AUDIT & GOVERNANCE COMMITTEE

DATE	10 November 2022
REPORT OF	Sharon Wroot, Executive Director, Environment, Economy & Resources
SUBJECT	Treasury Half-Year Report 2022-23
STATUS	Open

CONTRIBUTION TO OUR AIMS

Effective treasury management will provide support towards the achievement of Council Plan aims and objectives. Treasury management is an integral part of the Council's finances providing for cash flow management and financing of capital schemes. It therefore underpins all the Council's aims.

EXECUTIVE SUMMARY

The report contains details of treasury management arrangements, activity and performance during the 2022/23 financial year.

During the period covered, the Council complied with its legislative and regulatory requirements.

The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Prudential and Treasury Indicators	31.3.22 Actual £'m	2022/23 Original Forecast £'m	30.9.22 Actual £'m
Capital Expenditure	**32.0**	**67.6**	**29.6**
Capital Financing Requirement	**190.3**	**223.9**	**205.3 (est)**
Authorised Borrowing Limit	**290.0**	**290.0**	**290.0**
Operational Boundary	**245.0**	**250.0**	**250.0**
External Borrowing	**154.4**	**196.3**	**155.2**
Investments >365 days	**0.0**	**0.0**	**0.0**

RECOMMENDATIONS

Audit & Governance Committee is requested to:

1) Consider the content of the report and makes any recommendations to Cabinet as necessary in respect of treasury management activity during 2022/23.

REASONS FOR DECISION

The Council's treasury management activity is guided by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year with interim updates on performance against Prudential Indicators reported quarterly. We therefore report in full after Quarter 2 (this Report) and year end with Prudential Indicators being reported additionally after Quarters 1 and 3 in the Commissioning and Resource Report.

1. BACKGROUND AND ISSUES

1.1. CIPFA has defined treasury management as:

The management of the organisation'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.

1.2. The Treasury Management Strategy Statement (TMSS) for 2022/23 was developed in consultation with our treasury management advisors, Link Asset Services Ltd. This statement also incorporates the Investment Strategy.

1.3 Whilst the Council has appointed advisors to support effective treasury management arrangements, the Council is ultimately responsible for its treasury decisions and activity. No treasury activity is without risk. The successful identification, monitoring and control of risk is therefore an important and integral element of treasury management activities.

1.4 The Council has nominated the Audit & Governance Committee as responsible for ensuring effective scrutiny of the treasury management arrangements.

1.5 Key points to note with specific regard to the Treasury Strategy:

- The first half of 2022/23 was dominated by signs of economic activity losing momentum as production fell due to rising energy prices and surveys reported consumer confidence at all-time lows. This was bourne out when the first print of GDP data for August suggested the economy shrank by 0.3% in that month alone.

- CPI inflation did ease to 9.9% y/y in August, having been 10.1% in July (It was 9.0% in April), but domestic price pressures showing little sign of abating in the near-term

- In September the unemployment rate fall to a 48-year low of 3.5% due to a large shortfall in labour supply;

- Retail sales fell 1.6% month-on-month in August, the ninth fall in 10 months.

- At period end, the new Prime Minister and Chancellor made a step change in government policy. The government's huge fiscal loosening from its proposed significant tax cuts will add to existing domestic inflationary pressures and will potentially leave a legacy of higher interest rates and public debt. Whilst the government's utility price freeze, which could cost up to £150bn (5.7% of GDP) over 2 years, will reduce peak inflation from 14.5% in January next year to 10.4% in November this year, the long list of tax measures announced at the "fiscal event" adds up to a loosening in fiscal policy relative to the previous government's plans of £44.8bn (1.8% of GDP) by 2026/27.

- Fears that the government has no fiscal anchor on the back of these announcements meant that the pound weakened significantly, briefly hitting all-time lows against the US dollar, adding further upward pressure to interest rates. Indeed, the subsequent partial recovery of Sterling was due to hopes that the Bank of England will deliver a very big rise in interest rates at the policy meeting on 3rd November and the government will lay out a credible medium-term plan in the near term.

- The Authority secured £25m of new and future borrowing across various tenors in August prior to the sharp rises in rates. Whilst these transactions look very attractive now, versus a 'wait and see' approach, the Authority has an ongoing borrowing requirement and future loans will be much, more expensive. On current data significant overspends are expected over existing budget projections.

- The higher balances that had been maintained during the Covid pandemic had corrected to long-run average levels by period end.

- If the Capital Programme is fully delivered in year our projected year end borrowing will be £188m, slightly lower than originally forecast.

- The Treasury Management Strategy covers the Council's treasury aims and principles. The Council may consider 'commercial' and service driven, non-treasury investments from time to time. Although reference is made to these types of investments in the TMSS these transactions are guided and limited by the Capital Strategy document.

2. RISKS AND OPPORTUNITIES

2.1 No Treasury activity is without risk. Specific risks include, but are not limited to, Counterparty Credit Risk (the risk of an investment not being repaid), liquidity risk (the risk that the Authority does not have its funds in the right place, at the right time and in the right amount to make it's payments as they fall due), interest rate risk (the risk that future rate movements have a revenue implication for the Authority) and reputational risk (see Section 4 below).

