POLICY AND RESOURCES SCRUTINY COMMITTEE - 21ST FEBRUARY 2023

SUBJECT: TREASURY MANAGEMENT AND CAPITAL FINANCING PRUDENTIAL INDICATORS QUARTER 3 MONITORING REPORT (1ST APRIL 2022 TO 31ST DECEMBER 2022)

REPORT BY: CORPORATE DIRECTOR FOR EDUCATION AND CORPORATE SERVICES

1. PURPOSE OF REPORT

1.1 To present Members with details of Treasury Management activities and Capital Financing, together with the related Prudential Indicators for the period 1st April 2022 to 31st December 2022.

1.2 To review the Treasury Management Strategy for 2022/23 as set out in the Annual Investment Strategy and Capital Financing Prudential Indicators Report.

2. SUMMARY

2.1 The Code of Practice on Treasury Management in the Public Services 2009, which was adopted by the Council on 12th October 2010, sets out a framework of operating procedures, which is encompassed in the Treasury Management Practices (TMPs). TMP6 (Reporting Requirements and Management Information Arrangements) which requires the Authority to approve treasury management semi-annual and annual reports.

2.2 Under the provisions of the Local Government Act 2003, The Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 [The Capital Regulations], and the CIPFA's "The Prudential Code for Capital Finance in Local Authorities" [the Code], the Authority is obliged to approve and publish a number of indicators relevant to Capital Finance and Treasury Management.

2.3 The updated Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, which is to be a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The capital strategy for 2022/23 was submitted to Full Council on the 24th February 2022.

2.4 The Authority's Annual Treasury Strategy and Capital Financing Prudential Indicators for 2022/23 were also approved by Council on the 24th February 2022.

3. RECOMMENDATIONS

3.1 Members are asked to note the contents of this report.

4. REASONS FOR THE RECOMMENDATIONS

4.1 Compliance with the CIPFA “Code of Practice for Treasury Management in the Public Services”.

5. THE REPORT

5.1 Treasury Management

5.1.1 Borrowing Activity

The current policy of internal borrowing is not sustainable in the long-term, but where prudent the policy of internal borrowing will be utilised. As at the 31st March 2022 the internal borrowing position was £49.5m.

The Annual Treasury Management Strategy was approved by Council in February 2022. As part of the strategy approval was given to borrow £42m in 2022/23 to part fund the General Fund capital programme if required. A further £17.7m was approved for the HRA to fund the WHQS and Affordable Housing capital programme. During the reported period no external borrowing has taken place and internal funds have been used.

During the period covered by this report, PWLB loans to the value of £1.8 m were repaid on maturity. Such loans had an average interest rate of 4.40%. £30k of the WRU Loan and £517k of the Salix Loan was also repaid. Total debt outstanding as at 31st December 2022 was £317.4m and comprised of £248.7m PWLB loans; £30m market loans (LOBOs); £10m Bank loan; £25.3m WG loans, £30k WRU loan; and a £3.4m Salix Energy Finance loan.

With respect to the £30m LOBO loans, 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. During the reporting period our total LOBO portfolio with a value of £30m had a rate option reviewed, and the lenders chose not to exercise the option. The LOBO’s represent 9.5% of the Authority’s debt portfolio, which is exposed to interest rate risk.

The loans from WG are charged at zero interest providing we meet the loan obligations and the loans will be repaid though future capital receipts.

5.1.2 Rescheduling

The Annual Strategy allows for the utilisation of debt rescheduling providing for both in year and future year savings and additional revenue resources. No rescheduling opportunities were utilised during the period covered by this report.

5.1.3 <u>Investments</u>

During the reported period the Authority was holding £79.4m of long-term investments where the maturity date is greater than 365 days. These investments are in accordance with the approved Investment Strategy. The long-term investments comprise of UK Gilts, Bank Deposits, Loans to Registered Providers, Loans to Local Authorities, Real Estate Investment Trusts (REITS) and pooled funds. The value of short-term deposits as at 31st December 2022 was £103.0m.

The total investments held as at 31st December 2022 were £182.4m and had a total average rate of income return equating to 2.41%. The minimum target rate which was set for our return on investments in the Treasury Management Strategy 22/23 was the base rate in place at that time of 0.25%. Over the reporting period, the base rate has increased from 0.75% to 3.5%, with an average rate of 1.79%. Our return of 2.41% exceeded the target rate and will continue to do so as further interest rate rises are forecast.

