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| Agenda Item No: | **8** | |
| Committee: | **Council** | |
| Date: | **12 December 2022** | |
| Report Title: | **Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review 2022/23** | |

## Cover sheet:

### 1 Purpose / Summary

The purpose of this report is to review the Council's Treasury Management activity for the first six months of 2022/23.

### 2 Key issues

- The Treasury Management Mid-Year Review 2022/23 as presented to Cabinet on 12 December 2022 is attached.
- The report highlights all the key activities carried out within the Treasury Management function during the first six months of 2022/23. All activities have been conducted in accordance with the approved strategy and policies.
- Prudential indicators for the Capital Financing Requirement (CFR) and the capital position have been revised.

### 3 Recommendation

It is recommended that Members note the report.

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| Agenda Item No: | **7** | |
| Committee: | **Cabinet** | |
| Date: | **12 December 2022** | |
| Report Title: | **Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review 2022/23** | |

## Cover sheet:

### 1 Purpose / Summary

The purpose of this report is to review the Council's Treasury Management activity for the first six months of 2022/23 and to provide members with an update on matters pertinent to future updates to the Council's Treasury Management Strategy.

### 2 Key issues

- The Council has operated within its Treasury Management Strategy Statement (TMSS), Annual Investment Strategy, treasury limits and prudential indicators set by Council for the first six months of 2022/23.
- Forecasts are that Bank Rate will increase from its current rate of 3% to a peak of 4.50% in Q2, 2023 before subsequently decreasing back to 2.5% in Q3 of 2025.
- PWLB certainty rates are forecast to remain high in the near-term, given the extent to which market expectations are already priced in and then to fall back once inflation starts to fall through 2023.
- The Prudential indicators for capital expenditure and capital financing requirement (CFR) have been adjusted reflecting the updates to the capital programme since February 2022.
- No new external borrowing has been taken out to date in 2022/23. The current Medium Term Financial Strategy assumes that some external borrowing will be required over the three-and-a-half-year period to 31 March 2026.
- Investment income received from temporary investments (call accounts and fixed term deposits) for the first six months of 2022/23 was £164k. Due to the rise in investment returns as a consequence of Bank Rate increases, the projected outturn for 2022/23 has been revised to £500k against an original budget of £100k.
- Projected Income from property funds for 2022/23 is forecast at £130,000 against an original budget of £150,000.

### 3 Recommendations

It is recommended that Members note the report.

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|---|---|
| Wards Affected | All |
| Portfolio Holder(s) | Cllr Chris Boden, Leader and Portfolio Holder, Finance |
| Report Originator(s) | Peter Catchpole, Chief Finance Officer and Corporate Director<br>Mark Saunders, Chief Accountant |
| Contact Officer(s) | Peter Catchpole, Chief Finance Officer and Corporate Director<br>Mark Saunders, Chief Accountant |
| Background Paper (s) | Link Asset Services template<br>Council Report - 24 February 2022 - General Fund Budget 2022/23 and Capital Programme 2022-25<br>Cabinet Report – 11 July 2022 - Capital Programme Update<br>Cabinet Report – 12 December 2022 – Draft Budget 2023/24 and Medium-Term Strategy |

## Report:

### 1 Context

1.1 The Council's responsibilities in relation to Treasury Management are defined as part of the Local Government Act 2003 ('the Act'). The Act requires the Council to have regard to the Treasury Management Code published by the Chartered Institute of Public Finance and Accountancy, (CIPFA).

1.2 Additionally, there is a statutory requirement for the Council to comply with the Prudential Code. There is a close interaction between the Treasury Management Code and the Prudential Code. The Prudential Code establishes a framework for the Council to self-regulate the affordability, prudence and sustainability of its capital expenditure and borrowing plans whilst the Treasury Management Code is concerned with how the Council uses its Treasury Management function to progress the future plans developed with reference to the Prudential Code.

1.3 The 2017 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

1.4 The Council's Capital Strategy for 2022/23 was approved by Full Council on the 24 February 2022.

**Treasury Management**

1.5 Treasury management is defined as "The management of the local authority'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."

1.6 The Council complies with the requirements of CIPFA's Code of Practice on Treasury Management (revised 2017 & 2021).

1.7 The primary requirements of the Code applicable to the 2022/23 financial year are as follows:

- Creation and maintenance of a Treasury Management Policy Statement, which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices, which set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by Full Council of an annual Treasury Management Strategy Statement, including the Annual Investment Strategy and Minimum Revenue Provision Policy for the year ahead, a Mid-year Review Report and an Annual Report covering activities during the previous year.
- 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.
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies (including Mid-year Review Report) to a specific named body. For this Council the delegated body is the Audit and Risk Management Committee.

