

## REPORT TO EXECUTIVE



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PORTFOLIO	Resources and Performance Management
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## 2022/23 Treasury Management Mid-Year Report

## PURPOSE

1. To report treasury management activity for the first half year of 2022/23 covering the period 1 April to 30 September 2022.

## RECOMMENDATION

2. The Executive is requested to;
  - Note the treasury management activities undertaken during the period 1 April to 30 September 2022, and;

Recommend that Full Council;

- Endorse the mid-year update on Treasury Management Strategy for 2022/23 in compliance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management.

## REASONS FOR RECOMMENDATION

3.
  - To inform members of the treasury management activity in the first half of 2022/23 and to fulfil statutory and regulatory requirements.

## SUMMARY OF KEY POINTS

4. **Background**

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. The first main function of treasury management

operations is to ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return.

The second main function of the treasury management service is to ensure 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 commitments. This management of longer term cash may involve arranging long or short term loans, or using cash flow surpluses, and, on occasions, any current debt may be restructured to meet Council risk or cost objectives.

Treasury management is defined as:

“The management of the Council'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.”

The monitoring requirements for treasury were set out in the report which included both the Treasury Management Strategy for 2022/23 and the Prudential and Treasury Indicators for 2022/23 – 2024/25, approved by Full Council on 23 February 2022.

## 5. 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 Strategy 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 manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by Full Council of an annual Treasury Management Strategy - 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 Scrutiny 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 six months of 2022/23;
- A review of the Treasury Management Strategy 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 2022/23;
- 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.

## 6. **Economic Update (Provided by Link Asset Services)**

- The second quarter of 2022/23 saw:
  - GDP revised upwards in Q1 2022/23 to +0.2% q/q from -0.1%, which means the UK economy has avoided recession for the time being;
  - Signs of economic activity losing momentum as production fell due to rising energy prices;
  - CPI inflation ease to 9.9% y/y in August, having been 9.0% in April, but domestic price pressures showing little sign of abating in the near-term;
  - The unemployment rate fall to a 48-year low of 3.6% due to a large shortfall in labour supply;
  - Bank Rate rise by 100bps over the quarter, taking Bank Rate to 2.25% with further rises to come;
  - Gilt yields surge and sterling fall following the "fiscal event" of the new Prime Minister and Chancellor on 23<sup>rd</sup> September.
- The UK economy grew by 0.2% q/q in Q1 2022/23, though revisions to historic data left it below pre-pandemic levels.
- There are signs of higher energy prices creating more persistent downward effects in economic activity. Both industrial production (-0.3% m/m) and construction output (-0.8% m/m) fell in July 2022 for a second month in a row. Although some of this was probably due to the heat wave at the time, manufacturing output fell in some of the most energy intensive sectors (e.g., chemicals), pointing to signs of higher energy prices weighing on production. With the drag on real activity from high inflation having grown in recent months, GDP is at risk of contracting through the autumn and winter months.
- CPI inflation eased from 10.1% in July to 9.9% in August, though inflation has not peaked yet. The easing in August was mainly due to a decline in fuel prices reducing fuel inflation from 43.7% to 32.1%. And with the oil price now just below \$90pb, we would expect to see fuel prices fall further in the coming months.
- However, utility price inflation is expected to add 0.7% to CPI inflation in October when the Ofgem unit price cap increases to, typically, £2,500 per household (prior to any benefit payments). But, as the government has frozen utility prices at that level for two years, energy price inflation will fall sharply after October and have a big downward influence on CPI inflation.
- Nonetheless, the rise in services CPI inflation from 5.7% y/y in July to a 30-year high of 5.9% y/y in August suggests that domestic price pressures are showing little sign of abating. A lot of that is being driven by the tight labour market and strong wage growth. CPI inflation is expected to peak close to 10.4% in November and, with the

supply of workers set to remain unusually low, the tight labour market will keep underlying inflationary pressures strong until early next year.

