APPENDIX B

CABINET

THURSDAY 1ST DECEMBER 2022

COUNCIL

TUESDAY 13th DECEMBER 2022

REPORT OF THE PORTFOLIO HOLDER FOR FINANCE, RISK AND CUSTOMER SERVICES

TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY MID-YEAR REVIEW REPORT 2022/23

EXEMPT INFORMATION

None

PURPOSE

To present to Members the Mid-year Review of the Treasury Management Strategy Statement and Annual Investment Strategy.

RECOMMENDATIONS

That Council be requested to approve the Treasury Management Strategy Statement and Annual Investment Strategy Mid-year Review Report 2022/23.

EXECUTIVE SUMMARY

This mid-year report has been prepared in compliance with the requirements of the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (revised 2017), and covers the following:-

- An economic update for the half of the 2022/23 financial year;
- A review of the Treasury Management Strategy Statement 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.

The main issues for Members to note are:

1. The Council has complied with the professional codes, statutes and guidance.

2. There are no issues to report regarding non-compliance with the approved prudential indicators.
3. The investment portfolio yield, excluding property fund returns, for the first six months of the year is 1.78% (0.26% for the same period in 2021/22) compared to the average 3 Month SONIA benchmark rate of 1.71% for the period (previously benchmarked against 3 Month LIBID which was -0.043% for the same period in 2021/22).

The aim of this report is to inform Members of the treasury and investment management issues to enable all Members to have ownership and understanding when making decisions on Treasury Management matters. In order to facilitate this, training on Treasury Management issues was most recently delivered for Members in February 2022 and further training is planned during 2022/23.

RESOURCE IMPLICATIONS

All financial resource implications are detailed in the body of this report which links to the Council's Medium Term Financial Strategy.

LEGAL/RISK IMPLICATIONS BACKGROUND

Risk is inherent in Treasury Management and as such a risk based approach has been adopted throughout the report with regard to Treasury Management processes.

EQUALITIES IMPLICATIONS

None

SUSTAINABILITY IMPLICATIONS

None

REPORT AUTHOR

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LIST OF BACKGROUND PAPERS

Background Papers -	*Local Government Act 2003*
	CIPFA Code of Practice on Treasury Management in Public Services 2017
	Annual Report on the Treasury Management Service and Actual Prudential Indicators 2021/22 – Council 20th September 2022

	Treasury Management Strategy & Prudential Indicators Report 2022/23 - Council 23rd February 2021
	Budget & Medium Term Financial Strategy 2021/22 - Council 22nd February 2022
	Quarter 2 2022/23 Performance Report Including Financial Healthcheck

APPENDICES

Appendix 1 – Investments Held at 30th September 2022

TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY MID-YEAR REVIEW

In December 2017, the Chartered Institute of Public Finance and Accountancy (CIPFA) issued revised Prudential and Treasury Management Codes. These require all local authorities to prepare a Capital Strategy which is to provide the following:-

- A high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- An overview of how the associated risk is managed
- The implications for future financial sustainability

A report setting out our updated Capital Strategy will be included with the Budget and Medium Term Financial Strategy report presented to Cabinet and Council in February 2023.

The CIPFA Code of Practice on Treasury Management (revised 2017) suggests that Members should be informed of Treasury Management activities at least twice a year, but preferably quarterly. This is the second monitoring report for 2022/23 presented to Members this year and therefore ensures the Council is embracing best practice. Cabinet also receives regular monitoring reports as part of the quarterly healthcheck on Treasury Management activities and risks.

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the Treasury Management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the Treasury Management service is 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 operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly, 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."

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), which was adopted by this Council on 27th February 2018.

The primary requirements of the Code 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 the 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 (stewardship 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 to a specific named body. For this Council the delegated body is the Audit and Governance Committee.

1. Economics and Interest Rates

1.1 Economics update

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 Prime Minister and Chancellor on 23rd 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.

