Appendix C

Treasury Management Half Yearly Report

Introduction

The Authority 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.

The Authority's treasury management strategy for 2022/23 was approved by full Council in February 2022. The Authority has borrowed 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.

CIPFA published its revised Treasury Management Code of Practice (the TM Code) and Prudential Code for Capital Finance in December 2021. The key changes in the two codes are around permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments. The principles within the two Codes took immediate effect although local authorities could defer introducing the revised reporting requirements within the revised Codes until the 2023/24 financial year if they wish which the Authority has elected to do.

Treasury risk management at the Authority is conducted within the framework of the TM Code. This Code now also includes additional requirements for service and commercial investments, beyond those in the 2017 version.

External Context

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 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.

The Bank of England (BoE) increased Bank Rate by 0.75% to 3.0% in November 2022, the largest single rate hike since 1989 and the eighth successive rise since

December 2021. The decision was voted for by a 7-2 majority of the Monetary Policy Committee (MPC), with two members voting for a 0.50% rise and one other for just a 0.25% rise.

The November quarterly Monetary Policy Report (MPR) forecast a prolonged but shallow recession in the UK with CPI inflation remaining elevated at over 10% in the near-term. While the projected peak of inflation is lower than in the August report, due in part to the government's support package for household energy costs, inflation is expected to remain higher for longer over the forecast horizon and the economic outlook remains weak, with unemployment projected to start rising.

CPI inflation is expected to peak at around 11% in the last calendar quarter of 2022 and then fall sharply to 1.4%, below the 2% target, in two years' time and to 0% in three years' time if Bank Rate follows the path implied by financial markets with a peak of 5.25%. However, the BoE has stated it considers this path to be too high, suggesting that the peak in interest rates will be lower, reducing the risk of inflation falling too far below target.

Interest rates have also been rising sharply in the US, with the Federal Reserve increasing the range on its key interest rate by 0.75% in November 2022 to 3.75%-4.0%. This was the fourth successive 0.75% rise in a pace of tightening that has seen rates increase from 0.25%-0.50% in March 2022. Annual inflation has been slowing in the US but remains above 8%. GDP grew at an annualised rate of 2.6% between July and September 2022, a better-than-expected rise, but with official interest rates expected to rise even further in the coming months, a recession in the region is widely expected at some point during 2023.

Inflation has been rising consistently in the Euro Zone since the start of the year, hitting an annual rate of 10.7% in October 2022. Economic growth has been weakening with an expansion of just 0.2% in the three months to September 2022. As with the UK and US, the European Central Bank has been on an interest rate tightening cycle, pushing up its three key interest rates by 0.75% in October, the third major increase in a row, taking its main refinancing rate to 2% and deposit facility rate to 1.5%.

Financial markets: Uncertainty remained in control of financial market sentiment and bond yields remained volatile, continuing their general upward trend as concern over higher inflation and higher interest rates continued to dominate. Towards the end of September, volatility in financial markets was significantly exacerbated by the UK government's fiscal plans, leading to an acceleration in the rate of the rise in gilt yields and decline in the value of sterling.

Due to pressure on pension funds, the Bank of England announced a direct intervention in the gilt market to increase liquidity and reduce yields.

Credit review: The weakening economic picture during 2022 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several local authorities and financial institutions, revising them from to negative from stable.

Local Context

On 31st March 2022, the Authority had net borrowing of £524.9m 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

	31.3.22 Balance £'000
General Fund CFR	556,682
Total Borrowing	524,973
Internal Borrowing	**31,709**

The Authority pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, to reduce risk.

The treasury management position on 30th September 2022 and the change over the six months is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.22 Balance £'000	Movement £'000	30.9.22 Balance £'000	30.9.22 Rate %
Long-term borrowing	350,000	0	350,000	1.92%
Short-term borrowing	174,973	-5,973	169,000	0.90%
Total borrowing	**524,973**	**-5,973**	**519,000**	**1.59%**
Long-term investments	10,760	0	10,760	3.60%
Short-term investments	37,500	-14,500	23,000	2.09%
Cash and cash equivalents	4,986	-1,611	3,375	1.10%
Total investments	**53,246**	**-16,111**	**37,135**	**2.44%**
Net borrowing	**471,727**	**10,138**	**481,865**	**1.52%**

Net borrowing has increased since the 31st March 2022, predominantly due to the ongoing requirement to fund the Council's ongoing capital programme.

