Agenda Item: 7

Meeting of:	**Cabinet**
Date of Meeting:	**Thursday, 17 November 2022**
Relevant Scrutiny Committee:	Corporate Performance and Resources
Report Title:	Treasury Management Mid-Year Report 2022/23
Purpose of Report:	To provide a mid-year report on the Authority's Treasury Management operations for the period 1st April, 2022 to 30th September, 2022
Report Owner:	Report of the Executive Leader and Cabinet Member Performance and Resources
Responsible Officer:	Matt Bowmer, Head of Finance/Section 151 Officer
Elected Member and Officer Consultation:	None
Policy Framework:	This report needs to be referred to Full Council for approval

Executive Summary:

- This interim report provides an update on the Authority's Treasury Management operations for the period 1st April to 30th September, 2022. All activities were in accordance with the Authority's approved strategy on Treasury Management.
- Total external borrowing as of 30th September, 2022 was £154.238m at an average rate of 4.48%. New external borrowing undertaken during the first 6 months of 2022/23 totalled £3m at an average rate of 3.07%.
- The Council invested with the Debt Management Deposit Facility, Local Authorities, Treasury Bills, Money Market Funds together with Lloyds and Santander Bank Call Accounts. Total investments as of 30th September, 2022 stood at £96.345m at an average rate of 0.97%.
- As the world emerges from the pandemic, the effects of Russia's invasion of Ukraine and the cost of living crisis this report contains a review of the UK economy together with forecasts for interest rates.
- The Authority must ensure compliance with the Prudential Code, which has been developed and written by CIPFA as a professional code of practice. To demonstrate the Authority has met the necessary requirements, the Code sets out prudential indicators that should be implemented and the factors that must be considered. The Council fully complied with these prudential indicators during the first six months of 2022/23.

- External borrowing of £3.451m has been included in the estimates to cover loan maturities during 2022/23 and supported borrowing. However, the decision on whether to proceed will consider reserve levels and capital spend projections, PWLB rate forward projections and cost of carry. Advice will be sought from the Council's Treasury Management advisers.
- The 2021 revised CIPFA Code of Practice requires Local Authorities to adopt a new prudential indicator called the Liability Benchmark from 2023/24, a consideration of this over 20 years has been included in this report.

Recommendations

1. That Cabinet approves the Treasury Management mid-year report for the period 1st April, 2022 to 30th September, 2022 and refers the same to Council, in December 2022, for consideration .
2. That the latest Treasury Management indicators be approved and referred to Council in December 2022, for consideration.
3. That, notwithstanding recommendations 1 and 2, the report also be forwarded to the next Corporate Performance and Resources Scrutiny Committee for consideration and discussion.

Reasons for Recommendations

1. To present the Treasury Management mid-year report as required by the CIPFA Treasury Management in the Public Services: Code of Practice.
2. To present an update of the Treasury Management indicators which are included in the Treasury Management Strategy.
3. To present this report to the Corporate Performance and Resources Scrutiny Committee in accordance with the remit of the Committee.

1. Background

Capital Strategy

1.1 In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2019/20, all Local Authorities have been required to prepare a Capital Strategy which is to provide the following: -

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

1.2 The Council's Capital Strategy for 2022/23 was approved by Council on 7th March, 2022, minute 904 refers, and the Draft Capital Strategy 2023/24 and Initial Capital Programme Proposals 2023/24 to 2027/28 were taken to Cabinet on 6th October, 2022, minute C91 refers.

1.3 The progress and revisions to the Capital Programme are reported as part of the regular capital monitoring reports to Cabinet and the most recent Capital Monitoring was reported to Cabinet on 3rd November, 2022, the refreshed Capital strategy and Capital Bids for 2023/24 to 2027/8 were reported to Cabinet on 6th October, 2022.

Treasury Management

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

1.5 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer-term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.6 Accordingly, treasury management is defined as:

"The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2. Key Issues for Consideration

2.1 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).

2.2 The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the way the Council will seek to achieve those policies and objectives.
- Receipt by the full Council of an annual Treasury Management Strategy Statement including the Annual Investment Strategy and Minimum Revenue Provision Policy for the year ahead, a Mid-year Review Report and an Annual Report, (stewardship report), covering activities during the previous year.
- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Corporate Resources and Performance Scrutiny Committee.

2.3 This mid-year report has been prepared in compliance with CIPFA's code of Practice on Treasury Management and covers the following:

- An economic update for the first half of the 2022/23 financial year.
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy for 2022/23.
- A review of the Council's capital expenditure and prudential indicators.
- A review of the Council's investment portfolio for 2022/23.
- A review of the Council's borrowing strategy for 2022/23.
- A review of any debt rescheduling undertaken during 2022/23 and
- A review of compliance with Treasury and Prudential Limits for 2022/23.

Economic Updates

UK Economic Review & Update as of 30th September, 2022

2.4 The second quarter of 2022/23 saw:

- Gross Domestic Product (GDP) revised upwards in Quarter 1 2022/23 to +0.2% quarter/quarter from -0.1%, which means the UK economy has avoided recession for the time being placing the focus on raising Bank Rate as the active instrument to control the level of inflation and ensure that over the medium term the Consumer Price Index (CPI) target of 2% is achieved. This is expected to reduce the level of growth in the UK over the next 12 to 18 months and could result in a recession during this period.
- Signs of economic activity losing momentum as production fell due to rising energy prices.
- CPI inflation eased to 9.9% year/year in August, having been 9.0% in April, but domestic price pressures showing little sign of abating in the near-term.
- The unemployment rate fell to a 48 year low of 3.6% due to a large shortfall in labour supply.
- Bank Base Rate rose by 1% over the quarter, taking the rate to 2.25% at September 2022 with further rises expected from MPC to control the level of inflation in the economy.
- Gilt yields surged and Sterling fell following the "Mini Budget/Fiscal Event" of the new Prime Minister and Chancellor on 23rd September, 2022. The new Government is expected to announce new spending and tax plans in an

announcement on 17th November. The new Chancellor has already reversed most of the unfunded spending and tax cuts announced in the Mini Budget. As a result, the market rates and Gilt yields have fallen back from the recent highs seen in late September/early October.

