WIRRAL

POLICY AND RESOURCES COMMITTEE

Wednesday, 9 November 2022

REPORT TITLE:	**TREASURY MANAGEMENT MID-YEAR REPORT 2022/23**
REPORT OF:	**DIRECTOR OF RESOURCES (S151 OFFICER)**

REPORT SUMMARY

The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires the production of an annual Treasury Management Strategy Statement on likely financing and investment activity. The Code also recommends that Members are informed of treasury management activities at least twice a year.

This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the Department for Levelling Up, Housing and Communities (DLUHC) Investment Guidance.

At the Mid-Year point the Treasury Management budget forecast for this year is for an overspend of £0.1 million. The forecast overspend is due to an increase in the interest rate environment, which will impact upon the borrowing costs of the Council. Some of this increase in interest cost will be offset by higher interest generated on Treasury Management investments. This position is incorporated into the Quarter 2 Revenue Monitoring report.

The report supports the Council ensures the effective management of financial resources which indirectly supports the delivery of all five priorities of the Wirral Plan 2021 - 26.

This matter is a key decision due to the level of expenditure involved and also as Treasury Management decisions affect all Wards within the Borough.

RECOMMENDATION

It is recommended that Policy and Resources Committee is requested to note the Treasury Management Mid-Year Report for 2022/23.

SUPPORTING INFORMATION

1.0 REASON/S FOR RECOMMENDATION/S

1.1 Wirral Council has adopted the CIPFA Code of Practice on Treasury Management ("the Code"), which includes regular update reports to Members of treasury activity. This report is the mid-year review for 2022/23.

2.0 OTHER OPTIONS CONSIDERED

2.1 As per the requirements of the CIPFA Code, this report updates Members on Treasury activities to 30th September 2022, therefore no other options have been considered.

3.0 BACKGROUND INFORMATION

3.1 Treasury management is defined by CIPFA as: "The management of the Council 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."

3.2 The Council approves the Treasury Management Strategy at the start of each financial year. This identifies how it is proposed to finance capital expenditure, borrow and invest in the light of capital spending requirements, the interest rate forecasts and the expected economic conditions. During the year Members receive a mid-year report on treasury management activities and at the end of each financial year an Annual Report.

3.3 Treasury Management activities must be considered within the economic context and environment in which they are undertaken.

3.4 Appendix A provides detail of the economic developments throughout the first half of 2022/23. In summary, regarding inflation and economic growth, inflation is at the highest levels seen for forty years. This has been driven by steep rises in energy costs. These record inflation levels have impacted upon the Bank of England's monetary policy as they have reacted by raising their lending base rate from 0.75% to 2.25% of the first half of the year, with further rate increases forecast in the months ahead. As Treasury activities centre around both lending and investing funds, these changes in interest rates have an effect on both the investment returns and borrowing interest costs for the Council.

3.5 There was a negative market reaction to the Governments 'mini budget', which led to increasing levels of Government debt. The Bank of England responded to this by purchasing long dated GILTs to steady the financial markets.

THE COUNCIL TREASURY POSITION

3.6 The table shows how the position has changed since 31 March 2022.

Table 1: Summary of Treasury Position

	Balance 31 Mar 22 £m	Maturities £m	Additions £m	Balance 30 Sep 22 £m
Investments	66.96	-271.28	240.69	36.37
Borrowings	-221.55	85.57	-67.50	-203.48
Other Long-Term Liabilites	-34.40	1.35	0.00	-33.05
Net Debt	**-188.99**	**-184.36**	**173.19**	**-200.16**

3.7 Throughout the first six months of the year the level of net debt has reduced due to the repayment of debt as it fell due, most notably a net repayment of £14.5 million of temporary loans from other Local Authorities that were taken out towards the end of 2021/22 for cashflow purposes. Temporary loans from other Local Authorities are relatively inexpensive compared to fixing into longer term loan arrangements with for example the Public Works Loan Board (PWLB), hence their use for short-term cashflow.

3.8 As reported in the Treasury Management Annual Report 2021-22 (Council 10th October 2022), included within the borrowings of £203.5 million is a loan with the PWLB for £6.5 million, which was arranged to match the 2020/21 cost of the capitalisation directive granted to the Council by DLUHC. This loan was arranged once the 2020/21 Statement of Accounts had been audited by Grant Thornton. This loan will need to be refinanced towards the end of this financial year. A similar loan will be arranged relating to the 2021/22 cost of the capitalisation directive, once the 2021/22 Statement of Accounts have been audited. It is intended to repay the capitalisation amounts via use of capital receipts at an appropriate point in the future thereby removing the need to borrow and associated interest costs.