1.8 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 taking account of expert analysis provided by the Council's Treasury Management Advisors, Link Asset Services;

- a review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- the Council's capital plans;
- a review of the Council's investment portfolio for 2022/23;
- a report of the Council's borrowing strategy for 2022/23;
- a report of debt rescheduling during 2022/23;
- a review of compliance with Treasury and Prudential Limits for 2022/23.

## 2 Economic Update

2.1 The second quarter of 2022/23 saw signs of economic activity losing momentum as production fell, inflation increased with domestic price pressures showing little sign of abating in the near-term, and bank base rate was raised to 3%. The unemployment rate has fallen to a 48-year low of 3.6% due to a large shortfall in labour supply.

2.2 In September and October 2022 there had been a step change in government policy and the fiscal loosening from its proposed tax cuts were likely to add to existing domestic inflationary pressures and could have potentially left a legacy of higher interest rates and public debt. Gilt yields had increased, and sterling had fallen following the "fiscal event" of the new Prime Minister and Chancellor on 23rd September 2022 adding further upward pressure to interest rates.

2.3 However, following the reversal of the Truss/Kwarteng fiscal policies and Rishi Sunak's appointment as the UK's new Prime Minister has ushered in a period of calm in UK financial markets. Much of the extra political risk percentages on gilts that emerged in the wake of the mini-budget on 23rd September appears to have unravelled.

2.4 The new Chancellor, Jeremy Hunt, delivered his Autumn Statement on 17th November announcing a fiscal tightening package peaking at £55bn per year, or just over 2% of GDP, in 2027/28, suggesting that after a period in which fiscal policy has provided the economy with support, it is about to become a major drag.

2.5 Market interest rate expectations have been pared back in recent weeks as fiscal policy has become tighter and although tighter fiscal policy may go some way to reducing the upward pressure on interest rates, stickier inflation means that Bank Rate is still expected to peak at around 4.50 – 4.75% next year.

2.6 The Bank of England Monetary Policy Committee has increased interest rates to their highest level since the Global Financial Crisis to date.

## 3 Interest Rate Forecast

3.1 The Council's treasury advisor, Link Group, provided the following forecasts on 8th November 2022 (PWLB rates are certainty rates, gilt yields plus 80bps):

| Link Group Interest Rate View | 08.11.22 | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Dec-22 | Mar-23 | Jun-23 | Sep-23 | Dec-23 | Mar-24 | Jun-24 | Sep-24 | Dec-24 | Mar-25 | Jun-25 | Sep-25 | Dec-25 |
| BANK RATE | 3.50 | 4.25 | 4.50 | 4.50 | 4.50 | 4.00 | 3.75 | 3.50 | 3.25 | 3.00 | 2.75 | 2.50 | 2.50 |
| 3 month ave earnings | 3.60 | 4.30 | 4.50 | 4.50 | 4.50 | 4.00 | 3.80 | 3.30 | 3.00 | 3.00 | 2.80 | 2.50 | 2.50 |
| 6 month ave earnings | 4.20 | 4.50 | 4.60 | 4.50 | 4.20 | 4.10 | 3.90 | 3.40 | 3.10 | 3.00 | 2.90 | 2.60 | 2.60 |
| 12 month ave earnings | 4.70 | 4.70 | 4.70 | 4.50 | 4.30 | 4.20 | 4.00 | 3.50 | 3.20 | 3.10 | 3.00 | 2.70 | 2.70 |
| 5 yr PWLB | 4.30 | 4.30 | 4.20 | 4.10 | 4.00 | 3.90 | 3.80 | 3.60 | 3.50 | 3.40 | 3.30 | 3.20 | 3.10 |
| 10 yr PWLB | 4.50 | 4.50 | 4.40 | 4.30 | 4.20 | 4.00 | 3.90 | 3.70 | 3.60 | 3.50 | 3.40 | 3.30 | 3.20 |
| 25 yr PWLB | 4.70 | 4.70 | 4.60 | 4.50 | 4.40 | 4.30 | 4.10 | 4.00 | 3.90 | 3.70 | 3.60 | 3.50 | 3.50 |
| 50 yr PWLB | 4.30 | 4.40 | 4.30 | 4.20 | 4.10 | 4.00 | 3.80 | 3.70 | 3.60 | 3.40 | 3.30 | 3.20 | 3.20 |

3.2 As shown in the forecast table above, the forecast in Bank Rate is that it will increase from its current rate of 3% to a peak of 4.50% in Q2, 2023 before subsequently decreasing back to 2.5% in Q3 of 2025.