The fall in the composite PMI from 49.6 in August to a 20-month low preliminary reading of 48.4 in September points to a fall in GDP of around 0.2% q/q in Q3 and consumer confidence is at a record low. Retail sales volumes fell by 1.6% m/m in August, which was the ninth fall in 10 months. That left sales volumes in August just 0.5% above their pre-Covid level and 3.3% below their level at the start of the year. There are also signs that households are spending their excess savings in response to high prices. Indeed, cash in households' bank accounts rose by £3.2bn in August, which was below the £3.9bn rise in July and much smaller than the 2019 average monthly rate of £4.6bn.

The labour market remained exceptionally tight. Data for July and August provided further evidence that the weaker economy is leading to a cooling in labour demand. Labour Force Survey (LFS) employment rose by 40,000 in the three months to July (the smallest rise since February). But a renewed rise in inactivity of 154,000 over the same period meant that the unemployment rate fell from 3.8% in June to a new 48-year low of 3.6%. The single-month data showed that inactivity rose by 354,000 in July itself and there are now 904,000 more inactive people aged 16+ compared to before the pandemic in February 2020. The number of vacancies has started to level off from recent record highs but there have been few signs of a slowing in the upward momentum on wage growth. Indeed, in July, the 3my/y rate of average earnings growth rose from 5.2% in June to 5.5%.

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, it is expected 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, 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 H1 2022, there was a change of both Prime Minister and Chancellor, with Liz Truss

and Kwasi Kwarteng making a step change in government policy. The government's huge fiscal loosening from its proposed significant tax cuts were set to add to existing domestic inflationary pressures and potentially leave a legacy of higher interest rates and public debt. The long list of tax measures announced at the "fiscal event" led to fears that the government had no fiscal anchor and meant that the pound weakened again, adding further upward pressure to interest rates.

Following the turmoil within the financial markets, the Chancellor was dismissed and shortly afterwards the Prime Minister resigned, triggering a further Tory leadership contest. The UK now has a new Prime Minister, Rishi Sunak, a new Chancellor, Jeremy Hunt, and new fiscal policies – to be firmed up on the 17th November Autumn Statement - that seek to ensure that the public finances are kept on a sound footing and that any projected gaps (possibly £50bn to £60bn) are fully funded from services efficiencies and/or net tax increases.

In the interim period, since the end of September, the Government scrapped the reduction in the basic rate of income tax by 1p in the £; maintained the higher band 45p in the £ income tax rate; did not reduce Corporation Tax to 19% from 25%; and only put in place support for businesses and households for 6 months (October to March) regarding caps on the unit costs of gas and electricity.

Throughout 2022/23, gilt yields have been on an upward trend. They were initially caught up in the global surge in bond yields triggered by the surprisingly strong rise in CPI inflation in the US in May. The rises in two-year gilt yields (to a peak of 2.37% on 21st June) and 10-year yields (to a peak of 2.62%) took them to their highest level since 2008 and 2014 respectively. However, the upward trend was exceptionally sharply 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 31st October. Second, it committed to buy up to £65bn of long-term gilts to "restore orderly market conditions" until 14th 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 28th 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 14th October or it decides to delay quantitative tightening beyond 31st 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. In recent days, calm has returned to the markets, the £ has risen from a historic low of $1.03 to $1.14, and the cumulative movement in gilt yields since the turn of the year is now broadly in line with that seen in the US and Euro-zone bond markets.

After a shaky start to the year, the S&P 500 and FTSE 100 climbed in the first half of Q2 2022/23 before falling to their lowest levels since November 2020 and July 2021 respectively. The S&P 500 is 7.2% below its level at the start of the quarter, whilst the

FTSE 100 is 5.2% below it as the fall in the pound has boosted the value of overseas earnings in the index. The decline has, in part, been driven by the rise in global real yields and the resulting downward pressure on equity valuations as well as concerns over economic growth leading to a deterioration in investor risk appetite.