Our investment in pooled funds allow the Authority to generate enhanced income returns and the intention is to hold them for a minimum of five years as per the Treasury Strategy 2022-23. These investments generated an income return of 4.18% during the reporting period.

The Authority continued to maintain our cash surpluses to subsidise our capital programme and delay any borrowing

The portfolio as at 31st December 2022 comprised of the following types of investments:

Counterparty	Investment Product	Sector	£m
Banks & Building Societies	Bonds and Fixed Term Deposits.	Financial	31.0
Banks	Short Term Notice	Financial	12.7
Money Market Fund	Cash Pooled Fund	Financial	39.9
UK Government	Gilts	UK Government	10.0
Local Authorities and Housing Associations	Fixed-term cash deposits	Local Government	69.2
External Fund Managers	Property Pooled Fund	Property	9.3
External Fund Managers	Bond Pooled Fund	Mixed	2.1
External Fund Manager	Equity Pooled Fund	Mixed	5.1
External Fund Manager	Multi Asset Pooled Fund	Mixed	2.1
REIT	Pooled Fund	Property	1.0
Total Investments as	**at 31st December 2022**		**182.4**

5.1.4 Economic Outlook

The conflict in Ukraine continued to keep global inflation elevated and the UK and global economic outlook remains weak. Political uncertainty in the UK improved in the later part of the period following a change in government to what financial markets perceived as being more fiscally prudent.

The economic backdrop during the April to December period continued to be characterised by high energy and commodity prices, high inflation and the associated impact on consumers' cost of living, as well as little likelihood that the Russia-Ukraine hostilities will end any time soon. China started to lift some of its zero-Covid policy restrictions at the end of the period causing a sharp increase in infections, but also leading to questions over potential under reporting of the number of cases by the Chinese government due to how it is counting the figures.

Central Bank rhetoric and action continued to remain robust. The Bank of England, Federal Reserve and the European Central Bank all increased interest rates over the period and committed to fighting inflation, even in the face of potential recessions in those regions.

UK inflation remained high, but there were tentative signs it may have peaked. Annual headline CPI registered 10.7% in November, down modestly from 11.1% in October. RPI was 14% in November, down from 14.2% in October, but slightly above expectations for a larger fall to 13.9%.

The UK government under Rishi Sunak and Jeremy Hunt reversed some of the support to household energy bills announced under the previous Liz Truss leadership. The previous support package which would have seen average consumption cost £2,500 annually until 2024 was replaced by a less generous scheme which was only maintained at this level until March 2023, to be replaced by a higher cap of £3,000 per year for the typical household from April onwards.

The labour market remained tight but with some evidence of softening demand for new labour. The unemployment rate 3m/year for April-June was 3.8%, which declined to 3.6% in July-September and picked up again to 3.7% in October-December. The inactivity rate was 21.5% in the latest quarter, down by 0.1% compared to the previous period. Pay growth in October-December was 6.1% for both total pay (including bonuses) and for regular pay. Once adjusted for inflation, however, both measures fell by 2.7%.

Household disposable income remained under pressure, pushing consumer confidence down to a record low of –49 in September, but following months showed registered modest improvements to December's reading of –42. Quarterly GDP for the April-June quarter was revised upwards to 0.2% (from -0.1%), following revisions to household and government spending, but fell by -0.3% in the July-September quarter, a larger decline than the -0.2% predicted.

The Bank of England increased the official Bank Rate to 3.5% over the period. From 0.75% in March, the Monetary Policy Committee (MPC) pushed through rises at every subsequent meeting over the period, with outsized hikes of 50bps in August and September, 75bps in November and then another 50bps in December. November's rise was voted by a majority of 7-2, with one MPC member preferring a 0.5% rise and another a 0.25% rise. The December vote was 6-3, with two members preferring to keep Bank Rate on hold at 3% while one member wanted a larger increase of 0.75%. Once again, the Committee noted that domestic inflationary pressures are expected to remain strong and continuing rhetoric around combating inflation means further rate rises are predicted.

Over the period the 5-year UK benchmark gilt yield rose from 1.41% to peak at 4.70% in September before ending the calendar year at 3.62%. Over the same timeframe the 10-year gilt yield rose from 1.61% to peak at 4.51% before falling back to 3.67%, while the 20-year yield rose from 1.82% to 4.96% and then declined to 4.03%.

The Sterling Overnight Rate (SONIA) averaged 1.75% over the period.

