BUDGET/COUNCIL PLAN COMMITTEE: 1 November 2022

EXECUTIVE OVERVIEW & SCRUTINY COMMITTEE: 3 November 2022

CABINET: 15 November 2022

COUNCIL: 14 December 2022

Report of: **Head of Finance, Procurement and Commercial Services**

Relevant Portfolio Holder: Adam Yates

Relevant Corporate Director: Transformation and Resources

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SUBJECT: TREASURY MANAGEMENT AND PRUDENTIAL INDICATORS Q2 MONITORING 2022-23

Wards affected: Borough wide

1.0 PURPOSE OF THE REPORT

1.1 To set out details of Treasury Management operations for the first half of 2022/23 and to report on the Prudential Indicators, where available.

2.0 RECOMMENDATIONS TO BUDGET/COUNCIL PLAN COMMITTEE

2.1 That the report be considered and any comments submitted to the Finance Portfolio Holder in advance of the Council meeting on 14 December 2022.

3.0 RECOMMENDATIONS TO EXECUTIVE OVERVIEW & SCRUTINY COMMITTEE

3.1 That the report be considered and any comments submitted to the Finance Portfolio Holder in advance of the Council meeting on 14 December 2022.

4.0 RECOMMENDATIONS TO CABINET

4.1 To note the Treasury Management activity and Prudential Indicator performance for the first quarter of 2022/23.

4.2 To note and endorse the changes to the Prudential Indicators highlighted in section 7 for approval by Council in December 2022.

5.0 RECOMMENDATIONS TO COUNCIL

5.1 To note the Treasury Management activity and Prudential Indicator performance for the first quarter of 2022/23.

5.2 To approve the changes to the Prudential Indicators highlighted in section 10.

6.0 BACKGROUND

6.1 The Council has adopted the CIPFA Treasury Management Code of Practice in Local Authorities. One condition of the Code is that a report must be made quarterly to the Council on the activities of the Treasury Management function including the exercise of Treasury Management powers delegated to the Head of Finance, Procurement and Commercial Services.

6.2 The CIPFA Prudential Code for Capital Finance sets out a range of prudential indicators to assess whether an authority's financial position is prudent, affordable and sustainable. It is best practice that performance on these indicators is reported to Members on a regular basis.

7.0 ECONOMICS UPDATE AND INTEREST RATE FORECAST

7.1 Gross Domestic Product was revised upwards in Q1 2022/23 to +0.2% q/q from -0.1%, which means the UK economy has avoided recession.

7.2 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. 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. 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.

7.3 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

7.4 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. Even so, coming after the Fed and ECB raised rates by 75 basis points (bps) in their most recent meetings, the Bank of England's latest 50 basis points hike looks relatively dovish. However, the UK's status as a large importer of commodities, which have jumped in price, means that households in the UK are now facing a much larger squeeze on their real incomes.

7.5 Since the fiscal event on 23rd September, our advisors Link 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 Link's forecast is lower than the peak of 5.50% - 5.75% priced into the financial markets at present.

Link Group Interest Rate View	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**

7.6 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.

7.7 Link's PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps, calculated as gilts plus 80bps) which has been accessible to most authorities since 1st November 2012.

Link Group Interest Rate View	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
5yr 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**
10yr 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**
25yr PWLB	**5.10**	**5.10**	**4.80**	**4.50**	**4.30**	**4.10**	**3.90**	**3.70**	**3.60**	**3.60**	**3.50**	**3.40**
50yr 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**

8.0 INVESTMENTS

8.1 The Treasury Management Strategy Statement (TMSS) for 2022/23, which includes the Annual Investment Strategy, was approved by the Council on 23rd 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 (yield) 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.

8.2 As a result of the SORP review, there were several changes to the criteria used for deciding upon counterparties for investment purposes as set out below.