2.5 The UK economy grew by 0.2% quarter on quarter in quarter 1 2022/23 through revisions to historical data left it below pre-pandemic levels.

2.6 There are signs of higher energy prices creating more persistent downward effects in economic activity. Both industrial production (-0.3% month on month) and construction output (-0.8% month on month) fell in July 2022 for a second month in a row. Although some of this was probably due to the heat wave at the time, manufacturing output fell in some of the most energy intensive sectors (e.g. chemicals), pointing to signs of higher energy prices weighing on production. With the drag on real activity from high inflation having grown in recent months, GDP is at risk of contracting through the autumn and winter months.

2.7 The Purchasing Managers Index (PMI) which measures the prevailing trends in manufacturing, fell from 49.6 in August 2022 to a 20-month low preliminary reading of 48.4 in September 2022 which points to a fall in GDP of around 0.2% quarter on quarter in Quarter 3 with consumer confidence is at a record low. Retail sales volumes fell by 1.6% month on month in August 2022, which was the ninth fall in 10 months. That left sales volumes in August 2022 just 0.5% above their pre-Covid level and 3.3% below their level at the start of the year. There are also signs that households are spending their excess savings in response to high prices.

2.8 The labour market remained exceptionally tight. Data for July and August 2022 provided further evidence that the weaker economy is leading to a cooling in labour demand. Labour Force Survey (LFS) employment rose by 40,000 in the three months to July 2022 (the smallest rise since February 2022). But a renewed rise in inactivity of 154,000 over the same period meant that the unemployment rate fell from 3.8% in June 2022 to a new 48 year low of 3.6%. The single month data showed that inactivity rose by 354,000 in July 2022 itself and there are now 904,000 more inactive people aged 16+ compared to before the pandemic in February 2020. The number of vacancies has started to level off from recent record highs but there have been few signs of a slowing in the upward momentum on wage growth.

2.9 Consumer Price Index (CPI) inflation eased from 10.1% in July 2022 to 9.9% in August 2022, though inflation has not peaked yet. The easing in August 2022 was mainly due to a decline in fuel prices reducing fuel inflation from 43.7% to 32.1%. And with the oil price now just below $90 per barrel there is an expectation of fuel prices falling further in the coming months. It has recently moved up again to 10.1% and the Bank of England Monetary Policy Committee are expected to raise Bank Rate to 4% by end of the 2022.

2.10 Utility price inflation is expected to add 0.7% to CPI inflation in October 2022 when the Ofgem unit price cap increases to £2,500 per household (prior to any benefit payments). The Government had announced a freeze on utility prices for two years and energy price inflation was expected to fall sharply after October 2022. This decision was reversed by the new Chancellor and the energy price cap will now only run to April 2023 and this may impact any previously anticipated downward influence on CPI inflation.

2.11 The rise in services CPI inflation from 5.7% year/year in July 2022 to a 30 year high of 5.9% year on year in August 2022 suggests that domestic price pressures are showing little sign of abating. This is being driven by the tight labour market and strong wage growth. CPI inflation is expected to peak close to 10.4% in November 2022 and with the supply of workers set to remain unusually low, the tight labour market will keep underlying inflationary pressures strong until early next year.

2.12 The second half of 2022 has seen a step change in Government policy. The Government's huge fiscal loosening from its proposed significant tax cuts announced in the mini budget on 23rd September, 2022 will potentially leave a legacy of higher interest rates and public debt. These included the reversal of April's 2022 national insurance tax on 6th November, 2022, the cut in the basic rate of income tax from 20p to 19p from April 2023, the cancellation of next April's corporation tax rise and the cut to stamp duty.

2.13 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 2023 to 10.4% in November 2022.

2.14 Fears that the Government has no fiscal anchor on the back of these significant tax cuts and utility price freeze has meant that the pound has weakened adding further upward pressure to interest rates. Whilst the pound fell to a record low of $1.035 on Monday 26th September 2022 following the Government's announcements it has since recovered to around $1.12. This is mainly due to hopes that the Bank of England will deliver a very big rise in interest rates at the policy meeting on 3rd November, 2022 and the Government will lay out a credible medium-term plan in the near term. However, with concerns over a global recession growing there are still downside risks to the pound.

2.15 The Monetary Policy Committee (MPC) has now increased interest rates seven times in seven meetings in 2022 and has raised rates to their highest level since the Global Financial Crisis. The UK's status as a large importer of commodities, which have jumped in price, means that households in the UK are now facing a much larger squeeze on their real incomes.

2.16 Since the Government's fiscal loosening announcement on 23rd September, 2022 the MPC is expected to increase interest rates further and faster from the current rate of 2.25% to a peak of 5.00% in February 2023. The combination of the Government’s tax cutting announcements, the tight labour market and inflation expectations means it is expected that the MPC will raise interest rates by 1% at the meeting in November 2022 to 3.25%, by 0.75% in December 2022 to 4% followed by further 0.5% hikes in February 2023 and March 2023 to 5.00%. Market expectations for what the MPC will do are volatile. If Bank Rate climbs to these levels the housing market looks very vulnerable.

2.17 Throughout 2022/23, gilt yields have been on an upward trend. They were initially caught up in the global surge in bond yields triggered by the surprisingly strong rise in CPI inflation in the United States in May 2022. The rises in two year gilt yields to a peak of 2.37% on 21st June, 2022 and 10 year yields to a peak of 2.62% took them to their highest level since 2008 and 2014 respectively.

2.18 However, the upward trend was exceptionally sharp at the end of September 2022 as investors demanded a higher risk premium and expected faster and higher interest rate rises to offset the Government’s extraordinary fiscal stimulus plans.

2.19 Following the Government's fiscal loosening policy announcement on 23rd September, 2022 the 30 year gilt yield rose from 3.60% to 5.10% which threatened financial stability by forcing pension funds to sell assets into a falling market to meet cash collateral requirements.

2.20 In response, the Bank of England (BOE) did two things. First, it postponed its plans to start selling some of its quantitative easing (QE) gilt holdings until 31st October 2022. Second, it committed to buy up to £65bn of long term gilts until 14th October, 2022 to “restore orderly market conditions". In other words, the BOE is restarting QE, although for financial stability reasons rather than monetary policy reasons.

