Borrowing Update

4.1. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield. The Authority does not plan to borrow to invest primarily for commercial return and is therefore unaffected by these changes and retains its ability to continue to fully access the PWLB.

Borrowing strategy during the period

4.2. On 30 June 2022 the Council held £684.9m of loans, a decrease of £15.5m (compared to 31 March 2022), as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30 June are summarised in Table 3 below.

Table 3: Borrowing Position

	31.03.22 Balance £m	Net Movement £m	30.06.22 Balance £m	30.06.22 Weighted Average Rate %	30.06.22 Weighted Average Maturity (years)
Public Works Loan Board	475.4	(0.5)	474.9	2.54	30
Banks (LOBO)	125	0.0	125	4.72	38
Local authorities (short-term)	100.0	(15.0)	85.0	0.84	0
Total borrowing	**700.4**	**(15.5)**	**684.9**	**2.73**	**28**

4.3. Over the April- June 2022 quarter, short-term rates rose between 0.5% and 0.9% and long-term rates rose between 0.6% and 0.8%.

4.4. The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective. The Council's strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

4.5. In keeping with the Council's objectives, no new borrowing was undertaken during the period, while £15.5m of existing loans were allowed to mature without immediate replacement. This strategy enabled the Council to keep new borrowing costs at a minimum due to the increase in interest rates.

4.6. Due to these increases in the borrowing rates during the quarter, the Council considered it to be more cost effective in the near term to use internal resources. The current economic uncertainty has caused significant volatility in the financial markets. The Council is prepared to undertake additional borrowing should rates fall below the target rates due to the market volatility.

4.7. The Council has a significant capital programme which extends into the foreseeable future. A large proportion of this will be financed by borrowing, which the Council will have to undertake in coming years. The Council's treasury advisor, Arlingclose undertakes a weekly 'cost of carry' analysis which informs the Council on whether it is financially beneficial to undertake borrowing now or delay this for set time periods based on interest rate forecasts.

4.8. The Council's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short and long-term borrowing is maintained.

LOBO Loans

4.9. The Authority continues to hold £125m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during the year.

5. Treasury Investment Activity

5.1. CIPFA's revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes defines treasury management investments as those which arise from the Council's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

5.2. The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Council's investment balances ranged between £71.2m and £38.0 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

Investments	31.03.22 Balance £m	Net Movement £m	30.06.22 Balance £m	30.06.22 Rate of Return %	30.06.22 Weighted Average Maturity (Days)
Money Market Funds	0.0	20.0	20.0	1.06%	1
UK Government:					
- Local Authorities	5.0	0.0	5.0	0.12%	53
- Debt Management Office	66.2	(53.2)	13.0	1.00%	1
Total investments	**71.2**	**(33.2)**	**38.0**	**0.92%**	**8**

5.3. Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum 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.

5.4. The 0.25% increases in Bank Rate at the Money Policy Committee's meetings in May and June and with the prospect of more increases to come, short-dated cash rates, which had ranged between 0.7% - 1.5% at the end of March, rose on average by 0.65% over the quarter.

5.5. At the end of June, the rates on Debt Management Account Deposit Facility (DMADF) deposits ranged between 1.05% and 1.78% and the return on sterling low volatility net asset value (LVNAV) Money Market Funds ranged between 0.9% and 1.1%.

5.6. The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below

Table 5: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (Days)	Rate of Return
31.03.2022	**4.46**	**AA-**	**44%**	**110**	**0.06%**
30.06.2022	**4.11**	**AA-**	**53%**	**8**	**0.92%**
Similar Local Authorities	**4.36**	**A+**	**71%**	**32**	**1.41%**
All Local Authorities	**4.20**	**A+**	**64%**	**16**	**1.78%**

Scoring:
AAA = highest credit quality = 1; D = lowest credit quality = 26
Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

Non-Treasury Investments

5.7. The definition of investments in CIPFA's revised 2021 Treasury Management Code covers all the financial assets of the Authority as well as other non-financial assets which the Authority 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.

5.8. Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) and Welsh Government also broadens the definition of investments to include all such assets held partially or wholly for financial return.

Treasury Performance

5.9. Treasury investments generated an average rate of return of 0.67% in the first quarter of the financial year. The Council's treasury investment income for the year is likely to be above the budget forecast due to the increase in interest rates during the first half of 2022.

5.10. Borrowing costs for 2022/23 are forecast in line with budget at Q1 at £26.2m (£14.9m HRA, £11.3m General Fund).

6. Compliance

6.1. The Director of Finance reports that all treasury management activities undertaken during the quarter complied fully with the principles in the Treasury Management Code and the Council's approved Treasury Management Strategy.

6.2. Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 6 below.

Table 6: Debt Limits

	30.06.22 Actual £m	2022/23 Operational Boundary £m	2022/23 Authorised Limit £m	Complied?
Borrowing	569.2	1,236.0	1,286.0	Yes
PFI and Finance Leases	28.2	23.4	25.7	Yes
Total debt	**597.4**	**1,259.4**	**1,311.7**	**Yes**

6.3. 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, however, the Council's debt remained well below this limit at all points in the financial year.

Treasury Management Indicators

6.4. The Authority measures and manages its exposures to treasury management risks using the following indicators.

Security

6.5. The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	30.06.22 Actual	2022/23 Target	Complied?
Portfolio average credit score	4.11 (AA-)	7.0 (A-)	Yes

Liquidity

6.6. The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

	30.06.22 Actual	2022/23 Target	Complied?
Total cash available within 3 months	38.0	10.0	Yes

Interest Rate Exposures

6.7. This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

Interest rate risk indicator	30.06.22 Actual	2022/23 Target	Complied?

Upper limit on one-year revenue impact of a 1% rise in interest rates	£0.10m	£1m	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	£0.10m	£1m	Yes

6.8. The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at current rates.

Maturity Structure of Borrowing

6.9. 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:

	30.06.22 Actual	**Upper Limit**	**Lower Limit**	**Complied?**
Under 12 months	13.9%	50%	0%	Yes
12 months and within 24 months	3.5%	40%	0%	Yes
24 months and within 5 years	3.4%	40%	0%	Yes
5 years and within 10 years	5.10%	40%	0%	Yes
10 years and within 20 years	13.1%	40%	0%	Yes
20 years and within 30 years	5.8%	40%	0%	Yes
30 years and with 40 years	21.4%	50%	0%	Yes
40 years and within 50 years	32.90%	50%	0%	Yes
50 years and above	0.00%	40%	0%	Yes

6.10. Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

6.11. The Council has used short term borrowing (under 1 year in duration) from other local authorities extensively in recent years, as an alternative to longer term borrowing from PWLB, due to lower interest rates, and corresponding revenue savings.

6.12. However, short term borrowing exposes the Council to refinancing risk: the risk that rates rise quickly over a short period of time and are at significantly higher rates when loans mature, and new borrowing has to be raised. With this in mind, the Council has set a limit on the total amount of short-term local authority borrowing, as a proportion of all borrowing.

Short term borrowing	**Limit**	**30.06.22**	**Complied?**
Upper limit on short-term borrowing from other local authorities as a percentage of total borrowing	30%	14%	Yes

Principal Sums Invested for Periods Longer than a year

6.13. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2022/23	**2023/24**	**2024/25**
Actual principal invested beyond year end	Nil	Nil	Nil
Limit on principal invested beyond year end	£10m	£10m	£10m

Complied?	Yes	Yes	Yes