1.2 Interest Rate Forecasts

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

The Bank of England's Quarterly Monetary Policy Report detailed that the UK economy is headed for eight quarters of negative growth based on the market's expectation for Bank Rate to increase to 5.25%. Since then, market expectations have been recalibrated, and now view a peak in Bank Rate of between 4.5% and 4.75%. These views are similar to those held by Link Group's Interest Rate Strategy Group (IRSG). IRSG has reduced its view on the peak of Bank Rate from 5% to 4.5%. However, although rates are seen to be peaking in May of 2023, it is now also believed that there are several challenges to the Bank that could see them leave rates at this level until early 2024.

The first of those challenges is the tight labour market (unemployment is at a 48 year low 3.5%), which shows no signs of dissipating, and that could mean wage increases continue to be north of 5% well into 2023 (the Bank would broadly want wages to be in the range of 3% - 3.5%). There is also the prospect that unless the workforce participation rate increases and/or immigration policies are relaxed, there is no clear route that would give rise to sustainable increases in economic growth. And, of course, inflation could be somewhat "sticky" if the Russian invasion of Ukraine remains unresolved and puts continued pressure on global energy prices and staple foods (e.g., wheat), among the many areas negatively impacted.

Against this backdrop, it is believed the MPC will have to tread carefully. It will need to evidence to the markets that it sees the reduction in inflation as a primary objective, but also that it remains alert to the fact that it does not want any recession to be deeper and more prolonged than it needs to be. On that basis Link's forecast sees Bank Rate increasing 50 basis points in both December and February before the MPC scales down the rate of increase to just 25 basis points in both March and May 2023.

Regarding Link's forecast for PWLB rates, the impact of the Truss/Kwarteng fiscal experiment has faded in the past month but it is thought investors will still remain a little nervous over the UK's future fiscal policy and therefore Link have reduced their forecast for

near-term PWLB rates across the curve, compared to September's forecast, but have left the longer end of the curve slightly higher to reflect the potential demand by foreign investors for a "confidence premium" in the light of recent market volatility.

As for the housing market, the most recent survey by Nationwide Building Society showed house prices starting to fall and the MPC will be very cognisant that affordability could be stretched now that fixed rate mortgages are somewhat higher than they were a few weeks ago. Historically, the MPC has appeared reluctant to tighten monetary policy in a falling housing market, but it may be willing to leave rates less high than the market had been pricing in prior to the 3rd of November Quarterly Monetary Policy Report but keep them there for longer as a compromise of sorts.

Of course, what happens outside of the UK is also critical to movement in gilt yields. The US FOMC has led with increases of 375 basis points in the year to date and is expected to increase rates further before the end of the year, and possibly into 2023. Similarly, the ECB has also started to tighten monetary policy, albeit from an ultra-low starting point, as have all the major central banks apart from Japan. Arguably, though, it is US monetary policies that will have the greatest impact on global bond markets.

A SUMMARY OVERVIEW OF THE FUTURE PATH OF BANK RATE

Link's central forecast for interest rates was previously updated on 28th September and reflected a view that the MPC would be keen to further demonstrate its anti-inflation credentials by delivering a succession of rate increases. This has happened but the new Government's policy of emphasising fiscal rectitude will probably mean Bank Rate does not now need to increase to further than 4.5%.

Further down the road, Link anticipate the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures are behind us – but that timing will be one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.

The CPI measure of inflation will peak at close to 11% in Q4 2022. Despite the cost-of-living squeeze that is still taking shape, the Bank will want to see evidence that wages are not spiralling upwards in what is evidently a very tight labour market.

Regarding the plan to sell £10bn of gilts back into the market each quarter (Quantitative Tightening), this has started but will focus on the short to medium end of the curve for the present so as to prevent any further disruption to the longer end of the curve following on from the short-lived effects of the Truss/Kwarteng unfunded dash for growth policy.

In the upcoming months, Link's forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but the on-going conflict between Russia and Ukraine. (More recently, the heightened tensions between China/Taiwan/US also have the potential to have a wider and negative economic impact.)

On the positive side, consumers are still estimated to be sitting on over £160bn of excess savings left over from the pandemic so that will cushion some of the impact of the above challenges. However, most of those are held by more affluent people whereas lower income families already spend nearly all their income on essentials such as food, energy

and rent/mortgage payments.

