Cheltenham Borough Council

Cabinet – 6 December 2022

Council - 12 December 2022

Treasury Mid-term Report – position at 30 September 2022

Accountable member:

Cllr Peter Jeffries – Cabinet Member for Finance and Assets

Accountable officer:

Gemma Bell - Director of Finance and Assets (Deputy Section 151 Officer)

Accountable scrutiny committee:

Treasury Management Panel

Ward(s) affected:

All

Key/Significant Decision:

No

Executive summary:

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities for the first six months of this financial year and highlights compliance with the Council's policies previously approved by members in March 2022. The Treasury Management Strategy for 2022/23 has been determined by the adoption of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the council to approve treasury management semi-annual and annual reports.

Recommendation:

1. **Following the recommendation of Treasury Management Panel, to note the contents of this summary report of the treasury management activity during the first six months of 2022/23 and recommend it onto Council.**

Background

1.1. On 21 March 2022, Council approved the Authority's treasury management strategy for 2022/23. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Council's treasury management strategy.

1.2. Chartered Institute of Public Finance (CIPFA) published its revised Treasury Management Code of Practice and Prudential Code for Capital Finance in December 2021. The key changes in the two codes are around permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments. Authorities could defer introducing the revised reporting requirements within the revised Codes until the 2023/24 financial year if they wish which this council has elected to do.

2. Economic Background

2.1. The economic backdrop during the April to September period continued to be characterised by high oil, gas and commodity prices, ongoing high inflation and its impact on consumers' cost of living, no imminent end in sight to the Russia-Ukraine hostilities and its associated impact on the supply chain, and China's zero-covid policy.

2.2. The ongoing conflict in Ukraine has continued to put pressure on global inflation and the economic outlook for UK and world growth remains weak. The UK political situation towards the end of the period following the 'fiscal event' increased uncertainty further.

2.3. Central Bank rhetoric and action remained robust. The Bank of England, Federal Reserve and the European Central Bank all pushed up interest rates over the period and committed to fighting inflation, even when the consequences were in all likelihood recessions in those regions.

2.4. UK inflation remained extremely high. Annual headline CPI hit 10.1% in July, the highest rate for 40 years, before falling modestly to 9.9% in August but then back up to 10.1% in September. RPI registered 12.3% in both July and August and then rose to 12.6% in September. The energy regulator, Ofgem, increased the energy price cap by 54% in April, while a further increase in the cap from October, which would have seen households with average energy consumption pay over £3,500 per annum, was dampened by the UK government stepping in to provide around £150 billion of support to limit bills to £2,500 annually until 2024.

2.5. The Bank of England increased the official Bank Rate to 2.25% over the period. From 0.75% in March, the Monetary Policy Committee (MPC) pushed through rises of 0.25% in each of the following two MPC meetings, before hiking by 0.50% in August and again in September 2022. The Committee noted that domestic inflationary pressures are expected to remain strong and so given ongoing strong expression around tackling inflation further Bank Rate rises should be expected. At the time of writing this report the Bank Rate has now increased to 3% in November.

2.6. On 23rd September the UK government, following a change of leadership, announced a raft of measures in a 'mini budget', loosening fiscal policy with a view to boosting the UK's trend growth rate to 2.5%. With little detail on how government borrowing would be returned to a sustainable path, financial markets reacted negatively. Gilt yields rose dramatically by between 0.7% - 1% for all maturities with the rise most pronounced for shorter dated gilts. The swift rise in gilt yields left pension funds vulnerable, as it led to margin calls on their interest rate swaps and risked triggering large scale redemptions of assets across their portfolios to meet these demands. It became necessary for the Bank of England to intervene to preserve market stability through the purchase of long-dated gilts, albeit as a temporary measure, which has had the desired effect with 50-year gilt yields falling over 100bps in a single day.

3. Credit review

3.1. Having completed its full review of its credit advice on unsecured deposits at UK and non-UK banks, in 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.

3.2. 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.

4. Treasury Management Summary position as at 31st March 2022

4.1. On 31st March 2022, the Authority had net borrowing of £152.751m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

4.2.

Table 1: Balance Sheet Summary

	31.3.22 Actual £m
General Fund CFR	115.287
HRA CFR	66.715
Total CFR	**182.002**
External borrowing	175.686
Less : Internal borrowing	6.316

Less: Usable reserves	20.957
Less: Working capital	1.978
Net borrowing	**152.751**

Borrowing

4.3. 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.