2.21 Since the BOE's announcement on 28th September, 2022 concerning the temporary purchases of long dated UK government bonds, the 30 year gilt yield has fallen back from 5.10% to 3.83%. The 2 year gilt yield dropped from 4.70% to 4.30% and the 10-year yield fell back from 4.55% to 4.09%.

2.22 There is a possibility that the BOE will continue with QE at the long end beyond 14th October, 2022 or it may decide to delay quantitative tightening beyond 31st October, 2022 even as it raises interest rates. So far, investors seem to have taken the Bank at its word that this is not a change in the direction of monetary policy nor a step towards monetary financing of the Government’s deficit, it is a temporary intervention with financial stability in mind.

2.23 Please note, the wording in sections 2.12 to 2.22 were an accurate summary of the key fiscal policies implemented by the Government in the Mini Budget in late September 2022. An update on announcements made by the new Chancellor and announcement of the new Government updated fiscal statement on 17th November, 2022 is provided in 2.24 to 2.25 of this report.

Looking Forward

2.24 The core of the Government's new policies that were announced in the mini budget on 23rd September, 2022 which included tax cuts, a cap on utility bills and regulatory simplification have now been superseded following the change of Prime Minister and Chancellor in October 2022.

2.25 The new Chancellor has announced a reversal of the planned tax cuts and changes to the level of Government spending and is seeking greater tax increases and efficiencies. The Medium Term Fiscal event due to take place on 31st October, 2022 should set out in more detail on how these will impact the public finances. However, this event has now been postponed to 17th November, 2022.

2.26 It is currently too early to say how these revised policies will impact growth and inflation, but the expectation is that the plans will reduce the concerns about the level of unfunded expenditure that had previously alarmed the markets. What is clear, is that the level of inflation in the UK is still materially above the MPC CPI inflation target of 2% and there is still an expectation that the Bank of England will continue to increase Bank Rate to around 5% by the end of the current financial year (March 2023) to ensure they can meet their target within the next two years. There has been significant market volatility in recent months and the actual movements in market rates will be impacted by how inflation pressures are impacted by revised fiscal (Government) policy and monetary policy. These include potential tax rises, cuts in central government spending and monetary tightening (Bank Rate rises and Quantitative Tightening from end of October 2022). These expected policy changes should reduce demand in the economy and will continue until the level of inflation has reduced from current levels. The increase in Bank Rate will support the Investment Strategy but could also mean that the rates for external borrowing are also higher than they have been in recent years. An update on the current Link Interest Rate forecast and how this impacts the Council's Borrowing and Investment Strategies are provided in later sections of this report.

Interest Rate Forecasts

2.27 The Council has appointed Link Group as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. The PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 basis points) which has been accessible to most Authorities since 1st November, 2012.

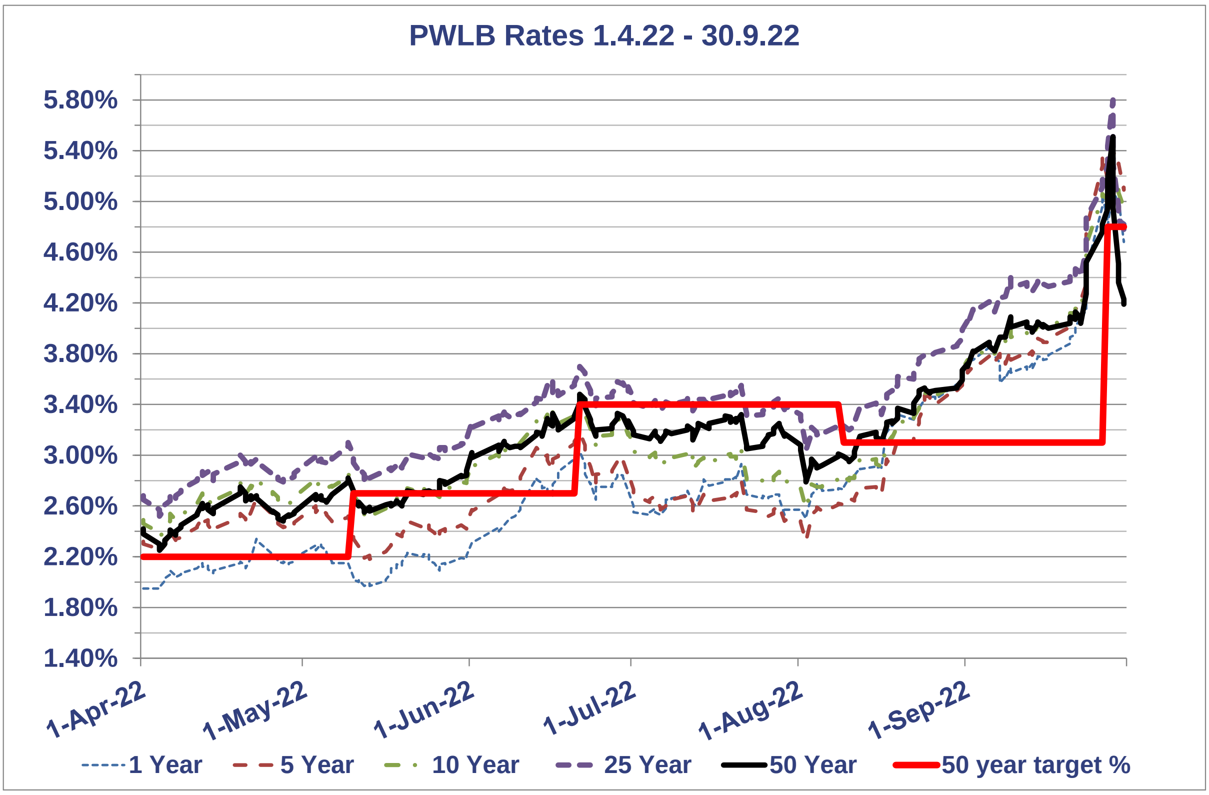
2.28 The latest forecast on 27th September, 2022 sets out a view that both short and long dated interest rates will be elevated as the Bank of England seeks to squeeze inflation out of the economy, whilst the Government is providing a package of fiscal loosening to try and protect households and businesses from the ravages of ultra high wholesale gas and electricity prices. The MPC has tightened short term interest rates with a view to trying to slow the economy sufficiently to keep the secondary effects of inflation as measured by wage rises under control.

