Corporate Governance, Audit and Standards Committee
28 November 2022

EXECUTIVE HEAD OF FINANCE
REPORT NO: FIN2235

TREASURY MANAGEMENT AND NON-TREASURY INVESTMENT OPERATIONS 2022-23

SUMMARY:
This report sets out the main activities of the Treasury Management and non-Treasury Investment Operations during the first half of 2022-23. Prudential indicators for the 2022-23 financial year have been updated for all treasury management and non-treasury activity during the first half of 2022-23.

RECOMMENDATIONS:
Members are requested to:

(i) Note the contents of this report in relation to the treasury management and non-treasury investment operations carried out during the first half of 2022-23.

1. INTRODUCTION

1.1 This report sets out the Treasury Management and Non-Treasury Investment operations for the first half of the year 2022-23. This report is a statutory requirement under the CIPFA Code of Practice on Treasury Management.

1.2 Full Council originally approved the Annual Treasury Management Strategy and Non-Treasury Investment Strategy for 2022-23 on 24 February 2022. The Council has as part of its proactive treasury management approach, invested substantial surplus cash balances (arising from timing differences between receipts and payments)and is therefore, exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Council's treasury management and non-treasury investment strategies.

2. PURPOSE

2.1 The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management 2017 ("the Code"), which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year. The Code also recommends that members be informed of Treasury Management activities at least twice a year. This report therefore ensures this authority is embracing best practice in accordance with CIPFA's recommendations.

2.2 The appendices (A to C) set out the Treasury Management operations, Non-Treasury Investment Operations and Prudential Indicators for 2022-23 and fulfil key legislative requirements as follows:

Appendix A

- The **Treasury Management operations** which sets out how the Council's treasury service operated during the first half of 2022-23, in accordance with CIPFA's Code of Practice on Treasury Management and Prudential Code;
- The **Treasury Management Borrowing operations** which sets out the Council's borrowing during the first half of 2022-23 in accordance with CIPFA's Code of Practice on Treasury Management, and;
- The **Treasury Management Investment operations** which sets out the Council's Treasury Management investment operations for the first half of 2022-23, in accordance with CIPFA's Code of Practice on Treasury Management.

Appendix B

- The **Non-Treasury Investment operations** sets out the Council's Non-Treasury investment performance for the first half of 2022-23, in accordance with MHCLG Investment Guidance.

Appendix C

- the **Prudential indicators forecast** sets out the forecast prudential indicators position at the end of 2022-23 based on 2022-23 half year position relating to treasury/non-treasury activities and capital financing for 2022-23. Performance is compared to the indicators set out in the Annual Capital Strategy for the year 2022-23.

3 CONCLUSIONS ON THE TREASURY MANAGEMENT AND NON-TRESURY INVESTMENT OPERATIONS DURING 2022-23 TO DATE

3.1 The Council's treasury team continued to concentrate primarily on the security of investments taking due regard for the returns available whilst managing liquidity.

3.2 In relation to borrowing the treasury team continually reviews the borrowing strategy, weighing up interest rate levels and risk of refinancing. During the 2022-23 financial year short-term interest rates have increased and are forecast to increase further. However, borrowing levels have remained the same. All treasury management borrowing decisions are taken with due regard to refinancing risk.

3.3 Total borrowing as at 30 September 2022 is £100m, no change from 31st March 2022 year-end position. Year-end borrowing is forecast to be £118.6mm below estimated levels due to slippage on the capital program. The lower level of borrowing but higher interest rates has resulted in forecast interest cost of borrowing increasing by £0.05m.

3.4 The Council is forecast to have non-treasury investments risk exposure of £134.1 of which £118.6m is funded via external loans.

3.5 Return of non-treasury investments is forecast to be below estimated return for 2022-23 due to the deferral of interest on Farnborough International Loan until June 2023.