3.9 The increase in Net Debt is the result of investment balances reducing by a more significant amount (£30.5 million) than the reduction in debt (£18.1 million). Investment balances are variable throughout the year as funds are required to finance day to day operations.

BORROWING AND DEBT MANAGEMENT

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

3.11 Over the April-September period short term PWLB rates rose dramatically, particular in late September after the Chancellor's 'mini-budget' prompted a fall in sterling and rise in market interest rate expectations. Interest rates rose by over 2% during the period in both the long and short term. As an indication the 5-year maturity certainty rate rose from 2.30% on 1st April to 5.09% on 30th September; over the same period the 30-year maturity certainty rate rose from 2.63% to 4.68%. Although interest rates across the board have risen, short-term borrowing from other local authorities remains at lower interest rates than long term borrowing.

3.12 The Council undertakes borrowing to fund capital expenditure. As short-term investment interest rates have remained lower than long-term borrowing rates, it is more cost effective in the short-term to use a mix of internal borrowing and short term cashflow loans.

3.13 The use of internal borrowing will not be sustainable over the medium term. Elements of the Capital Programme will ultimately require funding via borrowing from external sources. As reserves are called upon the resources temporarily available to use in lieu of external borrowing diminish, meaning the Council will reach a point when it is no longer possible to delay borrowing any further. Internal borrowing does not remove the need to externally borrow, it merely delays incurring the debt and consequently the financing costs.

3.14 The decision to continue to use internal resources in lieu of borrowing for capital purposes is helping to reduce borrowing costs in 2022/23. The level of cost reduction will be dependent upon the borrowing requirement of Capital schemes delivered within the financial year. In future years, as cash flows diminish through use of reserve and/or interest rates rise, external borrowing will have to increase. The Treasury Management team will continue to proactively manage the Council's cash flow to delay external borrowing for as long as is possible and prudent to reduce costs.

3.15 **Lender Option Borrower Option (LOBO) loans**: The Council continues to hold £94.5 million of LOBO loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. No banks have exercised their option during the first half of the year. Discussions have been taking place regarding the exiting of some LOBOs. Officers will only instigate this should it be financially advantageous to the Council. Market conditions are volatile but may offer some opportunities during the third quarter of the year.

3.16 Given the rising interest rate environment, it is possible that some banks may choose to exercise their LOBO option during the second half of the year. As per the Treasury Management Strategy (Council 28 February 2022), if a lender proposes to exercise their right to amend the interest rate of the loan, the default position will be the repayment of the LOBO without penalty i.e., the revised terms will not be accepted. Depending on the timescales, the initial repayment may be repaid via temporary cashflow before more permanent refinancing is arranged. There are £79.5 million of LOBO loans that could be called within the second half of this financial year, although it is highly unlikely that this full amount would be called.

3.17 Appendix B illustrates the Council's debt portfolio as the mid-year point. Borrowings have fallen by £18.1 million, which other long term liabilities (PFI agreements) also reducing by £1.35 million. Shorter term borrowing continues to be utilised, when possible, to keep interest costs reduced. Further detail is provided in Appendix B that describes the debt management approach taken in 2022/23 and provides additional details of borrowings in tables B1 and B2.

TREASURY INVESTMENT ACTIVITY

3.18 Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. These investments arise from a number of sources including General Fund Balances, Reserves and Provisions, grants received in advance of expenditure, money borrowed in advance of capital expenditure, Schools' Balances and daily cashflow / working capital.

3.19 CIPFA revised Treasury Management Code defines treasury management investments as those which arise from the Council'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.

3.20 Appendix C describes investment management, with a significant sum of available funding being utilised to temporarily minimise borrowing costs. Table C1 details investments held as at 30 September 2022.

3.21 From a starting position of £67 million of investments as at 31 March 2022, the level of investment decreased to £53 million at 30 June 2022 and then further reduced to a balance of £36 million as at 30 September 2022 due to:

- Invested cash being used to repay temporary loans as they become due, rather than entering into replacement loan agreements
- The continued utilisation of the funding as service need dictates

3.22 There were increases in Bank Rate over the period under review, with the prospect of more increases to come. The return on the Council's sterling Low Volatility Net Asset Value (LVNAV) Money Market Funds ranged between 0.44% - 0.58% at the end of March and between 1.73% and 2.12% at the end of September.