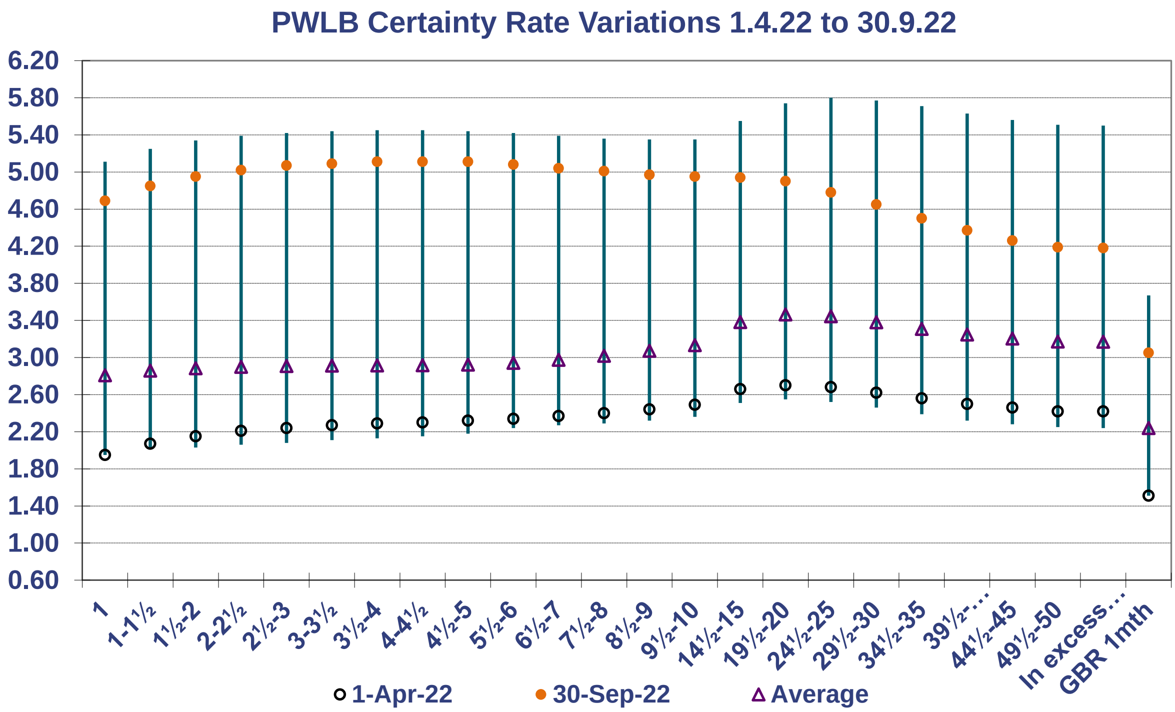
2.29 PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 basis points, calculated as gilts plus 80 basis points).

	Dec 2022	Mar 2023	Jun 2023	Sep 2023	Dec 2023	Mar 2024	Jun 2024	Sept 2024	Dec 2024	Mar 2025	Jun 2025	Sep 2025
Bank Rate	4.00	5.00	5.00	5.00	4.50	4.00	3.75	3.25	3.00	2.75	2.75	2.50
3 Month Ave Earnings	4.50	5.00	5.00	5.00	4.50	4.00	3.80	3.30	3.00	2.80	2.80	2.50
6 Month Ave Earnings	4.70	5.20	5.10	5.00	4.60	4.10	3.90	3.40	3.10	3.00	2.90	2.60
12 Month Ave Earnings	5.30	5.30	5.20	5.00	4.70	4.20	4.00	3.50	3.20	3.10	3.00	2.70
5yr PWLB	5.00	4.90	4.70	4.50	4.20	3.90	3.70	3.50	3.40	3.30	3.20	3.20
10yr PWLB	4.90	4.70	4.60	4.30	4.10	3.80	3.60	3.50	3.40	3.30	3.20	3.20
25yr PWLB	5.10	4.90	4.80	4.50	4.30	4.10	3.90	3.70	3.60	3.60	3.50	3.40
50yr PWLB	4.80	4.60	4.50	4.20	4.00	3.80	3.60	3.40	3.30	3.30	3.20	3.10

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

2.30 Gilt yields and PWLB rates were on a generally rising trend throughout the first six months of 2022, the exception being a short rally in gilts in July/August. However, they rose exceptionally sharply towards the end of September. The 50 year PWLB target certainty rate for new long term borrowing started 2022/23 at 2.20% and finished the half year at 4.80%. However, it is forecast that PWLB rates will trend downwards throughout 2023 and 2024 and are forecast to fall back to 3.10% by the end of September 2025.





HIGH/LOW/AVERAGE PWLB RATES FOR 01.04.22 – 30.09.22

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

The current PWLB Rates are set as margins over gilt yields as follow:

- PWLB Standard Rate is gilt plus 100 basis points.
- PWLB Certainty Rate is gilt plus 80 basis points.
- Local Infrastructure Rate is gilt plus 60 basis points.

Treasury Management Strategy 2022/23

2.31 Council approved the 2022/23 Treasury Management Strategy Statement (TMSS) at its meeting on 7th March, 2022 minute no 920.

2.32 The Authority's investment strategy is to secure the best return on its investments whilst having regard to capital security within the parameters laid down.

2.33 In line with the Authority's existing borrowing strategy the revised estimate for new loans required to support the Capital Programme for 2022/23 is £3.451m which is supported borrowing. The net decrease in the capital financing requirement after adjusting for Minimum Revenue Provision is £2.088m as set out in the table at paragraph 2.46 below.

2.34 Given the current and projected level of Council reserves, the market uncertainty post Brexit, the Russian invasion of Ukraine, the cost of living crisis and the political uncertainty in the UK which has recently seen elevated borrowing costs, it is likely that the sum required for supported borrowing of £3.451m will now be internally borrowed during 2022/23.

2.35 The effects of the coronavirus pandemic, market uncertainty post Brexit, the cost of living crisis and the current political uncertainty in the UK on the Capital Programme objectives are being assessed, therefore, the Authority's borrowing strategy will be reviewed and then revised to achieve optimum value and risk exposure in the long term.