<u>Borrowing Strategy during the period</u>

As outlined in the treasury strategy, the Authority'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 Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

Over the April-September period short term PWLB rates rose dramatically, particularly in late September after the Chancellor's 'mini-budget', included unfunded tax cuts and additional borrowing to fund consumer energy price subsidies. Exceptional volatility threatened financial stability, requiring Bank of England intervention in the gilt market. Over a twenty-four-hour period, some PWLB rates increased to 6%, before the intervention had the desired effect, bringing rates back down by over 1% for certain maturities. PWLB rates have now fallen further and settled throughout November 2022 as market certainty returned following the instatement of a new Prime Minister and Chancellor.

At 30th September 2022 the Authority held £519m of loans, a decrease of £5.9m compared to 31st March 2022, as part of its strategy for funding previous and current years' capital programmes. This reduction is predominantly due to the reduction in investments over the period, therefore reducing the need to borrow. Outstanding loans on 30th September are summarised in Table 3 below.

<u>Table 3: Borrowing Position</u>

	31.3.22 Balance £'000	Net Movement £'000	30.9.22 Balance £'000	30.9.22 Average Rate %
Public Works Loan Board	350,000	0	350,000	1.92%
Local authorities	153,233	-5,973	169,000	0.90%
Total Borrowing	**503,233**	**-5,973**	**519,000**	**1.59%**

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

Treasury Investment Activity

CIPFA's revised TM Code defines treasury management investments as those which arise from the Authority's cash flows or treasury risk management activity that ultimately represents balances which need to be invested until the cash is required for use in the course of business.

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances ranged between £22m and £55m due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

Investment Position	31.3.22 Balance £'000	Net Movement £'000	30.9.22 Balance £'000	30.9.22 Income Return %
Banks	4,986	-1,611	3,375	1.10%
Money Market Funds	37,500	-14,500	23,000	2.09%
CCLA Property Fund	10,760	0	10,760	3.60%
Total Investments	**53,246**	**-16,111**	**37,135**	**2.44%**

Both the CIPFA Code and government guidance require the Authority 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 Authority'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.

Externally Managed Pooled Funds: The Authority is invested in the CCLA Local Authorities Property Fund. The improved market sentiment in the past 6 months is reflected in equity, property, and multi-asset fund valuations and, in turn, in the capital values of the Authority's investments in the property fund.

Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's medium- to long-term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rates.

Compliance

The Chief Financial Officer reports that all treasury management activities undertaken during the first half of 2022/23 complied fully with the Authority's approved Treasury Management Strategy.

Table 5: Investment Limits

	Q2 Maximum £'000	30.9.22 Actual £'000	2022/23 Limit £'000	Complied
Any single organisation, except the UK Government	10,000	3,375	10,000	Yes
Any single Money Market Fund	10,000	10,000	10,000	Yes
CCLA Property Fund	9,466	9,466	14,500	Yes

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 6 below. Neither the Operational Boundary, not Authorised Limit were breached during the first half of 2022/23

Table 6: Debt Limits

	2022.23 Maximum £'000	30.9.22 Actual £'000	2022/23 Operational Boundary £'000	2022/23 Authorised Limit	Complied
Borrowing	530,000	519,000	587,470	597,470	Yes

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.

Treasury Management Indicators

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

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio.

	30.9.22 Actual	2022/23 Target	Complied
Portfolio average credit score	A	A	✓

Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount it can borrow each quarter without giving prior notice.

	30.9.22 Actual	2022/23 Target	Complied
Total sum borrowed in past 3 months without prior notice	£0m	£0m	✓

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed was:

	30.9.22 Actual	2022/23 Limit	Complied
Upper limit on fixed interest rate exposure	67%	100%	✓
Upper limit on variable interest rate exposure	33%	100%	✓

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

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:

	30.9.22 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	28%	100%	0%	✓
12 months and within 24 months	0%	100%	0%	✓
24 months and within 5 years	6%	100%	0%	✓
5 years and within 10 years	37%	100%	0%	✓
10 years and above	29%	100%	0%	✓

Principal Sums Invested for Periods 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 on the long-term principal sum invested to final maturities beyond the period end were:

	2020/21 £'000	2021/22 £'000	2022/23 £'000
Actual principal invested beyond year end	0	0	0
Limit on principal invested beyond year end	£14.5m	£14.5m	£14.5m