PWLB RATES

The yield curve movements have become less volatile of late and PWLB 5 to 50 years Certainty Rates are, generally, in the range of 4.20% to 4.80%. Link view the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the poor inflation outlook but markets are volatile.

The balance of risks to the UK economy: -

The overall balance of risks to economic growth in the UK is to the downside.

Downside risks to current forecasts for UK gilt yields and PWLB rates include: -

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, rising gilt yields).

- **The Bank of England** acts too quickly, or too far, over the next two years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.

- **Geopolitical risks,** for example in Ukraine/Russia, China/Taiwan/US, Iran, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows.
-

Upside risks to current forecasts for UK gilt yields and PWLB rates: -

- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly and for a longer period within the UK economy, which then necessitates an even more rapid series of increases in Bank Rate faster than currently expected.

- **The Government** acts too quickly to cut taxes and/or increases expenditure in the light of the cost-of-living squeeze.

- **The pound weakens** because of a lack of confidence in the UK Government's fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.

- Longer term **US treasury yields** continue to rise strongly and pull gilt yields up even higher than currently forecast.

2. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy Statement (TMSS) for 2022/23 was approved by Council on 22nd February 2022.

There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

3. The Council's Capital Position (Prudential Indicators)

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 the limits in place for borrowing activity.

3.1 Prudential Indicator for Capital Expenditure

This table below shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Capital Expenditure	2022/23 Original Programme	Budget B'fwd from 2021/22	Virements in Year	Total 2022/23 Budget	Actual Spend @ Period 6	Predicted Outturn	2022/23 Revised Estimate*
	£m	£m	£m	£m	£m	£m	£m
General Fund	11.790	19.230	0.110	31.130	2.679	15.677	22.117
HRA	10.715	11.298	-	22.012	14.124	21.700	21.960
Total	**22.505**	**30.527**	**0.110**	**53.142**	**16.803**	**37.377**	**44.077**

* Includes potential expenditure slippage into 2023/24 of £6.7m

3.2 Changes to the Financing of the Capital Programme

The following table draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. Any borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2022/23 Capital Programme £m	2022/23 Predicted Outturn £m	2022/23 Budget * £m
Unsupported	0.252	2.940	3.015
Supported	22.253	34.437	50.127
Total spend	**22.505**	**37.377**	**53.142**
Financed by:			
Grants - Disabled Facilities	0.547	0.852	0.852
Coalfields Grant	0.157	0.157	0.157
Section 106's	-	1.076	1.253
GF Receipts	0.004	6.422	6.845
GF Reserve	0.673	0.270	0.764
Sale of Council House Receipts	0.139	0.349	0.521
HRA Receipts	0.420	0.910	0.910
Future High Street Fund	9.995	5.180	19.262
Community Infrastructure Levy (CIL)	-	-	0.030
Other Grants/Contributions	1.024	1.119	1.119
MRR	4.117	5.064	5.334
HRA 1-4-1 Replacements Receipts	0.100	0.661	0.661
HRA Reserve	2.648	8.745	8.787
HRA Regeneration Fund	2.430	3.631	3.631
Total Financing	**22.253**	**34.437**	**50.127**
Borrowing need	**0.252**	**2.940**	**3.015**

* includes schemes re-profiled from 2021/22 of £30.527m

3.3 Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary

The following table shows the Capital Financing Requirement (CFR), which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary.

Prudential Indicator – Capital Financing Requirement

We are on target to achieve the original forecast Capital Financing Requirement.

Prudential Indicator – the Operational Boundary for External Debt

	2021/22 Outturn £m	2022/23 Capital Programme £m	2022/23 Projected Outturn £m	2022/23 Budget £m
CFR – Non Housing	3.937	5.029	4.985	5.060
CFR – Housing	69.893	70.590	71.582	71.582
Total CFR	73.831	75.619	76.567	76.642
Net movement in CFR	**0.325**	**1.534**	**2.736**	**2.811**
Operational Boundary				
Expected Borrowing	63.060	63.060	63.060	63.060
Other long term liabilities	-	-		-
Total Debt 31st March	**63.060**	**63.060**	**63.060**	**63.060**

3.4 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of 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 which will be adhered to if this proves prudent.