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APPENDIX A

TREASURY MANAGEMENT OPERATION FOR FIRST HALF OF 2022-23

1 INTRODUCTION

1.1 The purpose of the treasury management operation is to ensure that cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in counterparties or instruments commensurate with the Council's low risk approach, pursuing optimum performance while ensuring that security of the investment is considered ahead of investment return. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure.

1.2 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 obligations. The management of longer-term cash may involve the arrangement of long and/or short-term loans (external borrowing) or may use longer term cash flow surpluses in lieu of external borrowing (internal borrowing).

2 TREASURY MANAGEMENT ADVICE

2.1 The Council continued to engage the services of Arlingclose for independent treasury advice during the year 2022-23. Arlingclose provide specialist treasury support to 25% of UK local authorities. They provide a range of treasury management services including technical advice on debt and investment management and long-term capital financing. They advise on investment trends, developments and opportunities consistent with the Council's Treasury Management Strategy.

2.2 With the exception of pooled funds all investment activity is carried out by the Council's own treasury team with advice from Arlingclose and having due regard to information from other sources such as the financial press and credit-rating agencies.

2.3 Pooled funds are managed at the discretion of the external fund managers associated with each fund. It should however be noted that whilst the funds are externally managed, the decision as to whether to invest lies solely with the Council in accordance with its Treasury Management Strategy.

2.4 The needs of the Council's treasury management staff for training in investment management are assessed on an ongoing basis and as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. During 2022-23, staff attended relevant workshops provided by Arlingclose and other service providers.

3 EXTERNAL CONTEXT

3.1 The Council's treasury management advisors have provided commentary on the economic background that prevailed during the first half of 2022-23. This commentary is provided at **Appendix D**.

4 LOCAL CONTEXT

4.1 On 30 September 2022, the Council had net borrowing of £100.0m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes for the 2022-23 financial year is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The projected CFR is summarised in **Appendix C**.

4.2 The treasury management position on 30 September 2022 and the change during the year is shown in the table below.

	31-Mar-22 Balance £m	Movement £m	30-Sep-22 Balance £m	30-Sep-22 Rate %
Long-term borrowing	-	-	-	
Short-term borrowing	100.0	-	100.0	0.39
Total Borrowing	**100.0**	**-**	**100.0**	
Long-term investments	(21.9)	-	(21.9)	4.61
Short-term Investments	-		-	
Cash and cash equivalents	(14.8)	4.2	(10.6)	0.02
Total Investments	**(36.7)**	**4.2**	**(32.5)**	
Net borrowing/(investments)	**63.3**	**4.2**	**67.5**	

4.3 **Liability indicator:** To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as CFR, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk.

	31-Mar-22	
	Estimate £m	Forecast £m
Outstanding borrowing	100.0	100.0
Investment MIF	(10.0)	(10.0)
Investments held that can be redeemed	(21.9)	(21.9)
Liability indicator	88.1	88.1

5 BORROWING ACTIVITY IN 2022-23

5.1 As at 30 September 2022 the Council held £100m of loans, no change from the position at 31 March 2022, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 31 March 20203 are summarised in Table 3 below.

	31-Mar-22 Balance £m	Movement £m	30-Sep-22 Balance £m	30-Sep-22 Rate %
Long-term borrowing	-	-	-	-
Short-term borrowing	100.0	-	100.0	0.39
Total Borrowing	**100.0**	**-**	**100.0**	

5.2 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.