3.3 Gilt Yields/PWLB Rates - The general situation is for volatility in bond yields to endure as investor fears for inflation and/or recession ebb and flow. The overall longer-run trend is for gilt yields and PWLB rates to remain high in the near-term, given the extent to which market expectations are already priced in and then to fall back once inflation starts to fall through 2023. PWLB rates and interest rates will both be kept under review by officers to inform the Council's strategy

## 4 Treasury Management Strategy Statement and Annual Investment Strategy Update

4.1 The Treasury Management Strategy Statement (TMSS) for 2022/23 was approved by Council on 24 February 2022. There are no policy changes to the TMSS.

4.2 Changes are required to some of the prudential indicators as a result of the forecast 2022/23 capital outturn. The following table compare the previous prudential indicators (agreed on 24th February) against the latest revised indicators.

| **Prudential Indicator** | **2022/23 Previous £000** | **2022/23 Revised £000** |
|---|---|---|
| Capital Programme | 16,039 | 13,203 |
| Capital Financing Requirement | 16,185 | 11,100 |

## 5 The Council's Capital Position

5.1 This part of the report is structured to update:

- the Council's capital expenditure plans;
- how these plans are being financed;
- the impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- compliance with limits in place for borrowing activity.

5.2 At its meeting on 11 July 2022 the Cabinet approved revised estimates for the 2022/23 capital programme and the financing of that programme. The revised estimate addressed amendments to the programme since February, including re-profiling schemes from 2021/22, the allocation of further capital funds for the redevelopment of 24 High Street, Wisbech and a re-assessment of resources available in the period 2022-25. An updated programme is being considered at this meeting as part of the Draft Budget Report at a separate agenda item. The tables in this report reflect this updated programme.

5.3 From February 2020 the programme has reflected the Council's decision to allocate £25m to take forward schemes in accordance with the Council's Commercial and Investment Strategy. Members will be aware that the Investment Board approved the purchase of an investment and residential property in previous years. The remaining allocation has been profiled to reflect the anticipating timing of future projects, including those due to be delivered by Fenland Future Limited. However, the Investment Board retains the discretion to vary when the available funds are utilised over the life of the programme.

5.4 The table below compares the revised estimates with the original capital programme which was incorporated into the 2022/23 Treasury Management Strategy Statement (TMSS).

| **Capital Programme** | **2022/23 Original Estimate £000** | **2022/23 Revised Estimate £000** |
|---|---|---|
| Capital Programme (Excluding Commercial and Investment Strategy Schemes) | 13,567 | 12,203 |
| Commercial and Investment Strategy Schemes | 2,472 | 1,000 |
| **Forecast Expenditure** | **16,039** | **13,203** |
| Financed by: | | |
| Capital Grants | 6,722 | 8,445 |
| Section 106's & Contributions | 115 | 196 |
| Capital Receipts | 215 | 265 |
| Capital Reserves | 200 | 255 |
| **Total Financing** | **7,252** | **9,161** |
| **Borrowing Requirement** | **8,787** | **4,042** |

5.5 The table below shows the anticipated CFR at 31 March 2023, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period; this is termed the Operational Boundary. The revised estimated CFR is significantly lower than the original budget forecast (see paragraph 5.2 above).

| **Prudential Indicators** | **2022/23 Original Estimate £000** | **2022/23 Revised Estimate £000** |
|---|---|---|
| **Capital Financing Requirement as at 31 March 2023** | **16,185** | **11,100** |
| | | |
| **External Debt / Operational Boundary** | | |
| Borrowing | 14,500 | 14,500 |
| Other Long Term Liabilities Finance Leases | 1,000 | 1,000 |
| Commercial Activities/ Non Financial Investments | 21,302 | 2,000 |
| **Total Debt 31 March** | **36,802** | **17,500** |

5.6 The Council has made provision to repay all 'borrowing' liabilities through increased Minimum Revenue Provision (MRP) in the General Fund revenue budget.