	2021/22 Outturn £m	2022/23 Original Estimate £m	2022/23 Projected Outturn £m	2022/23 Budget £m
Gross borrowing	63.060	63.060	63.060	63.060
Less investments	80.310	15.829	61.339	61.264
Net borrowing	-17.250	47.231	1.721	1.796
CFR (year end position)	**73.831**	**75.619**	**76.567**	**76.642**

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 of 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 Indicator	Current Position	2022/23 Revised Indicator
Borrowing	87.436	87.436	87.436
Total	87.436	87.436	87.436

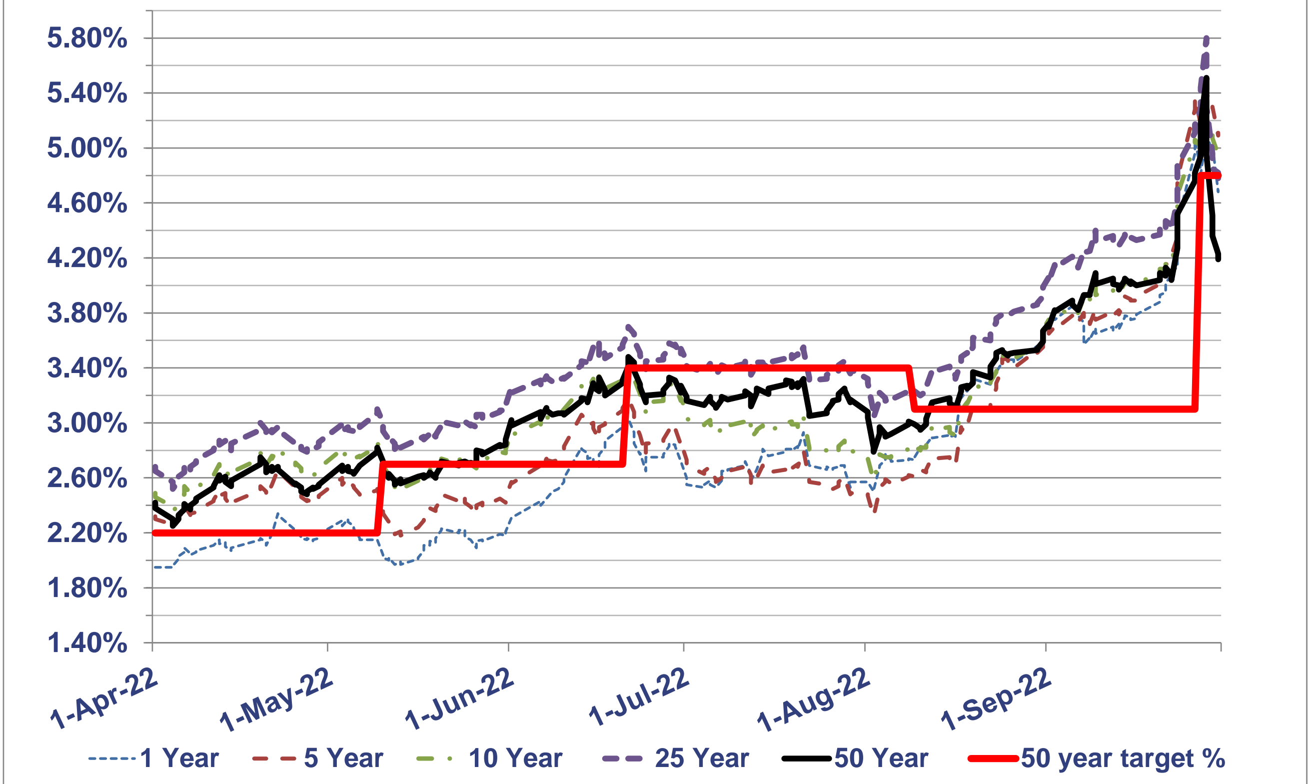
4. Borrowing

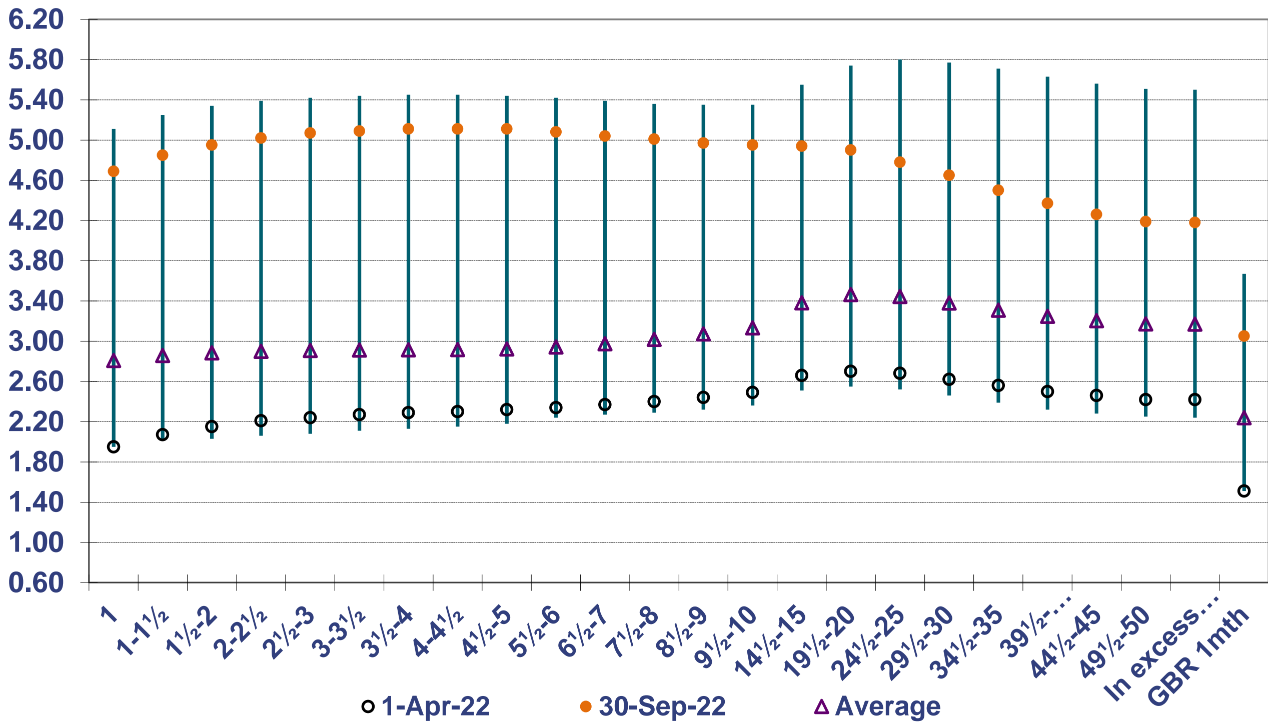
The Council's estimated revised capital financing requirement (CFR) for 2022/23 is £76.567m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. Table 3.4 shows the Council has borrowings of £63.060m and plans to utilise £13.507m of 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 upside risk to gilt yields prevails.

It is not anticipated that any additional borrowing will be undertaken during 2022/23.

PWLB maturity certainty rates (gilts plus 80bps) year to date to 30th September 2022

Gilt yields and PWLB rates were on a generally rising trend throughout H1 2022, the exception being a short rally in gilts in July/August. However, they rose exceptionally sharply towards the end of September. The 50-year PWLB target certainty rate for new long-term borrowing started 2022/23 at 2.20% and finished the half year at 4.80%.