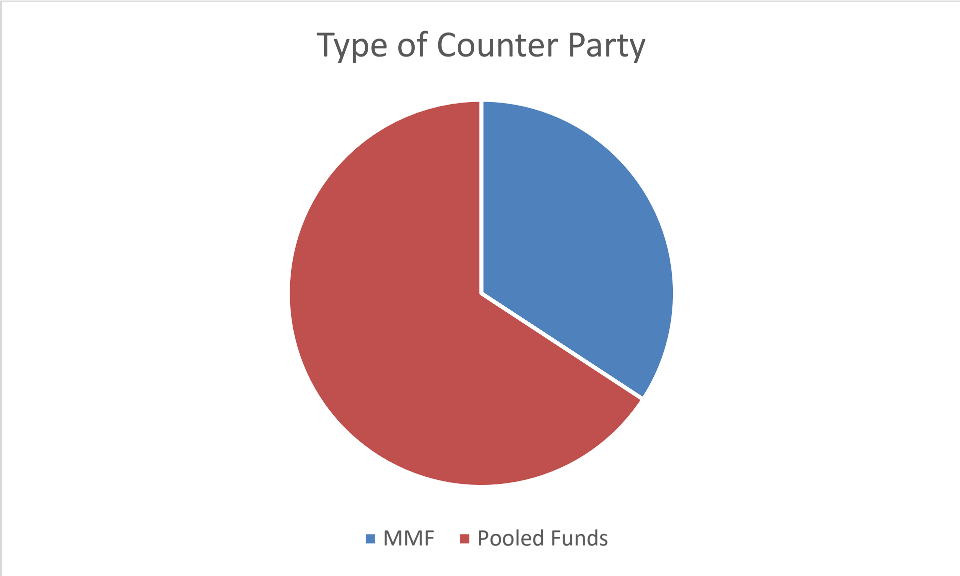
5.3 With short-term interest rates remaining much lower than long-term rates, the Council considers it to be more cost effective in the near term to use short-term loans.

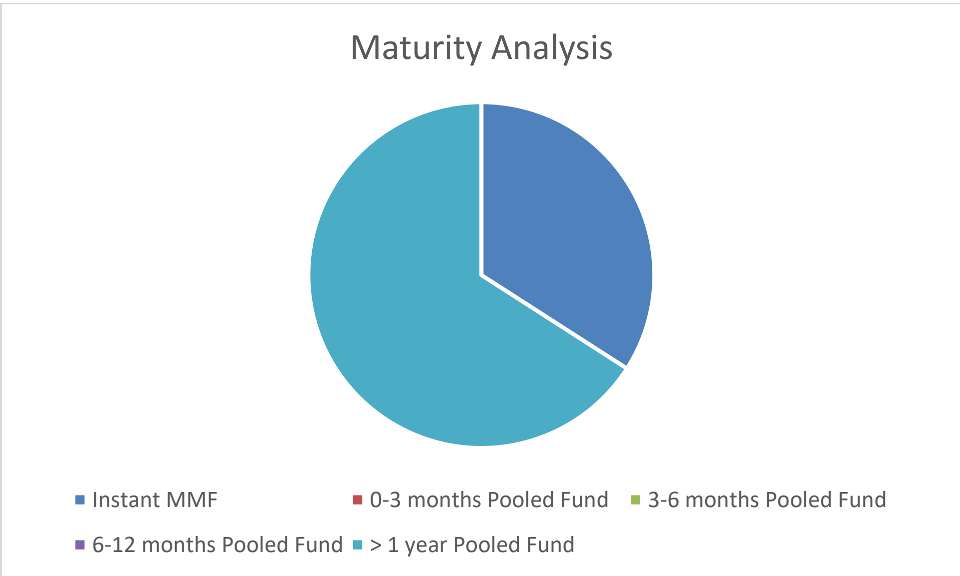
6 INVESTMENT ACTIVITY IN 2022-23

6.1 The Council holds significant invested funds. During the year, the Council's investment position is shown in the table below.