2.2 The attached Appendices define our approach toward mitigating these risks.

2.3 Treasury is an Authority-wide function and its environmental sustainability and equalities implications are the same as for the Council itself.

2.4 The Authority will have regard to the environmental and equality activities of its Counterparties (where reported) but

- Prioritises Security, Liquidity and Yield,
- Recognises that as large, global institutions our high-quality counterparties operate across the full range of marketplaces in which they are legally able to, and such exposures are small parts of their overall business.
- Excluding any one counterparty will likely mean others will similarly have to be avoided and thus impact the Authority's capacity to mitigate risk through diversification.

2.5 **General Data Protection Regulation 2018** – Relationships with external providers covered by the Treasury management Practices are governed by and operated in accordance with the act.

3. OTHER OPTIONS CONSIDERED

3.1 These were set out on Page 28 of the Treasury Management Strategy Statement.

4. REPUTATION AND COMMUNICATIONS CONSIDERATIONS

4.1 As you would expect, with large sums of public money involved, any treasury activity carries a high degree of reputational risk. Any losses have not just financial but also significant, ongoing resource implications for the Council.

5. FINANCIAL CONSIDERATIONS

5.1 As set out in the Appendices.

6. CHILDREN AND YOUNG PEOPLE IMPLICATIONS

6.1. As an Authority-wide corporate function, the immediate impacts of day-to-day Treasury operations on children and young people are the same as for the Council as a whole. However, certain Treasury decisions, most notably those relating to Long-Term Borrowing transactions, will place a greater burden on young residents, over time, relevant to other demographics.

7. CLIMATE CHANGE AND ENVIRONMENTAL IMPLICATIONS

7.1 In line with the Authority's declaration of a Climate Emergency, the S151 Officer will aim to assess and monitor, not just Environmental but all, ESG factors when selecting investment options. Full assessment is however restricted by the fact that, at the time of writing, there is no consistent rating framework with which to measure and benchmark specific counterparty ESG metrics. Until this market data gap is fully resolved, our approach to managing the risks associated with the Environmental activities of our Counterparties is as follows:-

- As the Ratings Agencies headline ratings on our Counterparties now incorporate ESG risk assessments alongside more traditional financial risk metrics and so provide both an holistic risk measure and a proxy for ESG 'scoring' in the absence of anything more robust

- The Council will continue to Prioritise Security, Liquidity and Yield, in that order

- The Council recognises that as large, global institutions our high-quality counterparties operate across the full range of marketplaces in which they are legally able to, and as a result climate change considerations are an increasingly important and heavily-scrutinised part of their overall business.

- Excluding any one counterparty will likely mean others will similarly have to be avoided and thus impact the Authority's capacity to mitigate risk through diversification.

- The Council notes that bonds issued by Supranational institutions offer strong ESG credentials, combined with the explicit underwriting support of all major developed countries. This results in excellent ratings (typically AA+ - AAA) being applied. As such, the Council actively seeks exposure to these assets (commensurate with its investment horizon) and in doing so, contributes to market liquidity and therefore capital raising abilities of these bodies who then deploy that capital in ESG positive schemes.

8. FINANCIAL IMPLICATIONS

8.1 As set out in the appendix.

9. MONITORING COMMENTS

9.1 In the opinion of the author, this report does not contain recommended changes to policy or resources (people, finance or physical assets). As a result no monitoring comments have been sought from the Council's Monitoring Officer (Chief Legal Officer) or Strategic Workforce Lead.

10. BACKGROUND PAPERS

10.1 CIPFA Treasury Management Code and Guidance Notes

11. CONTACT OFFICER(S)

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Councillor Harness
Portfolio Holder for Finance, Resources and Assets

Appendix 1

Treasury Half-year Report 2022/23

Contents

Abbreviations Used In This Report

- **CFR:** capital financing requirement - the council's annual underlying borrowing need to finance capital expenditure and a measure of the council's total outstanding indebtedness.
- **CIPFA:** Chartered Institute of Public Finance and Accountancy – the professional accounting body that oversees and sets standards in local authority finance and treasury management.
- **Gilts:** gilts are bonds issued by the UK Government to borrow money on the financial markets. The yields on Gilts are (usually) fixed and so will change inversely to the price of gilts i.e. a rise in the price of a gilt will mean that its yield will fall.
- **LOBO:** a loan carrying provision for the lender to periodically amend the interest rate applicable. If the lender chooses to exercise this option the borrow then receives the secondary option to choose to repay the loan without penalty.
- **DLUHC:** the Department for Levelling Up, Housing and Communities - the Government department that directs local authorities in England.
- **MRP:** minimum revenue provision - a statutory annual minimum revenue charge to reduce the total outstanding CFR, (the total indebtedness of a local authority).
- **PWLB:** Public Works Loan Board – the section within H.M. Treasury which provides loans to local authorities to finance capital expenditure.
- **S151 Officer:** an Officer appointed under section 151 of the Local Government Act to carry out the duties of 'Responsible Financial Officer' as defined by CIPFA
- **SONIA:** Sterling Overnight Index Average, the 'risk-free' rate for market transactions.
- **TMSS:** the annual treasury management strategy statement reports that all local authorities are required to submit for approval by the full council before the start of each financial year.