PWLB Rates 1.4.22 - 30.9.22
5.80%
5.40%
5.00%
4.60%
4.20%
3.80%
3.40%
3.00%
2.60%
2.20%
1.80%
1.40%
1-Apr-22
1-May-22
1-Jun-22
1-Jul-22
1-Aug-22
1-Sep-22
1 Year
5 Year
10 Year
25 Year
50 Year
50 year target %


PWLB Certainty Rate Variations 1.4.22 to 30.9.22
6.20
5.80
5.40
5.00
4.60
4.20
3.80
3.40
3.00
2.60
2.20
1.80
1.40
1.00
0.60
1
1-1½
1½-2
2-2½
2½-3
3-3½
3½-4
4-4½
4½-5
5½-6
6½-7
7½-8
8½-9
9½-10
14½-15
19½-20
24½-25
29½-30
34½-35
39½-…
44½-45
49½-50
In excess…
GBR 1mth
1-Apr-22
30-Sep-22
Average

HIGH/LOW/AVERAGE PWLB RATES FOR 01.04.22 – 30.09.22

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.95%	2.18%	2.36%	2.52%	2.25%
Date	01/04/2022	13/05/2022	04/04/2022	04/04/2022	04/04/2022
High	5.11%	5.44%	5.35%	5.80%	5.51%
Date	28/09/2022	28/09/2022	28/09/2022	28/09/2022	28/09/2022
Average	2.81%	2.92%	3.13%	3.44%	3.17%
Spread	3.16%	3.26%	2.99%	3.28%	3.26%

The current PWLB rates are set as margins over gilt yields as follows: -.

- **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

5. 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.

6. Compliance with Treasury and Prudential Limits

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the half year 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 Executive Director Finance reports that no difficulties are envisaged for the current or future years in complying with these indicators.

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

7. Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2022/23, which includes the Annual Investment Strategy, was approved by the Council on 22nd 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, using the Link suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

Creditworthiness
Following the Government's fiscal event on 23rd September, both S&P and Fitch have placed the UK sovereign debt rating on Negative Outlook, reflecting a downside bias to the current ratings in light of expectations of weaker finances and the economic outlook.

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.

Investment balances
The Council held £78.144m of investments as at 30th September 2022, excluding investments in property funds (£68.299m at 31st March 2022) and the investment portfolio yield for the first six months of the year is 1.78% against a benchmark of the average 3 months SONIA of 1.71%. A full list of investments held as at 30th September 2022 is detailed in **APPENDIX 1.**

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

The Council's budgeted investment return for 2022/23 is £120.71k, and we are currently forecasting an additional £966k in investment income as at September Period 6, due to increased balances available for investment due to capital slippage, plus increasing interest rates.

Investment Counterparty Criteria

The current investment counterparty criteria selection approved in the TMSS and as approved by Council on 22nd February 2022 meets the requirements of the Treasury Management function.

8.Changes in risk appetite

The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy should be brought to members' attention in treasury

management update reports. There are no such changes to report to Members at this stage.

9. Property Funds

To date, the Council has invested £1.85m with Schroders UK Real Estate Fund, £6.057m with Threadneedle Property Unit Trust, and £4.057m with Hermes Federated Property Unit Trust, total investment £11.962m. Although the capital values of the funds did initially fall, mainly since 31st March 2020, they then recovered and as at 31st March 2022 there was an overall gain of £1.32m. However, since then capital values have fallen again, and as at 30th September the valuation stands at £12.89m, with an overall gain of £928k. It should be noted that investments in property are subject to fluctuations in value over the economic cycle and should yield capital growth in the longer term as the economy grows.

Fund Valuations	Investment	Valuation 31/03/2019	Valuation 31/03/2020	Valuation 31/03/2021	Valuation 31/03/2022	Valuation 30/09/2022
Schroders UK Real Estate Fund	1,848,933	1,897,716	1,884,412	1,848,933	2,139,618	2,092,044
Valuation Increase / (reduction)		48,783	35,479	0	290,685	243,111
Threadneedle Property Unit Trust	2,000,249	1,921,884	1,836,032	1,794,439	2,097,097	2,066,097
Valuation Increase / (reduction)		(78,365)	(164,216)	(205,810)	96,848	2,066,097
Threadneedle Property Unit Trust	4,056,536	-	-	-	4,407,163	4,342,015
Valuation Increase / (reduction)					350,627	285,478
Hermes Federated Property Unit Trust	4,056,500	-	-	-	4,450,808	4,389,967
Valuation Increase / (reduction)					394,308	333,467
Total		**3,819,601**	**3,720,444**	**3,643,372**	**13,094,687**	**12,890,122**
Valuation Increase / (reduction)		(29,581)	(128,738)	(205,810)	1,132,469	927,904
Annual Revenue % Return		-0.8%	-2.6%	-1.2%	12.5%	1.1%