Arlingclose expects Bank Rate to peak at 4.25% during 2023 before starting to fall during the latter part of 2024.

Official Bank Rate	Upside Risk	Arlingclose (Central case)	Downside Risk
2023/24 Q1	0.75	4.25%	-0.75
2023/24 Q2	1.00	4.25%	-0.75
2023/24 Q3	1.00	4.25%	-0.75
2023/24 Q4	1.00	4.25%	-0.75
2024/25	1.50	3.50%	-1.00
2025/26	1.25	3.25%	-1.00

5.1.5 <u>Borrowing Update</u>

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.

PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield;

The authority is not planning to purchase any investment assets primarily for yield within the next 3 years and so is able to take advantage of the reduction in the PWLB borrowing rate if required.

The UK Infrastructure Bank, which is wholly owned and backed by HM Treasury, has been set up with £4bn of funding earmarked to lending to Local Authorities. Loans will be available for qualifying projects at gilt yield plus 0.6%, which is 0.2% lower than the PWLB certainty rate.

5.1.6 Counterparty Update

Having completed its full review of its credit advice on unsecured deposits at UK and non-UK banks earlier in the year (May), Arlingclose extended the maximum duration limit for five UK banks, four Canadian banks and four German banks to six months. The maximum duration for unsecured deposits with other UK and non-UK banks on Arlingclose's recommended list is 100 days. These recommendations were unchanged at the end of the period.

Although local authorities remain under financial pressure, Arlingclose continues to take a positive view of the sector, considering its credit strength to be high. Section 114 notices have been issued by only a handful of authorities with specific issues. While Arlingclose's advice for local authorities on its counterparty list remains unchanged, a degree caution is merited with certain authorities.

Arlingclose continued to monitor and assess credit default swap levels for signs of credit stress but made no changes 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.

5.1.7 Non-Treasury Investments

The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. Such investments can comprise of property; shared ownership housing; loans to local businesses/ subsidiaries; and shareholdings. During the reported period the Authority did not hold any non-treasury related investments.

5.2 Prudential Indicators

5.2.1 Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose. In accordance with best professional practice, the

Authority does not associate borrowing with particular items or types of expenditure. In practice, the raising and repaying of loans is determined primarily by professional / expert advice and may not necessarily take place in the relevant year. In order to create an operating environment within which the Treasury Manager can legitimately react to appropriate advice, the various authorised limits as identified in Appendix 1 are set at a level in excess of the CFR. In the financial year to date, the Authority has been operating within the approved limits.

Appendix 1 shows a projected CFR value of £361.652m as at 31st March 2023. The actual CFR as at 31st March 2022 was £368.804m. Certain capital schemes have been delayed or the scheme extended which has resulted in a lower funding requirement than budgeted.

5.2.2 Prudential Indicators – “Prudence”

The Prudential Indicators for Treasury Management are shown in Appendix 1, and the Authority is currently operating within the approved limits.

5.2.3 Prudential Indicators – “Affordability”

There is a requirement to analyse and report the capital financing costs and express those costs as a percentage of the net revenue streams of the Authority. These are identified in Appendix 2 and currently show a projected reduction from the original budget as a consequence of deferred borrowing for the General Fund.

5.2.4 Capital Expenditure and Funding

A summary of capital expenditure and funding is attached at Appendix 3 and shows that there will be an underspend on the core capital budget for HRA due to delays in awarding contracts for the PAMS programme due to resource issues. Any underspend is ringfenced and is therefore carried forward accordingly. The HRA budget is as per the approved HRA Business Plan 22/23.

6. ASSUMPTIONS

6.1 The details set out in the report are based on actuals that have occurred between 1st April 2022 and 31st December 2022 (period 9).

7. SUMMARY OF INTEGRATED IMPACT ASSESSMENT

7.1 This report is for information only and no Integrated Impact Assessment is required.

8. FINANCIAL IMPLICATIONS

8.1 As detailed throughout the report.

9. PERSONNEL IMPLICATIONS

9.1 There are no personnel implications arising from this report.

10. CONSULTATIONS

10.1 There are no consultation responses that have not been reflected in this report.

11. STATUTORY POWER

11.1 Local Government Acts 1972 and 2003.

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Appendices:

Appendix 1 – Treasury Management Prudential Indicators – Prudence
Appendix 2 – Capital Finance Prudential Indicators – Affordability
Appendix 3 – Capital Expenditure and Funding