Key Messages:

All investment and borrowing transactions were in line with the Approved 2022-23 Treasury Strategy.

There were no in-year policy changes to the TMSS; the details in this report update the outturn position set against the updated economic environment and budgetary changes already approved.

Our revised central case for rates is now for interest rates to continue to rise to a peak of around 4% - 5% by mid-2023. Uncertainty remains and the implications for both investment income and borrowing cost will be closely monitored.

This report covers Treasury and it's related financial transactions. A Capital Strategy is reported separately covering non-treasury related investments.

S151 Officer Overview

The Council operates a balanced budget, which broadly means cash raised during the year will meet its non-capital expenditure, however there will always be timing differences in how funds are received and expenses settled. A fundamental element of treasury management is to ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, whilst retaining adequate liquidity before considering optimising investment return.

Our 2022-23 Treasury Strategy was tailored to allow the Council to manage risks related to cash investments and has stood up well to the ongoing volatility in financial markets. As such, no changes are proposed at the mid-point of the year,

The second main function of the treasury management service is the arrangement of funding for 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 plans as they fall due. During the period we arranged several loans once a clear trend toward lasting higher rates appeared. This activity was proportionate and varied in terms of tenor and start date. Future borrowing will now come at a significantly higher cost although we will try to limit the impact through the use of short-term loans to cover the period of monetary tightening until signals of a looser approach from central banks has a beneficial impact on our gilt derived longer term loan rates.

The first half of 2022-23 has been driven by the inflation expectations, and the reaction of Central bankers around the World to try and reign it in as non-discretionary elements of spending (energy, fuel, food) moved markedly upward. Gilt rates (on which the Council's new borrowing is based) rose steadily through the period. However, this upward trend accelerated 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". Developments since then have seen some reduction in rates though high levels of volatility remain, such as that seen as a consequence of the Pension Scheme related market dysfunction.

Sharon Wroot, Director of Finance

October 2022

Key Messages:

No Treasury activity is without risk. These risks include, but are not limited to, Credit Risk, Liquidity Risk, Interest Rate Risk, Inflation Risk and Reputational Risk.

The Council uses in-house knowledge, advisors (Link Asset Services), treasury management software (Treasury Live) and the CIPFA Treasury Management Code to manage these risks.

Scrutiny of Treasury activity is undertaken by Audit and Governance Committee and reported twice-yearly to Full Council. In accordance with Code revisions, updates on Prudential Indicators are also provided as part of quarterly budget updates Reports.

Introduction and External Context

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 2021) to provide a review of treasury management activities and the actual prudential and treasury indicators for 2022/23. This report also references the most recent Revisions to the Code and meets the requirements of both the CIPFA Code of Practice on Treasury Management, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

This report covers the following:

- An economic update for 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 in 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 regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to the above treasury management report by the Audit Committee before they were reported to the full Council. Member training on treasury management issues was undertaken during 2021/22 in order to support members' scrutiny role.

The Authority 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. This report covers treasury activity and the associated monitoring and control of risk.

Key Messages:

The Council has taken a cautious approach to investing, but is also fully appreciative that the external risk environment is very much shaped by developments around inflationary pressures and economic outlooks.

As of September 2022 our advisors, Link Group are forecasting further increases in Bank Rate through to a peak of 5% by Mid 2023, although the picture remains somewhat uncertain in terms of path for inflation and the potential for a 'hard-landing' (combined effects of inflation and rates resulting in a dramatic slowdown in growth or even a recession).

Introduction and External Context

Having moved away from historic lows in the latter months of 2021/22 rates moved – first steadily and then at an accelerated pace – higher during the first half of 2022/23. Our advisors' expectation for interest rates within the treasury management strategy for 2022/23 was that Bank Rate would advance to only 0.5% by September 2022. Although the faster increases we have seen (Bank Rate is now 2.25%) we have been able to capture some lower rate forward borrowing, have seen welcome additional return on investments and slower than anticipated Capital Programme spend means budgets for debt cost still remain achievable as at the time of writing for 2022/23. If rates remain elevated, a revision to budgets and/or Capital Plans may be necessary for future years.

Key economic data during the period included:-

- - Signs of economic activity losing momentum as production fell due to rising energy prices;
- - CPI inflation eased 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 and a peak is anticipated in Q4 2022 ;
- - The unemployment rate fall to a 48-year low of 3.6% due to a large shortfall in labour supply;
- - Bank Rate rose to 2.25% with further rises to come;
- - Gilt yields surge and sterling's fall following the "fiscal event" of the new Prime Minister and Chancellor on 23rd September.