2.36 Council officers in conjunction with the treasury advisors continually monitor the prevailing interest rates and the market forecasts and adopt a pragmatic approach to changing circumstances in respect of its borrowing needs.

2.37 The Head of Finance (Section 151 Officer) can positively report that all Treasury Management activity undertaken during the period complied with the approved strategy, the CIPFA Code of Practice and the relevant legislative provisions.

2.38 Throughout the period under review the Authority has continued to use the broader range of investment tools placing investments with other Local Authorities, the Debt Management Office (DMO), Treasury Bills, Money Market Funds (MMFs), instant access accounts with Lloyds Bank PLC and notice accounts with Santander Bank PLC.

2.39 As of 30th September, 2022, there were no policy changes to the Treasury Management Strategy Statement (TMSS.) The details in this report update the position in the light of the updated economic position and budgetary changes which were already approved.

2.40 Following delays caused by the Coronavirus pandemic the introduction of the IFRS16 Leasing will now commence from April 2024. The revision of the prudential indicators to include the additional financial liabilities brought onto the Council's balance sheet will form part of the 2023/24 Treasury Management and Investment Strategy and will be reported to Cabinet and Council early next year. Work is still ongoing to establish values for the lease liabilities in accordance with the standard and to agree an acceptable low value lease policy with Audit Wales in accordance with the standard. Whilst it is not expected that the introduction of this standard will impact the bottom line of the Council's balance sheet the standard will attempt to quantify the additional debt that the Council commits to when it enters into leasing agreements which is set against a controllable asset for the period.

2.41 A more detailed report concerning the introduction of IFR16 was presented to the Governance and Audit Committee on 23rd September, 2021 (Min 399) to outline the Council's approach to implementing the standard. An assessment of the likely impact and implications was reported to the Governance and Audit Committee early in 2022 alongside the Treasury Management Strategy for 2022/23.

The Authority's Capital Position (Prudential Indicators)

2.42 This part of the report is structured to update**:**

- The Authority's capital expenditure plans**.**
- How these plans are being financed.
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow.
- Compliance with the limits in place for borrowing activity**.**

2.43 The Treasury Management prudential indicators are based on the capital programme approved at Cabinet on 6th October and further reflects the amendments set out in the Capital Monitoring approved at Cabinet 3rd November, 2022.

2.44 It is a statutory duty for the Authority to determine and keep under review the affordable borrowing limits. During the half year ended 30th September, 2022, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2022/23. The Head of Finance (Section 151 Officer), reports that no difficulties are envisaged for the current or future years in complying with these indicators.

2.45 This table shows a comparison of the original capital programme as agreed by Council on 7th March, 2022 with the revised capital budget as agreed at Cabinet on 3rd November, 2022. The revised estimate also includes the amended City Deal budget which has been approved via emergency powers.

Capital Expenditure by Service	**2022/23 Original Estimate £m**	**2022/23 Revised Estimate £m**
Learning & Skills	20.381	30.587
Social Services	0.180	1.084
Environment & Housing	17.937	23.526
Place	5.801	5.287
Corporate Resources	0.856	2.565
City Deal	0.273	0.557
Housing Revenue Account	39.778	29.275
Total Capital Expenditure	**85.206**	**92.881**

Changes to the Financing of the Capital Programme

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

2.47 It can be noted that the level of borrowing in 2022/23 has reduced significantly from the original estimate, this is partly due to some significant slippage on the Capital Programme but also due to increased use of reserves and revenue contributions to deliver the Capital Programme.

Sources of Capital Financing	2022/23 Original Estimate £m	2022/23 Revised Estimate £m
Total Capital Expenditure	85.206	92.881
Financed by:		
GCF Grant	2.378	2.917
Additional GCF Grant	2.203	1.348
General Fund Reserves & Revenue	13.413	20.666
HRA Reserves & Revenue	18.452	23.471
S106	8.484	8.189
Welsh Government Grants	11.089	29.567
Capital Receipts (General & HRA) and Appropriations	5.120	3.272
Total Financing	61.139	89.430
Prudential Borrowing Requirement	**20.616**	**0**
Supported Borrowing Requirement	**3.451**	**3.451**

Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary

2.48 The table below shows the CFR, which is the underlying external need for the Council to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary. The Authority has revised the Capital Financing Requirement estimate for 2022/23 downwards which primarily reflects a decrease in the estimated borrowing for the Housing Revenue Account (HRA), Vehicles, City Deal and The Sustainable Communities for Learning Programme.

	2022/23 Original Estimate £m	2022/23 Revised Estimate £m
Prudential Indicator – the Capital Financing Requirement		
CFR – Non-Housing	123.665	119.149
CFR – HRA	92.518	76.462
Total CFR	216.183	195.611
Borrowing Requirement	32.000	3.451
Less Minimum Revenue Provision	(5.504)	(5.539)
Net movement in CFR	26.496	**(2.088)**

Prudential Indicator – the Operational Boundary for External Debt		
Borrowing	230.785	211.040
Other Long-Term Liabilities	0	0
Total Debt (Year End Position)	**230.785**	**211.040**

Borrowing Activity

2.49 A key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2022/23 and next two financial years. This allows some flexibility for limited early borrowing for future years. In line with CIPFA guidance the Council will not borrow more than or in advance of its needs purely to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds. The figure shown below reflects the Council's current strategy as outlined in paragraph 2.31 of this report in respect of maximising internal borrowing. This will be kept under review in consultation with the Council's Treasury Management advisers.