Type of Counterparty	Maximum loan by Council	Maximum Period
Major British Based Banks and Subsidiaries with at least A- credit rating.	£5m	Up to £5m 364 days Up to £3m 3 years
British Based Building Societies. – Only those with at least A- credit rating as advised by Link.	£5m	Up to £5m 364 days Up to £3m 3 years
Other Local Authorities, where agreed.	£5m	Up to 5 years
Property Funds, Corporate Bonds, Infrastructure Investments	£3m	Up to 3 years for Corporate, and 5 years for Property and Infrastructure
Money Market Funds AAA rated	£3m	N/A Callable deposits

8.3 The following table provides details on investment activity during the first six months of this year and last year.

INVESTMENT PORTFOLIO	31.3.22 Actual £000	31.3.22 Actual %	30.9.22 Actual £000	30.9.22 Actual %
Treasury investments				
Banks	11,500	41%	8,000	46%
Building Societies - rated	11,500	41%	6,500	38%
Building Societies – unrated		0%		0%
Local authorities	5,000	18%	2,750	16%
DMADF (H M Treasury)	-	0%	-	0%
Total managed in house	28,000	100%	17,250	100%
Bond funds				
Property funds				
Cash fund managers				
Total managed externally	0	0%	0	0%
TOTAL TREASURY INVESTMENTS	28,000	100%	17,250	100%

Non Treasury investments				
Third party loans				
Subsidiaries	1,575	100%	1,575	100%
Companies				
Property				
TOTAL NON TREASURY INVESTMENTS	1,575	100%	1,575	100%

Treasury investments	28,000	95%	17,250	92%
Non Treasury investments	1,575	5%	1,575	8%
TOTAL OF ALL INVESTMENTS	29,575	100%	18,825	100%

The maturity structure of the investment portfolio was as follows:

	31.3.22 Actual £000	30.9.22 Actual £000
Investments		
Longer than 1 year		
Up to 1 year	29,575	18,825
Total	29,575	18,825

The gross interest earned was as follows:

	31.3.22 Actual £	30.9.22 Actual £
Gross interest earned	133,472	146,340

8.4 Following the SORP review in 2019, the Treasury Management investment return budget for 2020/21 was increased by £326k to £499.8k. This target was based upon the view that the Council would have £10m available for short-term investments i.e., Banks/Building Societies up to 12 months and £10m available to invest in longer term, higher return vehicles i.e., Property/Investment/Infrastructure Funds and increasing rates of return on investments.

8.5 The 2022/23 budget was increased by a further £100k to £599.8k in February 2022 due to the forecast rise of interest rates and increase of investment returns.

8.6 It should be noted that although the Council had £18.825m out on investment at the end of September as per the table in 5.3 the total included several items of one-off funding from central government to support households and businesses during the pandemic and current cost of living crisis. Specifically, Covid-19 Additional Relief Fund £2.2m and S31 Relief funding of £4m. Consequently, true Council cash balances were around £12.4m and therefore the £10m earmarked to invest in the longer term was not available.

8.7 As part of the ongoing work to achieve best value in Treasury Management, we continually monitor our performance against a benchmark figure of the average 3-month SONIA interest rate. The average rate of interest earned at the end of September 2022 was 1.589% which was slightly below the benchmark average of 1.6523%.

8.8 The reduction in balances as set out in 5.6 means the Council will not achieve the investment income as anticipated under the SORP review. It is projected that the overall shortfall will be £244k, of which it is estimated that £170k is attributable to the GRA and £74k to the HRA.

9.0 BORROWING

9.1 No long-term borrowing was undertaken during the first half of 2022/23, however, given the true balances held for investment by the Council as set out in 5.6 and the ongoing large scale capital investment it is likely that there will be a need to borrow during 2022/23. Following advice from Link, the Council will look to borrow in the short-term if required to the point where long-term PLWB rates are expected to fall i.e. during the first quarter of 2023/24.

9.2 The Treasury Management function has managed cash flows in such a way as to avoid incurring borrowing costs despite the Council's GRA capital financing requirement (CFR), i.e. its underlying need to borrow to finance capital expenditure, being £23.3m at the end of 2021/22 as per the table in 7.3 below. Based on current 50-year PWLB rates 4.85% this will cost the Council £1.13m in interest per annum.

9.3 In April 2020 a future service pension prepayment of £7.15m was made to the Lancashire Pension Fund which realised a revenue saving to the Council of £150k for each of the subsequent three years.