4.4. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield and this Authority intends to avoid this activity in order to retain its access to PWLB loans.

4.5. As outlined in the treasury strategy, the Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective. The Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

4.6. Over the April-September period short term PWLB rates rose dramatically, particular in late September after the Chancellor's 'mini-budget', included unfunded tax cuts and additional borrowing to fund consumer energy price subsidies. Exceptional volatility threatened financial stability, requiring Bank of England intervention in the gilt market. Over a twenty-four-hour period some PWLB rates increased to 6%, before the intervention had the desired effect, bringing rates back down by over 1% for certain maturities. A truly wild and unprecedented period in fixed income markets, with a direct impact on PWLB rates.

4.7. Interest rates rose by over 2% during the period in both the long and short term. As an indication the 5-year maturity certainty rate rose from 2.30% on 1st April to 5.09% on 30th September; over the same period the 30-year maturity certainty rate rose from 2.63% to 4.68%.

Table 2: Treasury Management Summary

	31.3.22 Balance £m	Movement £m	30.9.22 Balance £m	30.9.22 Rate %
Long-term borrowing	119.686	(1.111)	118.575	3.17
Short-term borrowing	56.000	(10.500)	45.500	1.93
Total borrowing	**175.686**	**(11.611)**	**164.075**	**2.83**

Long-term investments Short-term investments Cash and cash equivalents	11.590 0.925 10.420	3.011 0.225 (9.405)	14.601 1.150 1.015	3.85 4.25 1.75
Total investments	**22.935**	**(6.169)**	**16.766**	**3.72**
Net borrowing	**152.751**	**(5.442)**	**147.309**	

4.7. The balance as can be seen in Table 2 shows a reduced figure of £147.309m as at 30th September 2022 compared with the balance held at 1st April 2022. The weighted average interest rate on these loans is 2.83% up from 2.20% in March 2022. Borrowing costs are expected to be £439k higher than forecasted in November 2021, however the budget will be re-aligned to the new forecast for 2022/23.

4.8. Current temporary borrowing of £45.5m has been used over several years to fund capital expenditure as an alternative to taking out longer term borrowing which was much more expensive at the time, however due to the acceleration of interest rates since December 2021, a review will be undertaken to see if this is the best method of funding going forward. The authority will liaise with Arlingclose first before any changes in strategy are required.

4.9. The outstanding loans on 30th September 2022 are summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.22 Balance £m	**2022/23 Movement £m**	**30.9.22 Balance £m**	**30.9.22 Rate %**
Public Works Loan Board Banks (LOBO) Banks (fixed-term) Local authorities (short-term)	103.786 7.000 8.900 56.000	(1.111) 0 0 (10.500)	102.675 7.000 8.900 45.500	3.04 4.45 3.82 1.93
Total borrowing	**175.686**	**(11.611)**	**164.075**	**2.83**

4.10. LOBO loans: The Authority continues to hold £7m of LOBO (Lender's Option Borrower's Option) loans where 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. No banks exercised their option during the first 6 months of this financial year.

5. Investments

5.1. The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the six month period the council's investment balance ranged between £14m and £32.5m due to timing differences between income and expenditure. The Authority also received a bulk income payment in late March 2022 of around £6.8m to distribute out the Energy Rebates to every household entitled to the £150 refund. This was successfully completed by the end of September. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.22 Balance £m	**Net Movement £m**	**30.9.22 Balance £m**	**30.9.22 Rate of Return %**
Money Market Funds/ Call Accounts	10.420	(9.405)	1.015	1.76
Pooled Funds	7.000	-	7.000	4.90
Other investments	5.478	3.225	8.703	3.29
Total Investments	**22.898**	**(6.180)**	**16.718**	**2.72**

5.2. Both the CIPFA Code and Government Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment.

5.3. The increases in Bank Rate over the period under review, and with the prospect of more increases to come, short-dated cash rates, which had ranged between 0.7% - 1.5% at the end of March, rose by around 1.5% for overnight/7-day maturities and by nearly 3.5% for 9-12 month maturities.

