

Crawley Borough Council

Report to Overview and Scrutiny Commission 21 November 2022

Report to Cabinet 23 November 2022

Treasury Management Mid-Year Review 2022/2023

Report of the Head of Corporate Finance **FIN/593**

1. Purpose

- 1.1 This report provides an update on the Council's Treasury Management Strategy for the two first quarters of 2022/2023.

2. Recommendations

- 2.1 To the Overview and Scrutiny Commission:

That the Commission consider the report and decide what comments, if any, it wishes to submit to the Cabinet.

- 2.2 To the Cabinet

That the Cabinet is recommended to note the report and the treasury activity for the first two quarters of 2022/2023

3. Reasons for the Recommendations

- 3.1 The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (Treasury Management Strategy, annual and mid-year reports). This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

4. Interest rate forecasts

- 4.1 The Council's treasury advisor, Arlingclose Limited, has provided the following 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	0.50	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	2.25	4.25	5.00	5.00	5.00	5.00	5.00	5.00	5.00	4.75	4.25	3.75	3.25
Downside risk	0.00	-1.00	-1.00	-0.75	-0.50	-0.50	-0.50	-0.75	-1.25	-1.50	-1.75	-1.75	-1.75

5. Annual Investment Strategy

- 5.1 The Treasury Management Strategy for 2022/23, which includes the Annual Investment Strategy, was approved by this Council on 23 February 2022. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity;
- Yield; and
- Ethical investment policy

6. Compliance with Treasury and Prudential Limits

- 6.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved Treasury Management Strategy.
- 6.2 During the financial year to date the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy and in compliance with the Council's Treasury Management Practices. The prudential and treasury Indicators are shown in Appendix 3.

7. Investment Portfolio 2022/23

- 7.1 CIPFA revised TM Code defines treasury management investments as those which arise from the Authority's cash flows or treasury risk management activity that ultimately represents balances which need to be invested until the cash is required for use in the course of business.
- 7.2 The Council held £138.898m of investments as at 30 September 2022 (£128.945m at 31 March 2022). Summary table below:

INVESTMENT PORTFOLIO	Actual 31 March 2022 £000	Net Movement £000	Actual 30 September 2022 £000	30 September 2022 Income Return %	30 September 2022 Weighted Average Maturity Days
Treasury investments					
Banks & building societies (unsecured)	556	9,593	10,149	1.99	38
Government	17,189	190	17,379	0.92	199
Local authorities	92,000	(300)	91,700	0.56	157
Money Market Funds	9,500	170	9,670	2.10	1
Cash plus funds	10,000	0	10,000	0.84	5
TOTAL TREASURY INVESTMENTS *	128,945	9,953	138,898	0.84	132

* Capital expenditure was budgeted at £49.1m for 2022/23. £14.6m has been spent to 30 September. The revised estimate is £37.6m. See Quarter 2 Budget Monitoring for further details.

A full list of investments held on 30th September 2022 is in appendix 2.

- 7.3 The Head of Corporate Finance confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2022/23.
- 7.4 Investment performance for the financial year to date as at 30 September 2022:

Investments managed in-house	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
31.03.2022	4.39	AA-	8%	192	0.27
30.09.2022	4.54	A+	8%	132	0.84
Similar Las	4.34	AA-	57%	42	1.70
All LAs	4.29	AA-	55%	18	1.72

The rate of return above is lower than the average shown as the Council has invested for longer periods, as shown in the weighted average maturity column. This has allowed the Council to achieve higher than average returns in the past, but means that it is slower to pick up additional yield when rates increase.

In the strategy set at the start of the year, the Council projected that there would not be a rise in interest rates. At the time, base rate was 0.5%, it is currently 2.25% and the expectation is that it rise sharply to 5.0% by year-end.

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.

By end 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 0.4% - 0.7% p.a. in early April and between 1.6% and 2.1% at the end of September

The average rate on the Council's investments is 0.48% for the first half of the year - mostly down to investments that were taken out before the rate increases. As these mature, the average rate will increase.