3.23 The budget for investment income is £1.2 million but achievable income will be in the region of £0.5 million. This reduction in investment income is attributable to these key factors:

a) Low interest rates offered for investments at the start of the financial year
b) The continuing policy of relying on internal borrowing to temporarily fund and thereby delay borrowing for the Capital Programme, which reduces balances available to put into investments but generates savings in interest incurred.

3.24 Given the risk of short-term unsecured bank investments, the Council has invested in alternative and/or higher yielding asset classes as shown in Appendix C, table C1.

3.25 However, the reduction in investment income is being offset by the savings of an estimated 3.0% on delayed borrowing for amounts internally borrowed, hence the minor net negative Treasury outturn projection for this financial year.

3.26 The return on investments, along with the policy of internally borrowing, reflects prevailing market conditions and the objective of optimising returns commensurate with the overriding principles of security and liquidity.

COMPLIANCE WITH TREASURY INDICATORS

3.27 The Chief Finance Officer reports that all treasury management activities undertaken during the first half of the year complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in Appendix D.

INTEREST RATE FORECAST

3.28 The Council's Treasury advisors, Arlingclose, expects the Bank Rate to rise further during 2022/23 to reach 5% by the end of the year.

3.29 Gilt yields will face further upward pressure in the short term due to lower confidence in UK fiscal policy, higher inflation expectations and asset sales by the Bank of England. Given the recent sharp rises in gilt yields, the risks are now broadly balanced to either side. Over the longer term, gilt yields are forecast to fall slightly over the forecast period.

3.30 A detailed outlook for the Bank of England Base Rate is included in Appendix E of this report. This is a commentary is provided by the Council's external Treasury advisor Arlingclose. The forecast predicts further rises in Bank of England interest rates in the coming months, peaking at 5% in March 2023, before reducing in December 2024.

4.0 FINANCIAL IMPLICATIONS

4.1 Capital debt finance has reduced annually over recent years, despite additional annual Capital commitments. This has contributed to the generation of substantial savings.

4.2 Investment income has also helped to generate resources for service delivery.

4.3 The projected overspend of £0.1 million is the result of the increase in financing costs due to rising interest rates. Whilst the upturn in rates will help generate additional investment income, the forecast increase in interest costs is anticipated to outweigh this. Investment income opportunities remain subdued due to the continuing policy of internal borrowing where possible to delay Capital programme borrowing.

4.4 The Treasury Management team will endeavour to further reduce interest costs wherever possible during the second half of the year.

4.5 Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP) and is a charge that is made against the Treasury Management budget. If the Capital Programme is delivered as forecast in the Quarter 2 Capital Monitoring report, the Council will consequently increase its capital debt by £43.0 million (this is down from a forecast £62.0 million in Quarter 1). This debt is repaid via charges to the revenue budget over the lives of the assets created or enhanced. The revenue impact of the additional £43.0 million of borrowing required to fund all forecast works in 2022/23 is as follows:

Table 2: MRP Charges to Revenue Relating to 2022/23 Debt Funded Capital

	2023/24 £m	2024/25 £m	2025/26 £m	2026/27 £m
Additional revenue cost	1.254	1.293	1.333	1.374

Note – MRP repayments from revenue only start the year after the capital expenditure has taken place i.e., for spend incurred in 202/23, the first MRP repayments will be charged in the 2023/24 revenue accounts.

4.6 The MRP charge is calculated on an annuity basis, which means the annual repayments gradually increase each year. This, coupled with additional capital activity each year results in an increase in the MRP charge year on year.

5.0 LEGAL IMPLICATIONS

5.1 The Council has adopted the CIPFA Code of Practice on Treasury Management. This requires the annual production of Performance Indicators and a Treasury Management Strategy Statement and the reporting of treasury management activities at least twice a year.

6.0 RESOURCE IMPLICATIONS: STAFFING, ICT AND ASSETS

6.1 There are none arising directly from this report.

7.0 RELEVANT RISKS

7.1 The Council is responsible for treasury decisions and activity and none of these decisions are without risk. The successful identification, monitoring and control of risk are important, and the main risks are: -

Risk	**Mitigation**
Exposure to inflation	That wherever possible investments are entered into at inflation equalling levels of interest. This depends entirely on the nature and purpose of the proposed investment.
Legal and Regulatory Risk	That appropriate legal advice is sought on new opportunities to ensure adherence to relevant legislation and regulation.