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. Their latest forecast on 27th September set out a view that both short and long-dated interest rates will be elevated for some little while, as the Bank of England seeks to squeeze inflation out of the economy, whilst the government is providing a package of fiscal loosening to try and protect households and businesses from the pressures of exceptionally high wholesale gas and electricity prices.

Link now expect Bank Rate to peak at 5% during 2023 before falling back steadily as the economy contracts. Rates for a typical 25yr PWLB loan are expected to be slightly lower (4.8%) but with the same profile of a peak mid-2023 and a steady decline through late-2023 to 2025.

The Authority does not typically have sufficient surplus cash balances to be able to place deposits for more than around six months so as to earn higher rates from longer deposits. In a rising rate environment this has the beneficial effect of being able to capture uplifts in rates sooner however.

Key Messages:

The Treasury Management Strategy Statement, (TMSS), for 2022/23 was approved by this Council in February 2022. No changes are considered necessary during the year despite the continued uncertainty around inflation and rate forecasts.

The Authority has an increasing CFR over the next four years due to the capital programme, and with reduced investments will therefore need to borrow to finance that capital programme as well as to replace maturing loans.

Since the 2008 financial crisis the Authority has adopted a cautious approach whereby investments are framed by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

Local Context

The Treasury Management Strategy Statement, (TMSS), for 2022/23 was approved by this Council on 24 February 2022.

There were no in-year policy changes to the TMSS – pleasing to note in the face of unprecedented economic circumstances; the Strategy did its job in protecting public funds whilst allowing sufficient flexibility to cope with exceptional operational demands.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council must ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This means that the Council is not borrowing to support revenue expenditure.

The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator and we are on target to achieve the original forecast.

	31 March 2022 Principal	Rate/ Return	Average Life yrs		30 September 2022 Principal	Rate/ Return	Average Life yrs
Total debt	*£154.4m*	*3.17%*	*27.0*		*£155.2m*	*3.28%*	*27.0*
Capital Financing Requirement (CFR)	*£190.8m*				*£205.3m (est)*		
Over / (under) borrowing	*(£36.4m)*				*(£50.1m)*		
Total investments	*£44.7m*	*0.54%*	*0.04*		*£25.9m*	*1.84%*	*0.04*
Net debt	£109.7m				£129.3m		

The overall level of investment balances held has remained higher through the Covid-19 pandemic, as the Authority sought additional liquidity and central Government provided additional support. These effects are now expected to reduce and, looking forward, it is anticipated that the Authority will revert to using internal borrowing to both defer more expensive long-term borrowing and reduce it's credit risk exposure.

Key Messages:

When undertaking new borrowing the Council will review both the source and tenure of loans it seeks to take.

At 31/09/2022 the Authority held £155m of loans, (up £1m in the period) as a result of funding previous years' capital programmes.

The Council's current borrowing portfolio is predominantly of a long-term and fixed nature. Whilst this provides certainty of cost it can restrict flexibility to restructure debts as plans and finances change.

No rescheduling was undertaken during the year as the differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Borrowing Strategy

The first key control over the treasury activity is the CFR, 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 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 such borrowing proves prudent, meets the CFR criteria above and after due evaluation is believed to represent a Value for Money proposition.

	2022/23 Outturn Original Estimate £m	Mid-year Position 30/09/2022 £m	Revised 2022/23 Final Position £m
Borrowing	196.3	155.2	188.6
Other Long Term liabilities	0.0	0.0	0.0
Total debt	196.3	155.2	188.6
CFR (year end position)	223.9	205.3 (est)	221.8 (est)

Type of Loan	Amount	% of Portfolio
PWLB Fixed	£77.4m	50%
LOBO	£21.0m	14%
Market Fixed	£41.7m	27%
Short-term Fixed	£15.0m	10%
Variable Rate	£0.2m	1%
Total	£155.2m	

*Figures are rounded so may not aggregate to total shown

Key Messages:

Affordability and the "cost of carry" remained strong influences on the Authority's borrowing strategy. As interest rates rose we arranged £25m of new loans over various periods and start dates to lock-in some lower cost of funding. Future borrowing will now become more expensive (at current rates/projections)

Borrowing short-term from other local authorities provides a useful source of funding below current long-term rates and with the ability to exit loans within a reasonable timeframe.

Additionally, there is a tactical advantage in using shorter term loans to manage the cost of debt while rates are rising and then potentially re-financing at a longer tenor once monetary policy shows signs of easing.

Borrowing Strategy (continued)

- During the period, the Council maintained an under-borrowed position. This means that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

- The policy of avoiding new borrowing by running down spare cash balances, has served well in recent years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt. £25m of fixed rate debt over various periods and start dates was arranged in the period to lock in some lower rates without creating burdensome cost of carry. Additionally, there is a tactical advantage in using shorter term loans to manage the cost of debt while rates are rising and then potentially re-financing at a longer tenor once monetary policy shows signs of easing. (see P11 for details).

- It is anticipated that further borrowing will be undertaken during the 2022/23 financial year.

- Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The S151 Officer therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks :

- where there was a significant perceived risk of a sharp FALL in long and short term rates, (e.g. due to a marked increased risk of recession or risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

- if it had been felt that there was a significant risk of a sharp RISE in long and short term rates, perhaps arising from 'sticky' inflation or Sterling weakness, then the portfolio position would be re-appraised. Indeed, as a result of this view some fixed rate funding was arranged whilst interest rates were lower than they were projected to be in the future.

Key Messages:

The Authority's traditional source of long-term borrowing is the Public Works Loan Board (part of HM Treasury).

The rate at which the Authority can borrow is determined by the Gilt Market (the Government's own primary source of borrowing) and fluctuates with market conditions. On top of this 'base rate' PWLB apply a margin, typically 0.8% for NELC.

In the first half of 2022-23 rates continued to rise as future hikes in Bank Rates were anticipated by markets. Significantly higher volatility also became a regular feature across the majority of financial markets, particularly at period end.

Borrowing Strategy (continued) 1

PWLB rates are based on gilt (UK Government bonds) yields through H.M.Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields, as well as Defined Benefit Pension Scheme liabilities.

The current margins over gilt yields are 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)

with rates being revised twice daily.

At the close of the day on 30 September 2022, all PWLB Maturity Certainty Rate loans from 1 to 5 years were between 4.85% – 5.11% while the 10-year and 25-year yields were at 4.95% and 4.78% but the market had become much more volatile than in previous periods.

With much of the negative outlook now priced into yields, not least the reaction to the 'mini-budget' which began to be unwound post period end, there is expected to be only a small rise in gilt yields and PWLB rates over the few months, even as Bank Rate is forecast to rise to 5% by mid-2023 as the Bank of England combats high inflation. Gilt markets tend to anticipate these rises, meaning our borrowing rates can change much more quickly, something we will be closely monitoring.

Borrowing in advance of need

The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed, so expects to retain access to PWLB. The forward starting loans recently arranged were secured to meet a portion of the anticipated requirement over the next year, while lower rates remained accessible.

Key Messages:

Several loans were agreed during 2022-23 to support the Council's Capital Plans and refresh maturing loans.

Borrowing Strategy (continued) 2

Borrowing – the following loans were arranged during the period:

Counterparty	Start Date	Maturity Date	Amount	Rate
PWLB	09/08/2022	09/08/2051	£5,000,000	2.97%
West of England Combined Authority	18/08/2022	17/08/2023	£5,000,000	1.30%
Lancashire County Council	31/08/2022	30/11/2022	£5,000,000	1.50%
Renfrewshire Council	21/11/2022	21/08/2023	£5,000,000	2.90%
Oxfordshire County Council	23/11/2022	21/11/2025	£5,000,000	2.25%

Shortly after these loans were arranged, rates rose dramatically, first, when the new Prime Minister announced her Energy Cap support measures and then again when that was followed in quick order by the new Chancellor launching a raft of unfunded growth measures. Markets initially reacted badly, eventually to such a degree that the Bank of England had to intervene to stabilise certain areas of the market related to Pension Fund derivatives, but subsequently settled a little after period end. However, uncertainty remains over the fiscal sustainability of the announced measures and the record levels of issuance likely to be necessary over the next few years on the back of these measures.

Whilst rates are currently expected to peak at around 5% (at the time of writing) in early to mid 2023, it is not our current base case that they then begin to revert to the levels seen in the past decade or so. We believe higher rates are here for the time being.

Key Messages:

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

All other things being equal we would expect to see balances fall each year by the amount of corporately funded capital expenditure less any new borrowing.

During 2022/23 the higher balances maintained as a result of officers adding liquidity through the Covid-19 pandemic and related Government support programmes slowly reduced toward more typical levels for the Authority. This trend is expected to continue during the remainder of the financial year.

Investment Activity

The Authority has held significant invested funds, representing income received in advance of expenditure plus balances and reserves held. As part of its national response to the Coronavirus pandemic the UK Government provided large sums of additional cash resources to local authorities. Some of these funds supported additional burdens experienced by Authorities as a result of the pandemic and others were provided for Authorities to distribute targeted support to the private sector.

During 2022/23 total investment balances ranged between £25.9m and £58.4 million. The average balance maintained was £44m (including central Government support programme monies) with a weighted average maturity of 15 days. During the period our target rate of 7-day SONIA was 1.22%. Up to 30 September we under-performed the benchmark (achieving a return of 1.03% vs the benchmark 1.22%). This is reflective of the rapid rises in rates during the period which emphasises the maturity lag of our investments before we can capture those higher yields. Our investments generated £0.229m of income during the first half of 2022/23.