8. Non-Treasury Investments

- 8.1 The definition of investments in CIPFA's revised 2021 Treasury Management Code covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).
- 8.2 Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) also includes within the definition of investments all such assets held partially or wholly for financial return.
- 8.3 The Council held £17.888m (see Appendix 2) of commercial investments in directly owned properties.
- 8.4 The Council also held £53.352m of service investments in

- Directly owned property £52.952m
- Loan to The Hawth £0.4m

8.5 Service investments are not held primarily for financial return and support service objectives of the Council.

8.6 These investments generated £0.5m of investment income for the Authority after taking account of direct costs, representing a rate of return of 3.78%.

9. Borrowing

9.1 The Council borrowed £260.325m in March 2012 for HRA self-financing. The average borrowing rate is 3.19%. There has been no requirement for further borrowing in 2022/2023.

10. Implications

10.1 The Council is under a duty to manage its resources prudently and therefore due consideration must always be given to its borrowing and lending strategy. A wide range of local authority financial activities, including borrowing, lending, financial management, and the approval of types of investment vehicle are governed by legislation and various regulations. The Council is obliged to comply with these. There are no other legal implications arising in this report.

10.2 The financial implications are addressed throughout this report.

10.3 Risks are highlighted throughout this report, but Appendix 3 addresses the risk to security, liquidity and yield of the Council's investment strategy.

11. Background Papers

[Treasury Management Strategy for 2022/2023 – Cabinet, 2 February 2022 \[report FIN/557 refers\]](#)

Quarterly Budget Monitoring 2022/2023 Quarter 2 – Cabinet, 23 November 2022 [report FIN/586 refers]

[2022/2023 Budget and Council Tax – Cabinet, 2 February 2022 \[FIN/549 refers\]](#)

“Treasury Management in the Public Services - Code of Practice and Cross-Sectoral Guidance Notes”, 2021 Edition - Chartered Institute of Public Finance and Accountancy

“The Prudential Code for Capital Finance in Local Authorities”, 2021 Edition - Chartered Institute of Public Finance and Accountancy

[DCLG Guidance on Local Government Investments \(Third Edition\)](#)

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Economic background: 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 'fiscal event' increased volatility in the UK economy.

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.

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.

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. RPI registered 12.3% in both July and August. 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.

The labour market remained tight through the period but there was some evidence of easing demand and falling supply. The unemployment rate 3m/year for April fell to 3.8% and declined further to 3.6% in July. Although now back below pre-pandemic levels, the recent decline was driven by an increase in inactivity rather than demand for labour. Pay growth in July was 5.5% for total pay (including bonuses) and 5.2% for regular pay. Once adjusted for inflation, however, growth in total pay was -2.6% and -2.8% for regular pay.

With disposable income squeezed and higher energy bills still to come, consumer confidence fell to a record low of -44 in August, down -41 in the previous month. Quarterly GDP fell -0.1% in the April-June quarter driven by a decline in services output, but slightly better than the 0.3% fall expected by the Bank of England.

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. August's rise was voted by a majority of 8-1, with one MPC member preferring a more modest rise of 0.25%. The September vote was 5-4, with five votes for an 0.5% increase, three for an 0.75% increase and one for an 0.25% increase. The Committee noted that domestic inflationary pressures are expected to remain strong and so given ongoing strong rhetoric around tackling inflation further Bank Rate rises should be expected.

Gilt yields rose by between 0.7% - 1% for all maturities with the rise most pronounced for shorter dated gilts. This 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.

Bank of England policymakers noted that any resulting inflationary impact of increased demand would be met with monetary tightening, raising the prospect of much higher Bank Rate and consequential negative impacts on the housing market.

After hitting 9.1% in June, annual US inflation eased in July and August to 8.5% and 8.3% respectively. The Federal Reserve continued its fight against inflation over the period with a 0.5% hike in May followed by three increases of 0.75% in June, July and September, taking policy rates to a range of 3% - 3.25%.