Credit and Counterparty Risk (Security of investments).	That any potential counterparty is subjected to suitable due diligence to ascertain appropriateness for investment and investment criteria
Council issues S114 notice	Should the Council encounter difficulties in obtaining borrowing following a S114 notice, the Council has access to borrow from the PWLB as a lender of last resort. Any such borrowing would be subject to higher rates of interest.

7.2 The risks mentioned above are inherent in Treasury activity, therefore they are persistent, continuous risks. Appendix 1 of the Treasury Management Strategy 22/23 (approved by Council on 28 February 2022) states that "the Council will create and maintain, as the cornerstones for effective treasury management: -

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities.
- Suitable Treasury Management Practices (TMPs), setting out the way the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities."

8.0 ENGAGEMENT/CONSULTATION

8.1 This strategy report has been written in consultation with the Council's external treasury management advisors, Arlingclose Ltd, in accordance with best practice.

9.0 EQUALITY IMPLICATIONS

9.1 There are none arising directly from this report.

10.0 ENVIRONMENT AND CLIMATE IMPLICATIONS

10.1 As part of future investment strategy, consideration will be given to potential opportunities to invest in environmentally focussed instruments or organisations. 'Ethical, Social and Governance' (ESG) investment criteria will be considered and, where viable in adherence to the policies laid out in this strategy, will only be entered into following satisfactory assessment of the instrument and/or organisation. Two such investments in the current investment portfolio are the holding in the Public Sector Social Impact Fund along with the Green Energy Bond held.

11.0 COMMUNITY WEALTH IMPLICATIONS

11.1 Investment vehicles that embrace green and sustainable practices will be given due consideration, should a suitable investment opportunity become available and subject to appropriate due diligence. One fund that the Council invest in is the Public Sector Social Impact Fund, an organisation that is keen to look at investment opportunities within the local area. Possible investment examples include (but not limited to;

- Social Housing – affordable places to live for many residents
- Solar/Wind Power – cleaner air and cheaper energy
- Community lending vehicles – creating jobs and revenues in local communities
- Forestry – greener communities
- Vehicle Charging Points– cutting down on pollution, cleaner air

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APPENDICES

Appendix A	Economic Background
Appendix B	Debt Management
Appendix C	Investment Management
Appendix D	Treasury Indicators 2022/23
Appendix E	Interest Rate Outlook - Arlingclose

TERMS OF REFERENCE

This report is being considered by the Policy and Resources Committee in accordance with 1.2(a)(i) of the Policy and Resources Committee Terms of Reference:

formulate, co-ordinate and implement corporate policies and strategies and the medium term financial plan (budget), which includes responsibility for any decision:
(i) that relates to such matters to the extent that they are not reserved to full Council.

BACKGROUND PAPERS

CIPFA Code of Practice on Treasury Management
Wirral Council Treasury Management Strategy 2022/23

SUBJECT HISTORY (last 3 years)

Council Meeting	Date
Treasury Management Mid-Year Report 2019-20	Cabinet – 25 Nov 2019
Treasury Management Strategy Statement 2020-21	Cabinet – 17 Feb 2020
Treasury Management Annual Report 2019-20	Cabinet – 27 July 2020
Treasury Management Mid-Year Report 2020-21	P&R – 3 Nov 2020
Treasury Management Strategy Statement 2021-22	P&R - 17 Feb 2021
Treasury Management Annual Report 2020-21	P&R - 28 July 2021
Treasury Management Mid-Year Report 2021-22	P&R - 10 Nov 2021
Treasury Management Strategy Statement 2022-23	P&R - 15 Feb 2022
Treasury Management Annual Report 2021-22	P&R - 13 Jul 2022

APPENDIX A

ECONOMIC BACKGROUND

Growth & Inflation

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

2 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.

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

4 UK inflation remained extremely high. Annual headline the Consumer Price Index (CPI) hit 10.1% in July, the highest rate for 40 years, before falling modestly to 9.9% in August. The Retail Price Index (CPI) 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.