Investment Policy – the Council's investment policy is governed by DLUHC and CIPFA guidance, which has been implemented in the annual investment strategy approved by the Council. Investment activity during the year conformed to the Investment Strategy for 2022/23 which aimed to reduce risk by;

- Setting value and term limits for counterparties based on Credit rating, available collateral and sector.
- Utilising data tools available via Treasury Live and Link Asset Services to monitor risk.
- Ensuring a minimum level of liquidity was maintained to allow payments to be made as they fell due

The Council aims to achieve an adequate return (yield) on its investments commensurate with robust levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs using our suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

Creditworthiness – Credit metrics for the financial institutions we interact with which had remained remarkably resilient throughout the Covid pandemic started to show general signs of increased risk as the global cycle of monetary tightening progressed. However, no changes to TMSS limits, or indeed (more restrictive) operational limits were necessary during the period. Even so in a post 'Bail-in' regulatory environment NELC seeks to largely avoid direct bank exposure.

Key Messages:

Counterparty credit quality is assessed and monitored with reference to credit ratings (the Authority's minimum long-term counterparty rating for institutions defined as having "high credit quality" is A-); credit default swap prices, financial statements, and reports from quality financial news feeds.

Balances which had been maintained at higher levels throughout the Covid pandemic were allowed to reduce naturally and were back at long-term average levels at period end.

Investment Activity

Investments	Balance on 31/03/2022 £m	Investments Made £m	Maturities/ Investments Sold £m	Balance on 31/09/2022 £m	Avg Rate/Yield (%) and Avg Life (years)
UK Government: - DMADF - Treasury Bills/Gilts	27.6 6.5	400.9 9.5	(423.2) (13.0)	5.3 3.0	0.92% 10 days 0.94% 56 days
Bonds issued by Multilateral Development Banks	-	9.6	(1.5)	8.1	1.22% 109 days
Direct Unsecured Investments (call accounts, deposits) with financial institutions - rated A- or higher - rated below A-	0.2 -	20.7	(20.3)	0.6	1.00% at Call
Tradable Investments with Financial institutions Corporates (CDs) rated A- or higher	2.0	2.0	(2.0)	2.0	1.32% 61 days
Money Market Funds	8.4	10.9	(12.4)	6.9	1.15% at Call
TOTAL INVESTMENTS	44.7	453.5	(472.3)	25.9	1.03% 30 days
Increase/ (Decrease) in Investments £m				(18.8)	

Given the increased risk and continued low returns from short-term unsecured bank investments, but having no funds available for longer-term investment, the Authority is unable to simply diversify into more secure and/or higher yielding asset classes such as repurchase agreements or covered bonds which are secured on financial assets. Eliminating Credit Risk by running down balances whilst still maintaining adequate liquidity therefore remains a key strand of operational activity.

Key Messages:

Figuratively the Authority's risk profile remained fairly steady for most of the year, (with a narrow set of counterparties our risk profile primarily moves with UK sovereign rating where there were no changes during the period).

An active strategy during the period has been to hold short-term Multi-lateral Bank Bonds. These instruments are typically AAA-rated thanks to their callable capital claims on the World's major developed countries. They have the additional positive characteristic of possessing strong ESG credentials.

Investment Activity (contd.)

Credit Risk

Counterparty credit quality as measured by credit ratings is summarised below:

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating
31/03/2022	3.45	AA
30/06/2022	2.88	AA
30/09/2022	2.39	AA+

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 26
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

Credit risk (as defined by Credit Swap premia) rose steadily during the period. The table above suggests that our own average risk remained very low and even improved slightly. Several factors contributed to this:-

- The scores above reflect Credit Rating Agencies ratings. These are far less 'agile' than CDS rates, so there is likely to be some lag present and we expect there may be Outlook changes and even downgrades in the remainder of the financial year, particularly if the UK Sovereign Rating is revised downward in response to the Government's fiscal stimulus plans.
- An active strategy during the period has been to hold short-term Multi-lateral Bank Bonds. These instruments are typically AAA-rated thanks to their callable capital claims on the World's major developed countries. They have the additional positive characteristic of possessing strong ESG credentials.
- NELC largely seeks to avoid direct bank exposure and where we do invest it is generally on a call/tradeable basis.

Key Messages:

In an environment where direct unsecured bank deposits present increased risk but low return NELC has sought to avoid this imbalance by utilising UK Government based investments and diversified funds.

Ultimately we seek to minimise counterparty risk by limiting our cash levels whilst still maintaining adequate liquidity.

There were no operational breaches of the limits set in the TMSS during the period.

Investment Activity (contd.)

Benchmarking

- Comparisons are made to other Authorities using the Treasury Live database which looks at over £9Bn of local Authority investments. As at the outturn date this shows that other Authorities:-
  - Hold more cash than NELC. Average balance £113m (estimated) vs £26m at NELC
  - Invest for longer periods. 123 days on average vs only 28 days at NELC
  - Take more risk than us collectively.
  - Deliver better return to us. 1.84% vs 1.74%
- The above shows how the Council has been able to take advantage of rising rates more quickly due to its shorter average investment term. NELC is of the view that, in a post Bail-in environment elimination of credit risk through lower balances is worth potential lower overall return. To ensure this strategy does not replace credit risk with liquidity risk NELC maintains a liquid balance at least £10m.
- Whilst we regularly monitor performance against data on 80 other Authorities' activity (as summarised above), in January 2022 Audit and Governance Committee requested that we obtain some additional specific data on what Unitary Authorities (like NELC), are investing in, to ensure we are not 'missing out' on anything those 'peers' are doing. Data was shared with us (confidentially and anonymised) by our Advisors, Link Asset Services. Against this narrower grouping we are even more 'in the bunch' with the only difference being those who have historically lent (sometimes long-term) to other Authorities. We have reviewed the data and considered LA lending but for the time being the S151 Officer has taken the decision not to do so.