Eurozone CPI inflation reached 9.1% y/y in August, with energy prices the main contributor but also strong upward pressure from food prices. Inflation has increased steadily since April from 7.4%. In July the European Central Bank increased interest rates for the first time since 2011, pushing its deposit rate from -0.5% to 0% and its main refinancing rate from 0.0% to 0.5%. This was followed in September by further hikes of 0.75% to both policy rates, taking the deposit rate to 0.75% and refinancing rate to 1.25%.

Financial markets: Uncertainty remained in control of financial market sentiment and bond yields remained volatile, continuing their general upward trend as concern over higher inflation and higher interest rates continued to dominate. Towards the end of September, volatility in financial markets led to an acceleration in the rate of the rise in gilt yields and decline in the value of sterling.

Due to pressure on pension funds, the Bank of England announced a direct intervention in the gilt market to increase liquidity and reduce yields.

Over the period the 5-year UK benchmark gilt yield rose from 1.41% to 4.40%, the 10-year gilt yield rose from 1.61% to 4.15%, the 20-year yield from 1.82% to 4.13% and the 50-year yield from 1.56% to 3.25%. The Sterling Overnight Rate (SONIA) averaged 1.22% over the period.

Credit review: In July Fitch revised the outlook on Standard Chartered from negative to stable as it expected profitability to improve thanks to the higher interest rate environment. Fitch also revised the outlook for Bank of Nova Scotia from negative to stable due to its robust business profile.

Also in July, Moody's revised the outlook on Bayerische Landesbank to positive and then in September S&P revised the GLA outlook to stable from negative as it expects the authority to remain resilient despite pressures from a weaker macroeconomic outlook coupled with higher inflation and interest rates.

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.

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.

Detailed holdings at 30 September 2022

APPENDIX 2

Counter Party	Deal Ref	Issue	Maturity	Days to Mature	Interest Rate	Nominal (£m)	Total (£m)	Limit (£m)	Rating
UK BANKS									
Lloyds Bank plc	20		01/10/2022	1	0.010%	0.149	0.149	10	A-
CENTRAL GOVERNMENT									
DMADF Cash Account	2744	01/07/2022	21/11/2022	52	1.540%	2.5			
	2755	02/09/2022	05/12/2022	66	2.165%	5	7.5	Unlimited	AA-
United Kingdom Gilts	2672	18/06/2021	31/01/2024	488	0.125%	4.886			
	2684	01/10/2021	31/01/2023	123	0.125%	4.993	9.879	15	AA-
LOCAL AUTHORITIES									
Birmingham City Council	2667	30/11/2021	29/11/2022	60	0.100%	5	5	15	AA-
Blaenau Gwent County Borough Council	2702	08/04/2022	06/04/2023	188	0.280%	2			
	2703	27/05/2022	26/05/2023	238	0.280%	3	5	15	AA-
Cambridgeshire CC	64	22/07/2022	22/01/2024	479	1.000%	5	5	15	AA-
Cheshire West and Chester Council	2671	04/01/2022	03/01/2023	95	0.100%	5	5	15	AA-
Cornwall Council	2731	01/08/2022	01/11/2022	32	0.930%	5	5	15	AA-
Derbyshire County Council	2653	28/10/2021	28/10/2022	28	0.100%	5	5	15	AA-
Gloucester City Council	2655	25/10/2021	24/10/2022	24	0.100%	3.7	3.7	15	AA-
Guildford Borough Council	2695	01/11/2021	01/11/2022	32	0.100%	5	5	15	AA-
London Borough Of Hillingdon	2661	20/12/2021	19/12/2022	80	0.100%	5	5	15	AA-
Kirklees Metropolitan Council	2698	01/04/2022	02/04/2024	550	0.500%	5	5	15	AA-
Lancashire CC	2690	01/11/2021	01/11/2022	32	0.200%	2	2	15	AA-
Monmouthshire County Council	2697	27/01/2022	26/01/2023	118	0.180%	3	3	15	AA-
North Lanarkshire Council	2752	15/09/2022	19/07/2023	292	2.250%	5	5	15	AA-
Royal Borough of Windsor & Maidenhe	2717	30/09/2022	29/09/2023	364	1.200%	5	5	15	AA-
Rotherham Metropolitan Borough Coun	2645	18/06/2021	16/06/2023	259	0.450%	5	5	15	AA-
Slough Borough Council	2657	29/10/2021	28/10/2022	28	0.100%	2			
	2659	19/11/2021	21/11/2022	52	0.100%	3	5	15	AA-
South Cambridgeshire District Council	2658	15/12/2021	14/12/2022	75	0.100%	5	5	15	AA-
Surrey Heath Borough Council	2718	16/06/2022	16/12/2022	77	0.750%	3	3	15	AA-
Utlesford District Council	2757	13/09/2022	13/12/2022	74	2.200%	5	5	15	AA-