	2022/23 Original Estimate £m	**2022/23 Revised Estimate £m**
External Net Borrowing	176.411	151.294
Other Long-Term Liabilities	0	0
Total Debt	176.411	151.294
CFR (Year End Position)	**216.183**	**195.611**
Estimated Internal Borrowing	**39.772**	**44.317**

2.50 No difficulties are envisaged for the current or future years in complying with this prudential indicator.

The Authorised Limit

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

Authorised limit for external debt	2022/23 Original Indicator £m	2022/23 Revised Indicator £m
Borrowing	241.693	222.975
Other long-term liabilities	0	0
Total	**241.693**	**222.975**

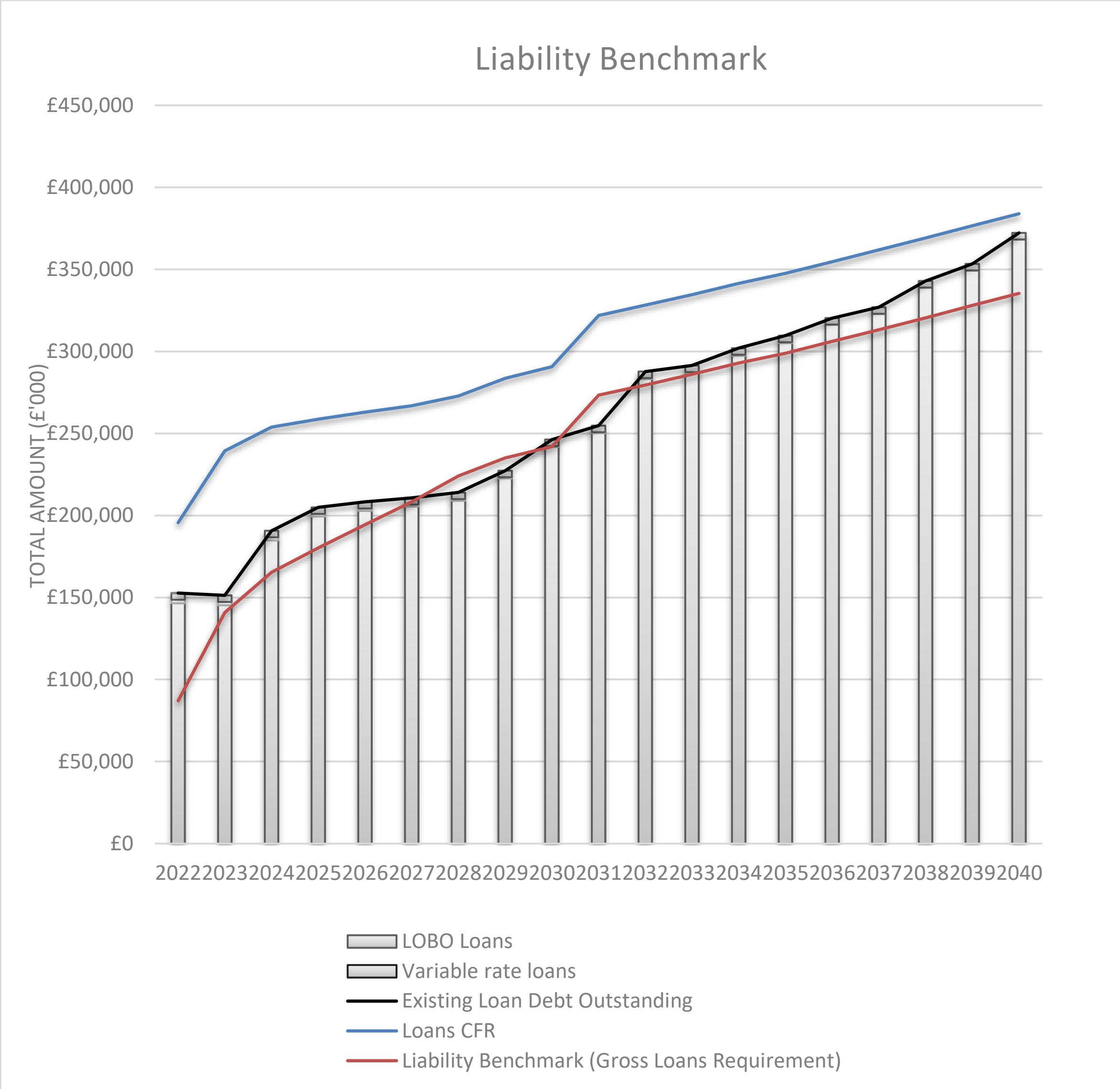
The Liability Benchmark

2.52 As part of the revised prudential code (December 2021) there is a requirement for the Council to adopt a new debt liability benchmark treasury indicator to support the financing risk management of the capital financing requirement.

2.53 The Liability Benchmark is effectively the Net Borrowing Requirement of a local authority plus a liquidity allowance. In its simplest form, it is calculated by deducting the amount of resources available for investment on the balance sheet (reserves, cash flow balances) from the amount of outstanding external debt and then adding the minimum level of investments required to manage day to day cash flow.

2.54 CIPFA recommends that the optimum position for external borrowing should be at the level of the Liability Benchmark where all balance sheet resources are used to maximise internal borrowing.

2.55 An initial projection is detailed in the graph below over 20 years, however a full updated 30 year projection will be included as part of the Treasury Management and Investment Strategy for 2023/24.



2.56 This graph shows that external borrowing is significantly below the Council's capital financing requirement as the Council currently maintains an under borrowed position. The projected CFR and external borrowing illustrated in this chart are set out in the table below.

	Projected	Projected	Projected
	CFR	External Debt	Under/Over Borrowing
	£000s	£000s	£000s
2021/22	197.70	153.35	44.35
2022/23	195.61	151.29	44.32
2023/24	239.33	190.71	48.62
2024/25	253.91	204.93	48.98
2025/26	258.76	208.27	50.49
2026/27	262.91	210.70	52.21
2027/28	266.89	213.97	52.92

2028/29	272.96	227.32	45.64
2029/30	283.84	246.30	37.54
2030/31	290.78	254.76	36.02
2031/32	322.18	287.74	34.44
2032/33	328.37	291.37	37.00
2033/34	334.78	301.95	32.83
2034/35	341.59	309.58	32.01
2035/36	347.71	320.33	27.38
2036/37	354.78	326.92	27.86
2037/38	361.89	342.93	18.96
2038/39	369.14	353.37	15.77
2039/40	376.50	372.25	4.25
2040/41	383.88	383.57	0.31

2.57 This means that the capital borrowing need was not fully funded with external loan debt as cash supporting the Council's reserves, balances and cash flow were used as an interim measure to finance the Council's borrowing requirement. This allows the Council to mitigate the volatility of the financial market and interest rates. The reserves are projected to reduce over the period under review and the Council is expected to borrow up to the CFR at the end of the period. The Council currently holds significant investments as detailed in this report, but these are expected to reduce as reserves are utilised. The Council will maintain a £30m investment buffer as part of the treasury management liquidity benchmark the value of this buffer will need to be kept under review in the context of the current inflationary factors.