Operational Breaches

- There were no operational breaches during the period.

Key Messages:

The Authority confirms compliance with its Prudential Indicators for 2022/23, which were set in February 2022 as part of the Authority's Treasury Management Strategy Statement.

Compliance with Prudential Indicators

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

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

	2022/23	2023/24	2024/25
Upper limit on fixed interest rate exposure	£290m	£290m	£290m
Actual*	£140m	(est)	(est)
Upper limit on variable interest rate exposure	£90m	£90m	£90m
Actual*	£15m	£35m (est)	£35m (est)

*= Peak position for 2022/23

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing were:

	Upper	Lower	Actual
Under 12 months	70%	0%	26%
12 months and within 24 months	30%	0%	1%
24 months and within 5 years	50%	0%	5%
5 years and within 10 years	50%	0%	11%
10 years and within 20 years	75%	0%	10%
20 years and within 30 years	75%	0%	18%
Over 30 years	100%	0%	29%

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. Note: LOBO option dates are included as potential repayment dates.

Prudential Indicators (The Liability Benchmark.)

Key Messages:

A minimum cash balance of £10m will be maintained to ensure forecast liquidity needs are met.

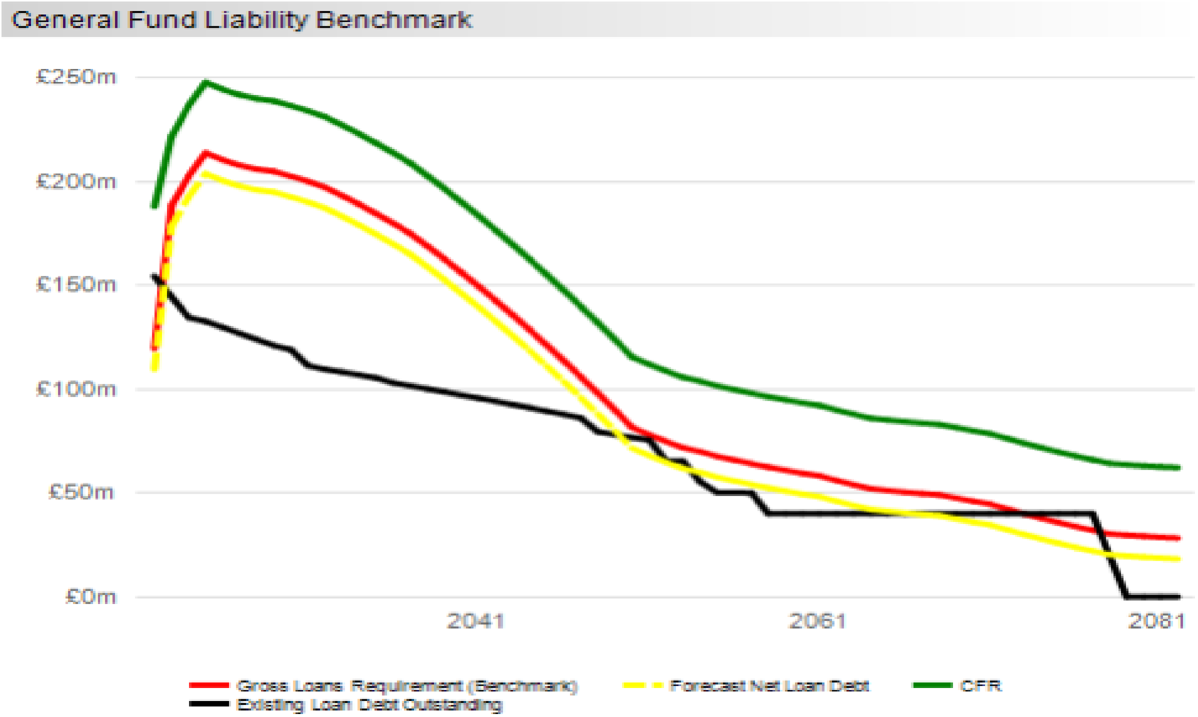
The gap between the red and black lines in the Liability Benchmark chart shown here depicts the additional borrowing need the Authority currently projects – a peak requirement of £76m new loans by the end of 2024-25 – including replacement of maturing debt.

Before new long-term borrowing is entered into the Authority will have regard to the Liability Benchmark and it's underlying assumptions will be assessed for their continuing prudency, with revisions made where necessary.

For 2022/23 CIPFA have revised their Guidance to require use of the **Liability Benchmark** tool as a formal Prudential Indicator. NELC have used, reported and provided Member training on this Benchmark for several years, so no change to current practice is necessary.