5.4. By the end of September, the rates on DMADF deposits ranged between 1.85% and 3.5%. The return on the Council's sterling low volatility net asset value (LVNAV) Money Market Funds ranged between 0.9% - 1.1% in early April and between 2% and 2.20% at the end of September 2022.

5.5. Investment income was budgeted to be £599,771 in the Council's 2022/23 budget, set in February 2022. The Council has reviewed its expectations for investment income in 2022/23 and has assumed after looking at the returns over the first 6 months that the income could exceed budget by £240,000, so the revised budget will be amended in line with the surplus expected due to the increasing interest rates and strong dividends in the first half of the year from the Pooled Funds.

5.6. £7m of the Authority's investments are held in externally managed strategic pooled equity, multi-asset and 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 have generated an average total return of 4.84% for the first 6 months of this financial year which is used to support services in year. Because 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 investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rate.

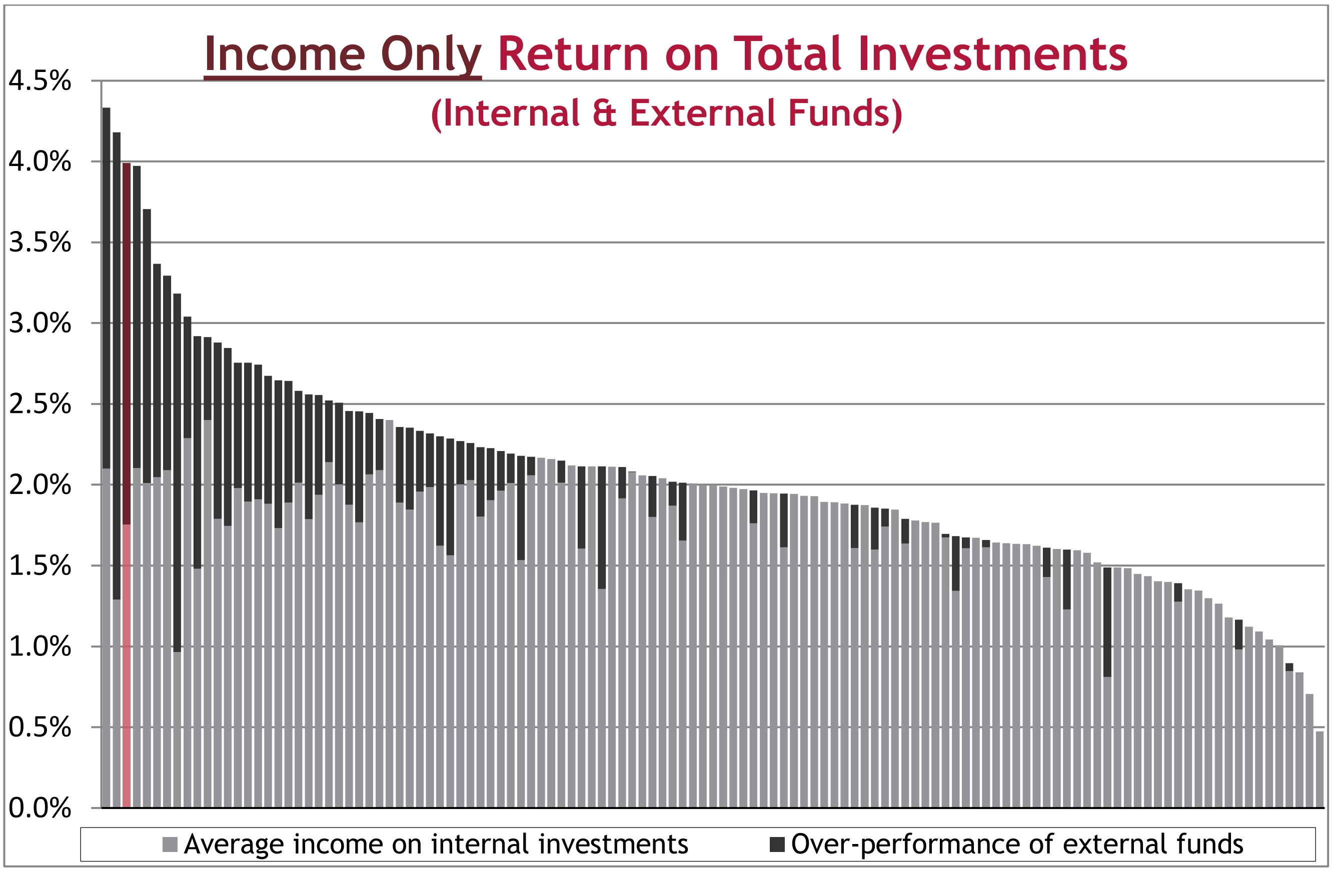
5.7. Table 5: Pooled Funds

FUND NAME	Initial Investment	1 April 2022 Fund Value	30 Sept 2022 Fund Value	Dividends paid out in 2022/23 as at 30 Sept	Gain / (Loss) for 2022/23	Gain / (Loss) to Initial Principal
	£	£	£	£	£	£
CCLA Property Fund	3,000,000	3,238,505	3,324,276	58,273	85,771	324,276
Schroders Income Maximiser Fund *	2,000,000	1,614,650	1,323,034	75,334	(291,616)	(676,966)
CCLA Diversified Income Fund	2,000,000	2,068,723	1,891,399	30,908	(177,324)	(108,601)
Total	**7,000,000**	**6,921,878**	**6,538,709**	**164,515**	**(383,169)**	**(461,291)**

* The Schroders Income Maximiser Fund has purchased shares within the oil and gas industry, which accounts 8.65% of the total amount invested in the fund (14% Sept 2021). This equates to £173,000 of the original £2m invested into the fund by this council. The dividend returns are currently returning over 7%. There are no plans at present to sell this investment as the fund is valued below the initial investment, which would need to be funded by revenue. As opportunities to support the climate ambitions of the Council arise, they will be considered. However, the treasury management function is controlled by statute and by professional guidelines and the first priorities of treasury must remain security, liquidity, and yield.

5.8. Total interest earned in the first 6 months of this financial year can be compared with all 121 clients of Arlingclose in table 6 below which see Cheltenham near the top of the table.

Table 6: Income returned for 2022/23.



Economic Outlook for the rest of 2022/2023

5.8. Table 7: Interest rate forecast

	Current	Dec 22	Mar 23	Jun 23	Sep 23	Dec 23	Mar 24	Jun 24	Sep 24	Dec 24	Mar 25	Jun 25	Sep 25
Official Bank Rate													
Upside Risk	0.00	0.25	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25