9.4 HM Treasury issued new guidance in November 2020 in relation to borrowing from the PWLB. It outlined permissible categories of local authority capital expenditure (service delivery, housing, regeneration, preventative action and treasury management). Any investment asset bought primarily for yield which was acquired after 26 November 2020 would result in the authority not being able to access the
PWLB in that financial year or being able to use the PWLB to refinance this transaction at any point in the future.

9.5 The change in PWLB lending criteria is likely to impact the Commercial Property Strategy agreed at Council in July 2020 as part of the SORP process. It was agreed to invest up to £30m over three years for the purchase/construction of commercial properties. If the purchase is primarily for yield rather than for say regeneration, then PWLB borrowing to finance the Council capital programme would not be available.

10.0 PRUDENTIAL AND TREASURY INDICATORS

10.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the quarter ended 30th September 2022, the Council has operated within the treasury and prudential indicators set out in the Council’s Treasury Management Strategy Statement for 2022/23. The Head of Finance, Procurement and Commercial Services reports that no difficulties are envisaged for the current or future years in complying with these indicators.

10.2 All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

10.3 The prudential and treasury indicators are shown below. It should be noted that a reconciliation of the Council's CFR position was carried out after the February 2022 Council meeting and the agreed slippage from the July 2022 capital outturn report have been incorporated into the revised budget for 2022/23 resulting in a change to the budgeted GRA and HRA figures although the overall CFR remained unchanged.

Treasury Indicators	31.03.22 Actual £’000	2022/23 Original Budget £’000	2022/23 Revised Budget £’000	2022/23 Forecast Outturn £’000
Authorised limit for external debt	88,212	153,571	153,571	153,571
Operational boundary for external debt	88,212	143,071	143,071	143,071
Gross external debt	88,212	88,212	88,212	88,212

Prudential Indicators	31.03.22 Actual £'000	2022/23 Original Budget £'000	2022/23 Revised Budget £'000	2022/23 Forecast Outturn £'000
Capital expenditure				
Non - HRA	8,961	11,156	12,115	12,111
HRA	16,441	14,431	21,586	18,348
Total	25,402	25,587	33,701	30,459
Capital Financing Requirement (CFR)				
Non - HRA	23,321	18,048	28,227	28,227
HRA	88,429	125,023	99,121	97,730
Total	111,750	143,071	127,348	125,957
Annual change in CFR				
Non - HRA	893	9,434	4,906	4,906
HRA	6,529	6,997	10,692	9,301
Total	7,422	16,431	15,598	14,207
In year borrowing requirement				
Non - HRA	1,200	10,000	5,220	5,220
HRA	6,879	6,997	11,042	9,651
Total	8,079	16,997	16,262	14,871
Ratio of financing costs to net revenue stream				
Non - HRA	1.19%	-1.08%	-0.78%	-0.45%
HRA	12.91%	10.88%	12.06%	12.26%
Ratio of income from commercial and service investments to net revenue stream				
Non - HRA	4.51%	7.85%	7.85%	7.85%
HRA	0.00%	0.00%	0.00%	0.00%

11.0 SUSTAINABILITY IMPLICATIONS

11.1 There are no significant sustainability impacts associated with this report and, in particular, no significant impact on crime and disorder. The report has no significant links with the Sustainable Community Strategy.

12.0 RISK ASSESSMENT

12.1 The formal reporting to Council of Prudential Indicators and Treasury Management performance is part of the overall framework set out in Codes of Practice to ensure that the risks associated with this area are effectively controlled. Given the Council's strict investment criteria the risk of loss of investment funds is low, the sums invested can be very large, so treasury management activities are included in the Council's Key Risk Register.

Background Documents

The following background documents (as defined in Section 100D (5) of the Local Government Act 1972) have been relied on to a material extent in preparing this Report.

Date	Document	File Ref
2021	CIPFA Updated Prudential Code for Capital Finance in Local Authorities	Accountancy Office
2021	CIPFA Updated Treasury Management Code of Practice	Accountancy Office

Equality Impact Assessment

The decision does not have any direct impact on members of the public, employees, elected members and / or stakeholders. Therefore, no Equality Impact Assessment is required.

Appendices

1. Minute of the Budget/Council Plan Committee 1 November 2022
2. Minute of the Executive Overview & Scrutiny Committee 3 November 2022
3. Minute of Cabinet 15 November 2022