The Benchmark forecasts our need to borrow over a 60 year period. This aids decision making when it comes to the quantum and term to be chosen, the aim being to avoid cost of carry revenue implications and avoid the trap of defaulting to ultra-long tenors just because the yield curve tail slopes downward. It represents the level of our anticipated borrowing and in the ordinary course of business would not be expected to be exceeded. It therefore should closely mirror the Operational Boundary. The benchmark assumes:

- future capital expenditure beyond the current programme funded by borrowing of c£5m a year on average
- minimum revenue provision on new capital expenditure based on an annuity profile of c30 years average
- No changes to Reserves beyond the current MTFP period (3 years)



Key Messages:

For 2022/23 a minimum cash level of £10m was targeted and there were no breaches of this, or other Indicators.

Compliance with Prudential Indicators (contd.)

Principal Sums Invested for Periods Longer than 365 days: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2021/22	2022/23	2023/24
Limit on principal invested beyond year end	£21m	£21m	£21m
Actual	£0m	£0m	£0m

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.

	Target	Actual
Portfolio average credit rating	A	AA

Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

	Target	Actual (Low)
Total cash available within 1 month	£10m	£26m*

*includes residual Council Tax Energy Rebate Grant balances held during the period for the purpose of dispersal to local households.

Key Messages:

Borrowing remains comfortably below control levels as a result of continued internal borrowing support for the Capital Programme.

Borrowing levels were projected to be £196m at the end of 2022/23 when the TMSS was set in Feb 2022. Half-way through the year this outturn is now projected to be £188m due to slower than anticipated delivery of the Capital Programme.

Compliance with Prudential Indicators (contd.)

Other Prudential Indicators

The following prudential indicators are relevant to the treasury function as they concern limits on borrowing and the adoption of the CIPFA Treasury Management Code.

Operational Boundary for External Debt: The operational boundary is based on the Authority's estimate of most likely, i.e. prudent, but not worst-case scenario for external debt.

Operational Boundary	2022/23 £m	2023/24 £m	2024/25 £m
Borrowing	£220m	£220m	£220m
Other long-term liabilities	£30m	£30m	£25m
Boundary for Total Debt	£250m	£250m	£250m

Authorised Limit for External Debt: The authorised limit is "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2022/23 the Council has maintained gross borrowing within its authorised limit.

Authorised Limit	2022/23 £m	2023/24 £m	2024/25 £m
Borrowing Limit	£250m	£260m	£260m
Other long-term liabilities	£40m	£40m	£40m
Total Debt Limit	£290m	£300m	£300m
Actual/projected Peak Debt levels	£188m	£m (est)	£m (est)

Adoption of the CIPFA Treasury Management Code: The Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition in February 2018.

Key Messages:

The Local Government Act 2003 requires the Authority to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow.

The Authority confirms compliance with its Capital Finance Prudential Indicators for 2022/23, which were set in February 2022 as part of the Authority's Treasury Management Strategy Statement.

Changes to the 2022/23 and later programmes may occur as these are progressed in the coming months.

Compliance with Capital Finance Prudential Indicators

The Local Government Act 2003 requires the Authority to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure

The Authority's planned capital expenditure and financing as at 30.9.2022 may be summarised as follows.

Capital Expenditure and Financing	2022/23 Original £m	2022/23 Changes £m	2022/23 Draft Outturn £m	2023/24 Estimate £m	2024/25 Estimate £m
Total Expenditure	70.7	-23.0	85.2	60.1	29.3
Capital Receipts	0.5	-0.1	0.4	0.4	0.0
Government Grants	30.8	11.6	44.2	31.7	8.9
Ring-fenced External Funding	0.0	0.0	0.0	5.1	0.4
Borrowing	39.4	1.3	40.7	22.9	20.0
Total Financing	70.7	-23.0	85.2	60.1	29.3

Key Messages:

The percentage of the Council's income required to service it's debt came in below projections due to a combination of slippage in the capital programme and the effect of using short-term lenders which offered lower interest rates and delivered in-year cost-savings.

Future year projections on the other hand have been adversely affected by the sharp rise in rate expectations during the period. Maintaining debt costs within 10% of the Council's overall budget now presents a challenge with several factors being beyond the Authorities control (rates (cost of borrowing) and inflation (cost of schemes being financed)).

Compliance with Capital Finance Prudential Indicators (contd.)

Ratio of Financing Costs to Net Revenue Stream

This is a voluntary indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2022/23 Original Estimate %	2022/23 Revised Estimate %	2023/24 Revised Estimate %	2024/25 Revised Estimate %
General Fund	7.9	7.8	10.2	10.9

There are a range of factors that affect these future estimates, some internal such as what the capital investment delivers, and others which are external and largely out of the Authority's control such as the impact of interest rate changes. Any future borrowing must be in accordance with prudential borrowing principles. Borrowing must be affordable, sustainable and prudent.

Future year projections have been adversely affected by the sharp rise in rate expectations during the period. Maintaining debt costs within 10% of the Council's overall budget now presents a challenge while rates remaining elevated beyond those levels in the original forecast.