Arlingclose Central Case	3.00	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	3.50	3.50	3.50	3.50
Downside Risk	0.00	0.25	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00

5.9. Arlingclose now expects Bank Rate to peak at 4.25% next year as seen in table 7 above. The MPC is particularly concerned about the implications of fiscal loosening, the tight labour market, sterling weakness and the willingness of firms to raise prices and wages.

5.10. The threat of inflation remaining much higher and stickier than expected continues to be central banks' validation for doubling down on policy rate hikes in increments almost unthinkable a year ago, despite sagging consumer confidence, indicators pointing to slowing growth and numerous geopolitical factors at play.

5.11. The Bank of England's quarterly Monetary Policy Report with revised inflation and growth forecasts was released on Thursday 3rd November. A further rise in domestic inflationary pressures and a tight labour market will compel the Monetary Policy Committee to increase policy rates by 0.75% at the culmination of its meeting on Thursday, even though indicators point to the economy contracting and heading for a recession.

5.12. UK government policy has mitigated some of the expected rise in energy inflation for households and businesses flattening the peak for CPI, whilst extending the duration of elevated CPI. Continued currency weakness could add inflationary pressure.

6. Compliance

6.1. The Chief Finance Officer reports that all treasury management activities undertaken during the first six months of 2022/23 complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy.

Table 8: Debt Limits

	30.9.22 Actual £m	2022/23 Operational Boundary £m	2022/23 Authorised Limit £m	Complied? Yes/No
Total debt	**164.075**	***264.00***	**274.00**	Yes

Council approved in March 2022 the authorised borrowing limit and operational boundary limit are increased to the new levels as shown above in table 8. Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

Treasury Management Indicators

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

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	30.9.22 Actual	2022/23 Target	Complied?
Portfolio average credit rating	A+	A-	Yes

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. This indicator covers the risk of replacement loans being unavailable, not interest rate risk. The upper and lower limits on the maturity structure of all borrowing were:

	30.9.22 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	0.28%	50%	0%	YES
12 months and within 24 months	30.79%	50%	0%	YES
24 months and within 5 years	1.73%	100%	0%	YES
5 years and within 10 years	11.91%	100%	0%	YES
10 years and above	55.29%	100%	0%	YES

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

7. Consultation

7.1. Arlingclose the Council's treasury advisors have supported officers in preparing the treasury activities over the first 6 months of this financial year.