Interest Rate Exposure

2.58 This indicator is set to control the Authority's exposure to interest rate risk. The limit is determined by the total amount borrowed by the Council. Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that either mature during the financial year or have a floating interest rate are classed as variable rate. The exposures to fixed and variable rate interest rates, expressed as an amount of net principal borrowed as of 30th September, 2022 were:

	Limit (£m)	Actual (£m)	Met
Upper limit on fixed rate exposures	154.238	150.138	✓
Upper limit on variable rate exposures	0	0	✓

2.59 Should the Council proceed to externally borrow the £3.451m of supported borrowing then the estimated fixed rate interest exposure limits at the 31st March, 2022 are set out in the table below.

	Limit (£m)	Actual (£m)	Met
Upper limit on fixed rate exposures	151.294	147.294	✓
Upper limit on variable rate exposures	0	0	✓

2.60 This prudential indicator was removed by the most recent edition of the CIPFA Treasury Management Code (December 2021) and is now classed as a local indicator. There is no longer a requirement to report it to comply with the CIPFA Code.

Maturity Structure of Borrowing

2.61 This indicator is set to control the Authority's exposure to refinancing risk. The maturity date of borrowing is the earliest date on which the lender can demand repayment. The maturity structure of fixed rate borrowing as of 30th September, 2022 was:

	Upper Limit	**Lower Limit**	**Actual**	**Met**
Under 12 months	20%	0%	3.69%	✓
12 months and within 24 months	20%	0%	6.63%	✓
24 months and within five years	30%	0%	14.35%	✓
Five years and within 10 years	40%	0%	35.98%	✓
10 years and above	100%	0%	39.35%	✓

Investments

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

2.63 The Authority has made the following investments for the period 1st April, 2022 to 30th September, 2022 as set out below: -

Investment Counterparty	**Opening Balance**	**Invested**	**Returned**	**Closing Balance**
	01/04/2022			**30/09/2022**
	£m	**£m**	**£m**	**£m**
UK Local Authorities	55.500	20.500	(44.500)	31.500
Debt Management Office	26.650	264.360	(286.810)	4.200
Treasury Bills	6.500	44.900	(7.000)	44.400
Money Market Funds (MMF)	4.200	55.040	(43.765)	15.475
Lloyds Deposit Accounts	0.020	0.500	(0.500)	0.020

Santander Notice Accounts	0.750	0.000	(0.000)	0.750
Total	**93.620**	**385.300**	**(382.575)**	**96.345**

2.64 Interest, at an average rate of 0.97% and amounting to £406,532.79 including interest accrued has been received from these investments during the first 6 months of 2022/23.

2.65 Throughout the period under review the Authority placed investments in the broader mix of investment tools as detailed above.

2.66 This strategy is considered prudent considering the continuing pressures in the financial markets caused by the Russian Invasion of Ukraine, the political uncertainty in the UK, the cost of living crisis, the threat of bail in for fixed term investments with banks and the remaining uncertainty with Brexit. The Head of Finance (Section 151 Officer) will continue to have regard to the security and liquidity of the investments before seeking the highest rate of return or yield.

Borrowing

2.67 The Council's estimated revised CFR for 2022/23 is £195.611m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing).

2.68 During 2021 PWLB introduced revised guidance that prevented Local Authorities borrowing for commercial purposes. The guidance set out several permitted purposes these were primarily for Service Capital Investment, Economic Regeneration and Debt Refinancing.

2.69 The following table sets out the monies externally borrowed/repaid during the period.

Loan Type	**Opening Balance**	**Received**	**Repaid**	**Closing Balance**
	01/04/2022			**30/09/2022**
	£m	**£m**	**£m**	**£m**
PWLB	146.502	3.000	(2.109)	147.393
LOBO	4.000	0.000	(0.000)	4.000
Salix Loans	1.695	0.000	(0.000)	1.695
Temporary Loans	0.100	0.000	(0.000)	0.100
WG Loans	1.050	0.000	(0.000)	1.050
Total	**153.347**	**3.000**	**(2.109)**	**154.238**

- Loans borrowed from the PWLB are intended to assist Local Authorities in meeting their longer term borrowing requirements. The above PWLB loans are all at fixed rates of interest. The rate paid on each loan is largely dependent upon the original duration of the loan and date taken out. The loans taken out for the Housing Revenue Account Subsidy buyout were at a predetermined range of rates specified by HM Treasury. The Council has a significant repayment schedule over the next five years that will see the Council repay some historical debt at high interest rates with the opportunity to refinance at the current lower PWLB rates after considering cost of carry considerations.
- Two new PWLB loans were taken out during the period under review. These were for £2m and £1m at interest rates of 3.05% and 3.11% respectively. Debt Repaid was at an average rate of 4.81%.
- Other longer term loans represent those non PWLB loans that are repayable at least 1 year or more from the date they are advanced. This debt is represented by a single LOBO loan of £4m.
- Two loans are included for Salix with balances outstanding totalling £1.695m which have been borrowed for energy management schemes primarily Street Lighting.
- Temporary loans represent those loans that are borrowed for a period of less than 1 year. They are borrowed on a 7 day notice arrangement.
- Welsh Government (WG) Loan is made up of two interest free loans provided by WG, a concessionary loan for £500k and a Town Centre Loan for £550k.

2.70 External interest at an average rate of 4.48% and amounting to £3,396.222m has been paid on these loans during the first 6 months of 2022/23.

2.71 With current market uncertainty in the UK and worldwide and the recent increase in the PWLB rates it is the Council's intention that no further external borrowing will be undertaken in 2022/23. The Council will maximise internal borrowing where possible. The Section 151 Officer will continue to liaise with Link Asset Management in respect of the Council's borrowing strategy and will keep any potential PWLB borrowing under review.