Warrington Borough Council	2668	30/11/2021	29/11/2022	60	0.110%	5	5	15	AA-
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MONEY MARKET FUNDS

Aberdeen Liquidity Fund	5		01/10/2022	1	2.135%	2.9	2.9	6	AAA
Federated Prime Rate Cash Man	1		01/10/2022	1	2.081%	6.77	6.77	6	AAA

Strategic Funds

Royal London	2714		01/10/2022	5	0.85%	10	10	10	A+
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SINGAPORE BANKS

DBS Bank Ltd	2751	11/08/2022	11/11/2022	42	2.070%	4			
	2753	15/08/2022	23/11/2022	54	2.080%	3			
	2754	15/08/2022	17/10/2022	17	1.820%	3	10	10	AA-

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132	138.898
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INVESTMENT PROPERTIES

Ashdown House	8.338
Ask High Street	1.183
Atlantic House	4.021
Voluntary Organisations	1.319
Telford Place Car Park	1.636
Other	1.391

17.888

156.786

Compliance with the authorised limit and operational boundary for external debt is demonstrated in the table below.

Debt Limits

£000	2022/23 Maximum	30.9.22 Actual	2022/23 Operational Boundary	2022/23 Authorised Limit	Complied?
Borrowing	261,095	260,325	261,325	271,325	Yes
Finance Leases	44	44	44	44	Yes
Total debt	261,139	260,469	261,369	271,369	Yes

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.

Investment Limits

	2022/23 Maximum	30.9.22 Actual	2022/23 Limit	Complied?
Any single organisation, except the UK Government	£10m	£10m	£10m	Yes
Any group of organisations under the same ownership	£10m	£10m	£10m	Yes
Any group of pooled funds under the same management	£10m	£10m	£25m	Yes
Negotiable instruments held in a broker's nominee account	£10m	£10m	£25m	Yes
Limit per non-UK country	£10m	£10m	£10m	Yes
Registered providers and registered social landlords	-	-	£10m	Yes
Unsecured investments with building societies	-	-	£10m	Yes
Loans to unrated corporates	-	-	£5m	Yes
Money Market Funds	£32.26m	£9.67m	Unlimited	Yes
Strategic pooled funds	£10m	£10m	£20m	Yes
Real Estate Investment Trusts	-	-	£20m	Yes

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

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 one-week period, without additional borrowing.

	30.9.22 Actual	2022/23 Target	Complied?
Total cash available within 1 week	£19.8m	£3m	Yes

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

Interest rate risk indicator	30.9.22 Actual	2022/23 Target	Complied?
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	£0.164m	£1m	Yes
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	£0.164m	£1m	Yes

The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at new market rates.

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 all borrowing were:

Refinancing rate risk indicator	30.9.22 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	4%	20%	0%	Yes
12 months and within 24 months	5%	20%	0%	Yes
24 months and within 5 years	16%	30%	0%	Yes
5 years and within 10 years	35%	40%	0%	Yes
10 years and within 20 years	40%	50%	0%	Yes
20 years and within 30 years	0%	10%	0%	Yes
30 years and within 40 years	0%	10%	0%	Yes
40 years and within 50 years	0%	10%	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.

Principal Sums Invested for Periods Longer than a year: 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 long-term principal sum invested to final maturities beyond the period end were:

	2022/23	2023/24	2024/25
Actual principal invested beyond year end	£5m	£20m	-
Limit on principal invested beyond year end	£20m	£20m	£20m
Complied?	Yes	Yes	Yes