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8. Implications

8.1. Financial implications

As detailed throughout this report.

Signed off by: Gemma Bell, Director of Finance and Assets (Deputy s151 Officer), 01242 264124

8.2. Legal implications

None arising from the report recommendations.

Signed off by: One Legal legalservices@onelegal.org.uk

8.3. **HR implications**

As detailed in the report.

Signed off by: Julie McCarthy, HR Manager, julie.mccarthy@publicagroup.uk

8.4. **Environmental and climate change implications**

The Council does have some exposure to investments in a pooled fund which has shares with oil and gas companies. This is detailed in Section 5.7 of the report. As a responsible investor, the Council is committed to considering environmental, social, and governance (ESG) issues, and has a particular interest in taking action against climate change and pursuing activities that have a positive social impact.

Signed off by: Laura Tapping, Climate Emergency Programme Officer, 01242 264263

8.5. **Property/asset implications**

None specific directly arising from the recommendations.

Signed off by: Gemma Bell, Director of Finance and Assets, 01242 264124

8.6. **Corporate policy framework implications**

Taking action to ensure overspends are reduced as far as possible by the end of the financial year will help ensure that the council can continue to deliver its corporate objectives as set out in the 2019-2023 Corporate Plan.

Signed off by: Richard Gibson, Head of Communities, Wellbeing and Partnerships, 01242 264280

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9. Performance management – monitoring and review

9.1. The budget position will continue to be monitored by the Finance team throughout the year and a revised budget will be presented to the December Cabinet with the 2023/24 draft budget proposal.

Report author:

Andrew Sherbourne, Capital and Treasury Management Accountant

Appendices:

1. Risk Assessment

Appendix 1: Risk Assessment

Risk ref	Risk description	Risk owner	Impact score (1-5)	Likelihood score (1-5)	Initial raw risk score (1 - 25)	Risk response	Controls / Mitigating actions	Control / Action owner	Deadline for controls/ actions
	LOBO Loans - If £7m of these loans is recalled by the banks if they choose to exercise their option then we would need to have the resources on the day to repay. Alternative borrowing arrangements at today's current rates would be favourable for the Council	Gemma Bell, Director of Finance and Assets	1	2	2	Accept and Monitor	If the loans are recalled the council could take out temporary borrowing/ new long term borrowing through the PWLB or sale of units held in Pooled Funds. Any capital receipts available could also be used to repay debt.	Gemma Bell, Director of Finance and Assets	Ongoing
	If the assumptions made within the strategies change, then the aspirations within the capital programme may become unaffordable	ED Finance and Assets	3	2	6	Accept and Monitor	The Treasury Management Strategy and Prudential and Treasury Indicators reflect various assumptions of future interest rate movements and Government support for capital expenditure. These will be continually monitored and any necessary amendments will be made in accordance with the Strategy	ED Finance and Assets	Ongoing
	If the assumptions made within the strategies change, then the projected returns and the return of the initial investments may not be	ED Finance and Assets	3	2	6	Accept and Monitor	The Treasury Management Strategy and Prudential and Treasury Indicators reflect various	ED Finance and Assets	Ongoing

Risk ref	Risk description	Risk owner	Impact score (1-5)	Likelihood score (1-5)	Initial raw risk score (1 - 25)	Risk response	Controls / Mitigating actions	Control / Action owner	Deadline for controls/ actions
	received.						assumptions of future interest rate movements and Government support for capital expenditure. These will be continually monitored and any necessary amendments will be made in accordance with the Strategy		
	If thorough due diligence is not undertaken when pursuing PRS schemes, the Council may not meet all of the criteria set out within its capital and investment strategies.	ED Finance and Assets	4	2	8	Accept & Monitor	Due diligence is of paramount importance. All of our investments have individual business cases that are subject to thorough risk assessment and stress testing and we also stress test the whole housing to ensure all risks are captured and properly controlled. Where appropriate to the size and scale of the project we also commission independent technical, legal, accounting, risk management, property, taxation advice	ED Finance and Assets	Ongoing