5.7 Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total CFR in the preceding year plus the estimates of any additional CFR for 2022/23 and the next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need. The policy permits borrowing in advance of need where it is prudent to do so. Members should note that the current limits and estimates set out below have been determined with reference to the existing capital programme.

| **Limits to Borrowing Activity** | **2022/23 Original Estimate £000** | **2022/23 Revised Estimate £000** |
|---|---|---|
| Gross Borrowing (Excluding Commercial and Investment Strategy Schemes) | 14,349 | 10,868 |
| Plus Other Long Term Liabilities Finance Leases | 23 | 23 |
| Commercial Activities/ Non Financial Investments | 2,472 | 1,000 |
| **Anticipated Gross Borrowing as at 31 March 2023** | **16,844** | **11,891** |
| | | |
| **Anticipated Capital Financing Requirement as at 31 March 2023** | **16,185** | **11,100** |

5.8 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit, which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level for borrowing which, while not desired could be afforded in the short term but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

| Authorised Limit For External Debt | 2022/23 Original Estimate £000 | 2022/23 Revised Estimate £000 |
|---|---|---|
| Debt | 19,500 | 19,500 |
| Plus Other Long Term Liabilities Finance Leases | 1,000 | 1,000 |
| Commercial Activities/ Non Financial Investments | 21,302 | 1,000 |
| **Total Borrowing** | **41,802** | **21,500** |

5.9 The Corporate Director & Chief Finance Officer reports that no difficulties are envisaged for the current year in complying with the above prudential indicators.

## 6 Investment Portfolio

6.1 In accordance with the Treasury Management Code, it is the Council's priority to ensure security of capital and liquidity and to obtain an appropriate level of return which is consistent with the Council's risk appetite.

6.2 The current forecasts for bank rate are shown in paragraph 3.1 above.

6.3 Following the Governments fiscal event on 23 September 2022, both Standard and Poor's (S&P) and Fitch have placed the UK sovereign debt rating on a Negative Outlook reflecting a downside bias to the current ratings in light of expectations of weaker finances and the economic outlook

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

6.5 The Council held £34.250m of investments, including property funds at 30th September 2022 (35.850m at 31st March 2022). The investment portfolio yield from temporary investments (call and fixed term deposits) for the first 6 months of the year was 1.10% (7 day backward looking average Sonia Rate 1.19%).

6.6 It should be noted that the value of investments remains high due to the distorting impact on working capital of some of the mechanisms government introduced in 2021/22 to mitigate the liquidity impact of the pandemic on local authorities and revenue and capital grants paid in advance of the 2022/23 financial year. Some of this funding has not been spent in the first six months of this year. However, it is expected that a significant proportion of this grant funding and the unravelling of the working capital previously advanced will be spent or repaid in the next 6 months and consequently investment balances will be lower by the end of this financial year.

6.7 The Council has achieved investment income of £164k to 30th September 2022. The 2022/23 projected outturn is £500k against a budget of £100k. With the Bank of England base rate rising steadily since December 2021 coupled with the recent volatile market conditions driven by global political events interest rates and therefore income returns have increased significantly.

6.8 £4m of the Council's investments are held in externally managed pooled property funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds are currently generating an average income return of 3.1% which is used to support services in year.

6.9 As the Council's externally managed funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council'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 are expected to exceed cash interest rates. The 2022/23 projected outturn for property fund income is £130k against a budget of £150k.

6.10 The Corporate Director and Chief Finance Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2022/23.

## 7 Borrowing Strategy

7.1 The Council's estimated CFR for 2022/23 is £11.100m (including finance lease borrowing facilities). The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.

7.2 No new external borrowing has been undertaken during 2022/23 to date. The Council has utilised surplus cash flow funds in lieu of borrowing. This is a prudent and cost-effective approach in the current economic climate but will require ongoing monitoring in the event that any upside risk to gilt yields prevails.

7.3 The current Medium Term Financial Strategy assumes that some external borrowing will be required over the three-and-a-half-year period to 31 March 2026. Assumptions about the level of external interest payable are included within the budget. Responsibility for deciding when to borrow externally, together with details of the amount to borrow and the term and type of any loan, rests with the Chief Finance Officer. The Chief Finance Officer's decision will be informed by advice from the Council's treasury management advisors and information regarding the progress of schemes set out in the capital programme. Any borrowing decisions will be reported to Cabinet through the annual treasury management report.

## 8 Debt Rescheduling

8.1 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 in the current financial year

8.2 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.

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