The following table details the dividend returns achieved from the property fund investments, which support the revenue budget. The Council received £269k in dividends from its property fund investments in 2021/22 (£128k in 2020/21), and has received £220k for the current financial year as at 30th September 2022.

Fund Valuations	Investment	Dividend Returns 31/03/2019	Dividend Returns 31/03/2020	Dividend Returns 31/03/2021	Dividend Returns 31/03/2022	Dividend Returns 30/09/2022
Schroders UK Real Estate Fund	1,848,933	48,118	56,638	52,898	61,655	34,925
Threadneedle Property Unit Trust	2,000,249	60,056	90,274	75,452	79,231	39,336
Threadneedle Property Unit Trust	4,056,536	-	-	-	70,417	82,667
Hermes Federated Property Unit Trust	4,056,500	-	-	-	57,352	62,955
Total		**108,174**	**146,911**	**128,350**	**268,655**	**219,883**
Annual Revenue % Return		2.8%	3.8%	3.3%	2.2%	3.7%

APPENDIX 1

Investments held as at 30th September 2022:

Borrower	*Deposit £*	*Rate %*	*From*	*To*	*Notice*
Thurrock Council	5,000,000	0.65%	09-Oct-20	07-Oct-22	-
Slough Council	5,000,000	0.15%	06-Oct-21	05-Oct-22	-
Goldman Sachs	5,000,000	1.60%	29-Apr-22	28-Oct-22	-
Lloyds Bank	5,000,000	1.55%	11-May-22	11-Nov-22	-
Standard Chartered	10,000,000	1.50%	13-May-22	11-Nov-22	-
Slough Council	5,000,000	2.60%	15-Jul-22	14-Jul-23	-
NatWest	5,000,000	2.50%	11-Jul-22	10-Jul-23	-
Thurrock Council	5,000,000	2.30%	15-Jul-22	14-Jul-23	-
NatWest	5,000,000	2.60%	08-Aug-22	08-Aug-23	-
Goldman Sachs	5,000,000	2.48%	12-Aug-22	10-Feb-23	
Lloyds Bank	4,000,000	3.35%	15-Sep-22	15-Mar-23	-
Santander	10,000,000	1.52%	-	-	180 day
MMF – Aberdeen	158,000	2.08%*	-	-	On call
MMF – PSDF	44,000	1.93%*	-	-	On call
MMF – Federated	8,942,000	2.08%*	-	-	On call
Total	**78,144,000**	**1.85%**	-	-	-
Schroders UK Real Estate Fund	1,848,933	3.77%	-	-	-
Threadneedle Property Unit Trust	6,056,785	3.68%	-	-	-
Hermes Federated Property Unit Trust	4,056,500	3.15%	-	-	-
Total	**90,106,218**	**2.07%**	-	-	-

** Interest rate fluctuates daily dependant on the funds investment portfolio, rate quoted is approximate 7 day average.*

Fund	**Initial Investment**	**Fund Value 30/09/2022**	**2022/23 Return to Date**		
Schroders UK Real Estate Fund	£1,848,933.03	£2,092,043.94	£34,294.51	3.77%	Returns Received Monthly. Received up to Sep-22.
Threadneedle Property Unit Trust	£6,056,785.32	£6,408,111.87	£122,003.45	4.02%	Returns Received Quarterly. Received up to Sep-22
Hermes Federated Property Unit Trust	£4,056,499.57	£4,389,966.58	£62,955.29	3.10%	Returns Received Quarterly. Received up to Sep-22
Total	**£11,962,217.92**	**£12,890,122.39**	**£219,889.25**	**3.67%**	