2.72 As of 31st March, 2022, the Authority internally borrowed £44.352m to finance the Capital Programme. If the Authority continues this approach, it is estimated that this amount could increase by a further £3.451m during 2022/23 based on the current borrowing requirement. This position will be kept under review by the Section 151 Officer, and advice sought from Link as required. The Council needs to keep this approach under review in the context surety of borrowing and use of reserves to ensure internal borrowing does not exceed a prudent proportion of reserves and core cash is maintained for operational purposes. An update will be included in the Treasury Management and Investment Strategy 2023/24.

2.73 Internal borrowing, borrowing that is not supported by a revenue stream is charged using the 3 month Sterling Overnight Interest Average rate (SONIA). The average rate calculated to the 30th September 2022 is 1.71%.

2.74 SONIA rates were introduced in the March 1997 and was reformed by the Bank of England in 2018 to provide a benchmark that complies with the international best practice. Sonia replaces the 3 month London Interbank Bid Rate (LIBID) previously used by Council which was phased out in the financial markets in 2021. Link Group Market Services, the Councils Treasury Management Advisors have stated that they would expect that most investors may well use the Term SONIA rates as their investment benchmarks, as these would reflect their own circumstances (cash flow, liquidity requirements, their own interest rate outlook etc.) as well as market expectations of policy rates as at the point of investment.

2.75 Internal Borrowing currently represents a far cheaper alternative to borrowing externally for the Council and is affordable given the current and projected level of reserves. The estimated total interest to be charged to revenue for internal borrowing for pooled loans should the £3.451m external borrowing be undertaken in 2022/23 is estimated to be £895,477.

2.76 When pooling the interest charges for external and internal borrowing, the average rate charged to the Council to deliver the Capital Programme is estimated to be 4.08%.

2.77 In addition, the Council has previously internally borrowed for the Local Government Borrowing Initiative (LGBI) for 21st Century Schools, Affordable Housing and Highways initiatives. The interest to be charged for this element of the internal borrowing for 2022/23 is £340,152.

Debt Rescheduling

2.78 Debt rescheduling opportunities have been very limited in the current economic climate. No debt rescheduling has therefore been undertaken to date in the current financial year. However, now that the whole of the yield curve has shifted higher there may be better opportunities in the future, although only prudent and affordable debt rescheduling will be considered. The Head of Finance/Section 151 Officer will liaise with the Council's advisors concerning any opportunities that may arise.

Changes in Risk Appetite

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

Non-Treasury Service Investment Strategy

Treasury Bills

2.80 Throughout the period under review Treasury Bills have consistently outperformed the other investment tools available to the Council and carry very low credit risk. Treasury Bills have been the Council's preferred investment tool during the period under review.

Money Market Funds

2.81 The 2018 No.325 (W.61) Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2018 introduced changes to accounting practice for Money Market Funds (MMFs) and they are no longer treated as capital expenditure.

2.82 The Authority uses this investment tool regularly and has accounts with CCLA and Federated Hermes. Instant access to the funds deposited has proved invaluable as cash flow forecasting has been problematic during the pandemic and now with the cost of living crisis where revenue streams and outgoings have not been easily identifiable.

2.83 Both funds are domiciled in the UK and their funds rated 'AAAmmf' (highest credit quality) by the Fitch credit rating agency. Funds to a maximum of £10m may be invested in each fund in accordance with the Council's revised counterparty limits.

Lloyds Deposit Accounts

2.84 The Authority opened two interest earning deposit accounts with Lloyds Bank in October 2020. The accounts are low yield and have been infrequently used during 2022/23 due to the exceptionally low returns. The Council has opted to place its highly liquid investments with MMFs to achieve a more favourable return at a lower credit risk.

2.85 As part of the agreement with Lloyds Bank, the Council is asked on an annual basis to sign a set off agreement which includes accounts that are included in our overdraft agreement. The agreement gives the bank the right at any time and without notice to combine or consolidate all these accounts with any of our liabilities and set off or transfer any credit balance towards setting off a liability.

2.86 The accounts covered by this agreement are managed on a day to day basis by the Council so that the total balance of these accounts remains positive. However, the Council does have a £2m overdraft facility so therefore this agreement currently has no impact on the Council's financial position. This does not include any stewardship accounts held on behalf of Social Services clients.

Non Treasury Investment

Big Fresh Catering Company

2.87 On 1st January, 2020, the Council set up a Local Authority Trading Company to deliver catering services called Big Fresh Catering Company. The Council owns 100% of the company shares. Profits from the venture will be given to local schools or reinvested back into the business. In accordance with WG Guidance this will be classified as a Non Treasury Investment. The value of the Council's investment is £1.

Service Investment Strategy

2.88 In February 2022 a new Non Treasury Investment Strategy to support Recovery and Regeneration through Economic Development schemes and development of Green Infrastructure was approved. Under the proposals up to £2.2m of earmarked reserves and £10m of PWLB borrowing could be utilised. These schemes are expected to recover the cost of financing any borrowing, however, they would increase the Council's Capital Financing Requirement, External Borrowing and Minimum Revenue Provision requirements. A specialist investment Committee would be set up to ensure sufficient oversight and scrutiny of any proposals. Further work is being carried out to identify potential opportunities, refine governance proposals and criteria for approving and monitoring funding proposals.

3. How do proposals evidence the Five Ways of Working and contribute to our Well-being Objectives?

3.1 The Treasury Management and Investment Strategy ensures that the financial plans of the Council are sustainable into the future and do not adversely impact on future generations.

3.2 The Treasury Management and Investment Strategy underpins the financial management of the Council and its ability to achieve its Well Being objectives as set out in the Corporate Plan.

4. Climate Change and Nature Implications

4.1 Councils and the UK Government are implementing policies in response to Climate Change.

4.2 Money Market Funds selected by the Council regularly monitor the environmental, social and governance (ESG) risk management activities with whom they invest.

5. Resources and Legal Considerations

Financial

5.1 Money is borrowed for capital purposes and interest charged to revenue accounts.

Employment

5.2 There are no direct employment issues relating to this report.

Legal (Including Equalities)

5.3 Compliance with the Local Government Act and CIPFA'S Code of Practice for Treasury Management in the Public Services is mandatory.

6. Background Papers

6.1 CIPFA'S Code of Practice for Treasury Management in the Public Services (2017 Edition), and WG guidance on Local Authority investments.