5 The labour market remained tight through the period but there was some evidence of easing demand and falling supply. The unemployment rate 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.

6 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.

7 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%.

8 Eurozone CPI inflation reached 9.1% 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 this was followed in September by further hikes of 0.75% taking the deposit rate to 0.75%.

Monetary Policy

9 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. 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.

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

11 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.

Market Reaction

12 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 was significantly exacerbated by the UK government’s fiscal plans, leading to an acceleration in the rate of the rise in gilt yields and decline in the value of sterling.

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

14 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%.

APPENDIX B

DEBT MANAGEMENT

1 The table below shows Council debt as at 30 September 2022:

Table B1: Council Debt as at 30 September 2022

Debt Principal	Balance 31 Mar 22 £m	Maturities £m	Additions £m	Balance 30 Sep 22 £m
Borrowings				
PWLB	-24.18	0.13	-	-24.05
Market Loans (Fixed Rate)	-41.50	3.00	-	-38.50
Market Loans (LOBO)	-94.50	-	-	-94.50
Interest Free Loans & Other	-3.88	0.45	-	-3.43
Total Capital Finance Loans	**-164.05**	**3.57**	**0.00**	**-160.48**
Other Long Term Liabilities (PFI)	-34.40	1.35	-	-33.05
Temporary Cashflow Loans	-57.50	82.00	-67.50	-43.00
TOTAL	**-255.95**	**86.92**	**-67.50**	**-236.53**

The reduction in total debt is due to a combination of factors:

- *Repayment of temporary cashflow loans that were required over the latter part of 2021/22.*
- *The full and partial repayment of longer term loans, through the use of internal resources rather than arranging new loans to replace the maturing debt.*

2 The following table shows the capital financing loans repaid during the first half of the year.

Table B2 – Loan Maturities in 2022/23

Loans maturing in 2022/23	Principal £'m	Fixed/ Variable	Rate %	Loan start date	Terms
PWLB	0.13	Fixed	2.16	February 2019	E I P
Barclays	3.00	Fixed	4.99	September 2004	Maturity
SALIX	0.45	Fixed	0.00	Various	E I P
Total Maturing Borrowing	**3.57**				

Note: Equal Instalments of Principal (EIP) loans are loans that are repaid in equal instalments spread over the duration of the loan. Maturity loans are repaid in full at the maturity date of the loan.

3 With external longer-term borrowing reducing, the Council has used the Local Council loan market to delay entering into more costly debt, generating savings. The deferral of further borrowing costs through internal borrowing and policy amendments have provided substantial one-off savings to the Council.

4 Effective utilisation of the short-term Local Council loan market has further delayed the need to enter into more costly longer-term loans. At 30th September, the Council had £43 million borrowed via such loans running at an average rate of 2.1%. These temporary, short-dated loans, from other local authorities remain affordable and attractive for periods of low cash flow.

5 Local authorities can borrow from the PWLB provided they can confirm they are not planning to purchase ‘investment assets primarily for yield’ in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 Officer. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing. The Council’s current Capital Programme does not contain schemes that are primarily focussed on a commercial return

6 Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

7 The Public Works Loans Board (PWLB) remains the Council’s preferred source of longer-term borrowing given the transparency and control that its facilities continue to provide.

8 Competitive market alternatives may be available for authorities with or without access to the PWLB. However, the financial strength of the individual Council and borrowing purpose will be scrutinised by commercial lenders.

9 Borrowing options and the timing of such borrowing will continue to be assessed in conjunction with the Council’s treasury advisor.

10 Other Long-Term Liabilities include the schools Private Finance Initiative (PFI) scheme and finance leases used to purchase vehicles, plant and equipment. Under International Financial Reporting Standards (IFRS) these are shown on the Balance Sheet as a Financial Liability and therefore need to be considered within any Treasury Management decision making process.