- During the first half of 2022, there has been a change of both Prime Minister and Chancellor. The new team (Liz Truss and Kwasi Kwarteng) have made a step change in government policy. The government's huge fiscal loosening from its proposed significant tax cuts will add to existing domestic inflationary pressures and will potentially leave a legacy of higher interest rates and public debt. Whilst the government's utility price freeze, which could cost up to £150bn (5.7% of GDP) over 2 years, will reduce peak inflation from 14.5% in January next year to 10.4% in November this year, the long list of tax measures announced at the "fiscal event" adds up to a loosening in fiscal policy relative to the previous government's plans of £44.8bn (1.8% of GDP) by 2026/27. These included the reversal of April's national insurance tax on 6<sup>th</sup> November, the cut in the basic rate of income tax from 20p to 19p in April 2023, the cancellation of next April's corporation tax rise, the cut to stamp duty and the removal of the 45p tax rate, although the 45p tax rate cut announcement has already been reversed.
- Fears that the government has no fiscal anchor on the back of these announcements has meant that the pound has weakened again, adding further upward pressure to interest rates. Whilst the pound fell to a record low of \$1.035 on the Monday following the government's "fiscal event", it has since recovered to around \$1.12. That is due to hopes that the Bank of England will deliver a very big rise in interest rates at the policy meeting on 3<sup>rd</sup> November and the government will lay out a credible medium-term plan in the near term. This was originally expected as part of the fiscal statement on 23<sup>rd</sup> November but has subsequently been moved forward to an expected release date in October. Nevertheless, with concerns over a global recession growing, there are downside risks to the pound.
- The MPC has now increased interest rates seven times in as many meetings in 2022 and has raised rates to their highest level since the Global Financial Crisis.
- Since the fiscal event on 23<sup>rd</sup> September, we now expect the Monetary Policy Committee (MPC) to increase interest rates further and faster, from 2.25% currently to a peak of 5.00% in February 2023. The combination of the government's fiscal loosening, the tight labour market and sticky inflation expectations means we expect the MPC to raise interest rates by 100bps at the policy meetings in November (to 3.25%) and 75 basis points in December (to 4%) followed by further 50 basis point hikes in February and March (to 5.00%). Market expectations for what the MPC will do are volatile. If Bank Rate climbs to these levels the housing market looks very vulnerable, which is one reason why the peak in our forecast is lower than the peak of 5.50% - 5.75% priced into the financial markets at present.
- Throughout 2022/23, gilt yields have been on an upward trend. However, the upward trend was exceptionally sharp at the end of September as investors demanded a higher risk premium and expected faster and higher interest rate rises to offset the government's extraordinary fiscal stimulus plans. The 30-year gilt yield rose from 3.60% to 5.10% following the "fiscal event", which threatened financial stability by forcing pension funds to sell assets into a falling market to meet cash collateral requirements. In response, the Bank did two things. First, it postponed its plans to start selling some of its quantitative easing (QE) gilt holdings until 31<sup>st</sup> October. Second, it committed to buy up to £65bn of long-term gilts to "restore orderly market conditions" until 14<sup>th</sup> October. In other words, the Bank is restarting QE, although for financial stability reasons rather than monetary policy reasons.

- Since the Bank's announcement on 28<sup>th</sup> September, the 30-year gilt yield has fallen back from 5.10% to 3.83%. The 2-year gilt yield dropped from 4.70% to 4.30% and the 10-year yield fell back from 4.55% to 4.09%.
- There is a possibility that the Bank continues with QE at the long-end beyond 14<sup>th</sup> October or it decides to delay quantitative tightening beyond 31<sup>st</sup> October, even as it raises interest rates. So far at least, investors seem to have taken the Bank at its word that this is not a change in the direction of monetary policy nor a step towards monetary financing of the government's deficit. But instead, that it is a temporary intervention with financial stability in mind.

## 7. **Interest Rate Forecast (Provided by Link Asset Services)**

The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates.

The latest forecast on 27<sup>th</sup> September sets out a view that both short and long-dated interest rates will be elevated for some little while, as the Bank of England seeks to squeeze inflation out of the economy, whilst the government is providing a package of fiscal loosening to try and protect households and businesses from the ravages of ultra-high wholesale gas and electricity prices.

The increase in PWLB rates reflects a broad sell-off in sovereign bonds internationally but more so the disaffection investors have with the position of the UK public finances after September's "fiscal event". To that end, the MPC has tightened short-term interest rates with a view to trying to slow the economy sufficiently to keep the secondary effects of inflation – as measured by wage rises – under control, but its job is that much harder now.

The 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

## 8. **Autumn Statement (November 2022)**

The Economic Update and Interest Rate forecasts reflect the current economic position at the time of writing this report, however there may be some changes following the Autumn Statement which is due to be announced 17<sup>th</sup> November 2022.

## 9. **Treasury Management Strategy update**

The Treasury Management Strategy (TMS) for 2022/23, which includes the Annual Investment Strategy, was approved by this Council on 23 February 2022. There are no policy changes to the TMS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

#### 10. **The Council's Capital Position**

The table below shows the financing of the Original Capital Budget approved by Full Council on the 23 February 2022 and the latest Revised Capital Budget. The increase is due to a combination of in year budget monitoring adjustments and reprofiling of capital expenditure into future years.

Capital	2022/23 Original Estimate £'000	2022/23 Revised Estimate £'000
<b>Total Budget</b>	<b>37,791</b>	<b>38,739</b>
Financed by:		
Capital receipts	2,022	2,341
Capital grants	19,437	20,919
Revenue	471	921
<b>Total financing</b>	<b>21,930</b>	<b>24,181</b>
<b>Borrowing need</b>	<b>15,861</b>	<b>14,558</b>

#### 11. **Investment Portfolio 2022/2023**

The Treasury Management Strategy Statement (TMSS) for 2022/23, which includes the Annual Investment Strategy, was approved by the Council on 23 February 2022. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

The Council will aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

##### **Investment Counterparty criteria**

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

##### **CDS prices**

It is noted that sentiment in the current economic climate can easily shift, so it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances

The average daily level of funds deposited during the financial year to date is £33.8m, compared with £26.9m for the same period in 2021/22. The actual value of funds deposited on the 30 September was £32.6m. These funds have been available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme.