APPENDIX C

INVESTMENT MANAGEMENT

1 **Table C1: Investment Profile**

Investments with:	**31 Mar 22 £m**	**30 Jun 22 £m**	**30 Sep 22 £m**
UK Banks			
Money Market Funds	46.96	32.74	16.76
Green Energy Bonds	1.50	1.50	1.50
Community Interest Companies	1.50	1.61	1.11
Other Pooled Funds:			
- *Property Funds*	1.00	1.00	1.00
- *Strategic Bond Funds*	1.00	1.00	1.00
- *Public Sector Social Investment Fund*	10.00	10.00	10.00
- *Cash Plus Funds*	5.00	5.00	5.00
TOTAL	**66.96**	**52.85**	**36.37**

2 **Table C2: Investment Sources**

Usable Reserves	**31 Mar 22 £m**	**30 Jun 22 £m**	**30 Sep 22 £m**
General Fund	10.68	10.68	10.68
Earmarked Reserves	104.94	104.94	104.94
Capital Receipts Reserve	6.18	6.25	6.25
Capital Grants Unapplied	40.17	46.82	61.94
	161.97	**168.69**	**183.81**
Internal Borrowing in lieu of External Borrowing	(95.01)	(115.84)	(147.44)
Reserves Invested	**66.96**	**52.85**	**36.37**

3 Security of capital remains the main investment objective. This is maintained by following the counterparty policy set out in the Treasury Management Strategy Statement for 2022/23 which defined high credit quality organisations as those having a long-term credit rating of A- or higher.

4 Counterparty credit quality is assessed and monitored with reference to credit ratings (the Council's minimum long-term counterparty rating for 2022/23 is A- across rating agencies Fitch, S&P and Moody's); Credit Default Swap (CDS) prices, financial statements, information on potential government support and reports in the quality financial press.

5 The following table shows the credit composition of the Council's investment portfolio as at 30th September 2022:

Table C3: Credit Composition of Investment Portfolio

Credit Rating	**Proportion of Portfolio %**
AAA	65
Unrated	35
Total	**100**

Note: *'Unrated' institutions are organisations that despite the absence of a formal rating, are deemed credit worthy due to analysis of their performance over a variety of credit metrics. These institutions are subject to a lower counterparty limit than those with formal credit ratings. Unrated investments at the 30 September 2022 are as follows:*

- £1.11 million credit facility with Edsential – a jointly owed company (Wirral and Cheshire West and Chester Council)
- £10.0 million investment with the Public Sector Social Investment Fund (PSSIF)
- £1.5 million in a Bagnall Green Energy Bond

Both the PSSIF and Bagnall Green Energy bond were subject to external due diligence before funds were invested.

6 The Public Sector Social Impact Fund (PSSIF), in which the Council is invested in, is restricted to Social Impact investments in the UK businesses only, with underlying investments having to demonstrate, either qualitatively or quantitatively, that their products/services improve the lives of UK residents. Within the first half of this year the fund has completed its first investment, into an ethical lending platform. The fund continues to generate opportunities to meet their social impact objectives which are subject to due diligence. It is hoped further transactions will be concluded in the coming months

7 Investments with banks are primarily call accounts and money market deposits. The maximum duration of any new investment was constantly reviewed in line with the prevailing credit outlook during the year as well as market conditions.

8 In keeping with the Department for Levelling Up, Housing and Communities (DLUHC – formerly the MHCLG) Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of Money Market Funds and the use of call accounts.

9 For diversification purposes the Council can invest in a variety of counterparties and financial instruments to help mitigate counterparty and liquidity risks. A summary of the instruments invested in follows:

Table C4: Investment Portfolio – Financial Instruments

Investment Instrument	Proportion of Portfolio %
Money Market Fund	46
Externally Managed Fund	47
Term Deposit	3
Green Energy Bond	4
Total	**100**

10 £17m of the Council's investments are held in externally managed strategic pooled bond, property and cash plus funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds generate an income return which is used to support services in year.

11 The April-September period was a very difficult environment for bonds engendered by global central banks' determination to bring high and persistent inflation under control through increases in policy rates and strong rhetoric. The sell-off in gilts, other sovereign bonds and corporate bonds with a rise in gilt/bond yields (i.e., a fall in price) was reflected in the Council's bond fund.

12 Significant financial market volatility and uncertainty remain due to economic stagflation fears, little sight of the war in Ukraine ending soon and ongoing supply chain issues, a lingering problem over the past 30 months, yet to be fully resolved.

13 As these funds have no defined maturity date, but most are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rates. In light of their performance over the medium to long-term and the Council's latest cash flow forecasts, investment in these funds has been maintained.

14 Currently, fluctuations in the value of the externally managed funds are held on the Council's balance sheet, with the gain or loss recognised in the revenue accounts on exiting the investment. The ability to delay recognising these movements in the revenue accounts is due to expire on 31st March 2023. The Department of Levelling UP, Housing and Communities (DLUHC) is undertaking a consultation to determine whether this statutory override be extended further.

APPENDIX D

TREASURY MANAGEMENT INDICATORS

2022/2023

Background

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

Treasury Management Indicators

1. Security

The Council 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.

Credit risk indicator	Target	As at 30.09.22
Portfolio average credit rating	A	AA-

2. Liquidity

The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount it can borrow each quarter without giving prior notice. As shown below the Council entered into temporary cashflow loans that exceeded the target set in the indicator. This evidences that there are sufficient sources of liquidity available to the Council, should the need arise.

Liquidity risk indicator	Target	As at 30.09.22
Total sum borrowed in past 3 months without prior notice	£10m (Minimum)	£63m

3. Maturity Structure of Borrowing

This indicator is set to control the Council’s exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Maturity Structure of Borrowing	Lower Limit 2022/23 %	Upper Limit 2022/23 %	Actual Maturity 30.09.22 %
Under 12 Months	0	90	67%
12 Months and within 24 months	0	75	2%
24 Months and within 5 years	0	75	8%
5 years and within 10 years	0	75	1%
10 years and over	0	100	23%
		Total	**100%**

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, including LOBO loans, many of which have repayment options every six months. The Council complied with this indicator in the first half of the year.

4. Principal Sums Invested for Periods Longer Than a Year

The Council has placed an upper limit for principal sums invested for periods longer than a year. This limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested.

Price risk indicator	2021/22	As At 30.09.22
Limit on principal invested beyond year end	£50m	£11.5m

APPENDIX E

INTEREST RATE OUTLOOK – ARLINGCLOSE

1 Arlingclose expects Bank Rate to rise further during 2022/23 to reach 5% by the end of the year.

2 The Monetary Policy Committee (MPC) is particularly concerned about the demand implications of fiscal loosening, the tight labour market, sterling weakness and the willingness of firms to raise prices and wages.

3 The MPC may therefore raise Bank Rate more quickly and to a higher level to dampen aggregate demand and reduce the risk of sustained higher inflation. Arlingclose now expects Bank Rate to peak at 5.0%, with 2% of increases this calendar year.

4 This action by the MPC will slow the economy, necessitating cuts in Bank Rate later in 2024.

5 Gilt yields will face further upward pressure in the short term due to lower confidence in UK fiscal policy, higher inflation expectations and asset sales by the Bank of England. Given the recent sharp rises in gilt yields, the risks are now broadly balanced to either side. Over the longer term, gilt yields are forecast to fall slightly over the forecast period

Background:

6 Monetary policymakers are behind the curve having only raising rates by 0.50% in September. This was before the “Mini-Budget,” poorly received by the markets, triggered a rout in gilts with a huge spike in yields and a further fall in sterling. In a shift from recent trends, the focus now is perceived to be on supporting sterling whilst also focusing on subduing high inflation.

7 There is now an increased possibility of a special Bank of England MPC meeting to raise rates to support the currency. Followed by a more forceful stance over concerns on the looser fiscal outlook. The MPC is therefore likely to raise Bank Rate higher than would otherwise have been necessary given already declining demand. A prolonged economic downturn could ensue.

8 Uncertainty on the path of interest rates has increased dramatically due to the possible risk from unknowns which could include for instance another Conservative leadership contest, a general election, or further tax changes including implementing windfall taxes.

9 The government's blank cheque approach to energy price caps, combined with international energy markets priced in dollars, presents a fiscal mismatch that has contributed to significant decline in sterling and sharp rises in gilt yields which will feed through to consumers' loans and mortgages and business funding costs.

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

11 The UK economy already appears to be in recession, with business activity and household spending falling. The short- to medium-term outlook for the UK economy is relatively bleak.

12 Global bond yields have jumped as investors focus on higher and stickier US policy rates. The rise in UK government bond yields has been sharper, due to both an apparent decline in investor confidence and a rise in interest rate expectations, following the UK government's shift to borrow to loosen fiscal policy. Gilt yields will remain higher unless the government's plans are perceived to be fiscally responsible.

13 The housing market impact of increases in the Base Rate could act as a "circuit breaker" which stops rates rising much beyond 5.0%, but this remains an uncertainty.

Arlingclose's Economic Outlook for the remainder of 2022/23

Official Bank Rate	Current	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-24	Sep-25
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%
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%