There were 8 investments carried forward from 2021/22 totalling £38.2m, of which £20.2m was in call accounts with our bank HSBC, £4m was in call accounts with Santander, £12m was in fixed term deposits, and £2m was a loan made to Burnley College.

There have been 7 new investments made during the period 1 April to 30 September 2022 totalling £24m, including £12m that was re-invested, as well as a daily average of £13.5m being invested with HSBC's deposit account. The table below shows the amount invested at 30 September 2022, and the rate of return against the market benchmark.

Counterparties	Date of Investment	Investment Made £m	Return	Benchmark (average return)
HSBC (31 Day Notice)	12/08/2020	2.0	1.75%	1.11%
Santander (31 Day Notice)	30/09/2022	4.0	1.88%	1.11%
Lloyds Bank Corporate Markets – 3 mth fixed	17/08/2022	4.0	2.12%	1.70%
Standard Chartered Sustainable – 2 mth fixed	19/08/2022	4.0	1.94%	1.70%
Goldman Sachs – 6 mth fixed	08/09/2022	2.0	3.22%	2.12%
Goldman Sachs – 3 mth fixed	29/09/2022	2.0	3.47%	1.70%
Burnley College Loan – 15 years fixed	28/03/2022	2.0	4.45%	NA

The Council has an approved list of counterparties which governs treasury management investment activity. This list is a restricted list taking into consideration the credit rating of the institution concerned and there are also limits on the amount which can be invested with any particular institution from a particular sector e.g. building society, bank etc. and also any group of institutions within an overall banking group. As part of the daily operations of the treasury management dealings, in consultation with guidance from Link Asset Services and the money market brokers, decisions are taken by the Head of Finance & Property Services, temporarily suspending/revising operations with individual counterparties. The latest deposit counterparties list was approved by the Full Council on 23 February 2022.

The table below shows the maximum amount invested with any of the counterparties at any one time during the period April 2022 to 30 September 2022 against the maximum limits approved in the 2022/23 Treasury Management Strategy.

Counterparties	Maximum Limits £m	Highest level of Investment 2022/23 (£m)
HSBC	50.0	22.3
Lloyds Bank Corporate Markets	4.0	4.0
Santander	4.0	4.0
Goldman Sachs	4.0	4.0

Standard Chartered Sustainable	4.0	4.0
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## 12. **Property Funds**

The council made 2 investments totalling £2m in property funds in 2018/19 for the purpose of increasing and diversifying our risk in investment income receivable and to help alleviate future revenue budget pressures. Dividends received in the 3 month period April to June 2022 amounted to £16,379, earning an average yield of 3.3%, compared to £16,707 received for the same period in 2021/22.

## 13. **Borrowing**

The Council's capital financing requirement ( CFR) for 2022/23 is £76.703m. The CFR denotes the Council's underlying need to borrow for capital purposes. Below is a summary of the Councils' external indebtedness, as at 1 April 2022, and as at 30 September 2022.

Borrowing	1 Apr 22 £'000	30 Sept 22 £'000	Change Apr – Sept £'000
Public Works Loan Board	61,127	61,127	-
Temporary Market Loans	19	19	-
<b>Total</b>	<b>61,146</b>	<b>61,146</b>	-

**PWLB Loans** – There was no maturity loan repayments made during the period 1 April to 30 September 2022. Two scheduled annuity repayments were made during the same period totalling £270k.

**Temporary Market Loans** – There has been no movement in temporary market loans during the period 1 April to 30 September 2022.

## 14. **Debt Rescheduling**

Debt rescheduling opportunities have been very limited in the current economic climate and following the various increases in the margins added to gilt yields which have impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year. However, now that the whole of the yield curve has shifted higher there may be better opportunities in the future, although only prudent and affordable debt rescheduling will be considered.

## 15. **Compliance with Treasury & Prudential Limits**

It is a statutory duty for the Council to determine and keep under review its affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved Treasury Management Strategy.

During the financial year to date the Council's treasury management activities operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy in compliance with the Council's Treasury Management Practices.



An extract of the Prudential and Treasury Indicators are shown in Appendix 1.

16. **Interest Payable on External Borrowing / Interest Receivable**

Provision is made in the revenue budget to meet the net interest payable on external borrowing. The figure in the original budget for 2022/23 was set at £1,422,470.

This budget has been revised up to £1,584,354 due to the council increasing it's borrowing to finance the capital programme towards the end of the last financial year.

The total interest receivable on temporary deposits for the period 1 April 2022 to 30 September 2022 amounted to £182k. An additional £16,379 was received in dividends on Property Funds for the period 1 April 2022 to 30 June 2022. The budget for the year for interest and dividend receipts was set at £270k. This is now forecast to be £350k due to the increase in interest rates paid on deposits.

<b>FINANCIAL IMPLICATIONS AND BUDGET PROVISION</b>
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17. None arising as a direct result of this report.

<b>POLICY IMPLICATIONS</b>
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18. Compliance with the revised CIPFA Code of Practice on Treasury Management.

<b>DETAILS OF CONSULTATION</b>
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19. None.

<b>BACKGROUND PAPERS</b>
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20. None.

<b>FURTHER INFORMATION</b>
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**PLEASE CONTACT:**

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and Property**