	31-Mar-22 Balance £m	Movement £m	30-Sep-22 Balance £m	30-Sep-22 Rate %
Managed in-house				
Money Market Funds	14.8	(3.4)	11.4	0.02
Managed Externally				
Pooled Funds:				
CCLA LAMIT Property Fund	3.9	-	3.9	3.46
M&G Investments Strategic Corporate Bond Fund	4.0	-	4.0	2.77
UBS Multi Asset Fund	5.0	-	5.0	4.82
Karmes	2.0	-	2.0	5.34
Threadneedle Investments	2.0	-	2.0	2.62
Schroder Income Maximiser	5.0	-	5.0	7.77
Total Investments	**36.7**	**(3.4)**	**33.3**	

6.2 The following chart illustrates the spread of investment by type of investment along with maturity analysis.


Type of Counter Party
MMF
Pooled Funds


Maturity Analysis
Instant MMF
0-3 months Pooled Fund
3-6 months Pooled Fund
6-12 months Pooled Fund
> 1 year Pooled Fund

Maturity Analysis for all Investments	Type of Counter Party	Amount Invested £	% of total Investments
Instant	MMF	11,350,000	34.1
0-3 months	Pooled Fund		-
3-6 months	Pooled Fund		-
6-12 months	Pooled Fund		-
> 1 year	Pooled Fund	21,942,954	65.9
Total for all duration periods		**33,292,954**	

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

6.4 Investment Income Benchmarking: The graph below has been produced by Arlingclose and demonstrates that the Council income only returns on total investment portfolio for the last 12 months up to September 2022 was 3.17%.

The rate of return has been calculated as:
External pooled funds: <u>income only</u> return for the past year, i.e. excluding capital gains and losses.
Other investments: effective interest rate (EIR) of investments held at the quarter end date.

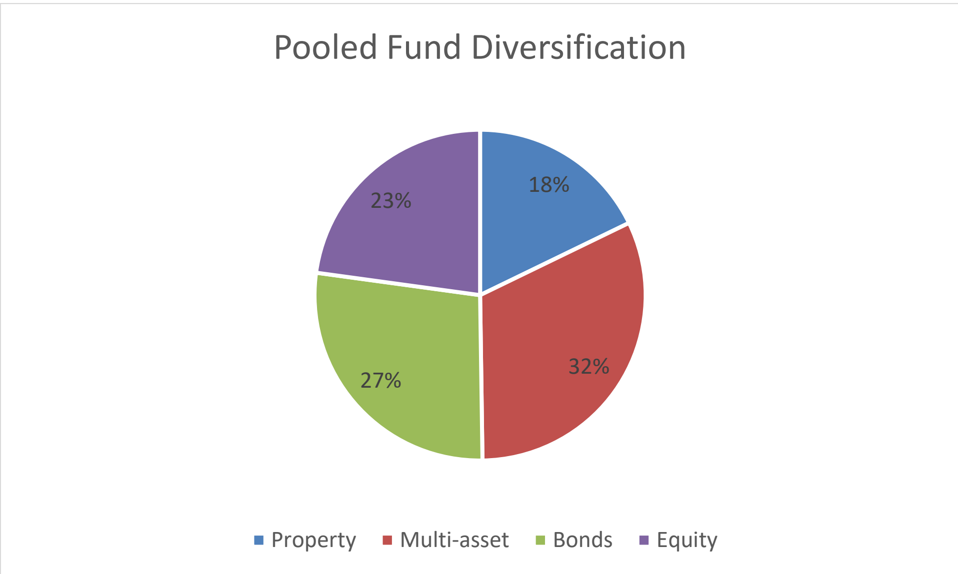
Since investment portfolios change over time, this will not equal your actual rate of return for the past year, but is a snapshot of current returns.

6.5 The table below shows the credit score and rating of the council's investments.

	Credit Score	Credit Rating	Bail-in Exposure
31-Mar-22	4.97	A+	100%
30-Sep-22	4.96	A+	100%
Similar LAs	**4.34**	**AA-**	**57%**
All LAs	**4.29**	**AA-**	**55%**

External Strategic Pooled Funds

6.6 £21.9m of the Council's investments are held in externally managed strategic pooled equity, multi-asset, bond and property funds where short-term security and liquidity are lesser considerations, and objectives are regular revenue income and long-term price stability. The pooled fund portfolio has generated an average total return during the first half of 2022-23 of (7.98)%. Capital returns have decreased by 10.25%. A summary of returns and diversification is set out below.



Type of Pooled Fund	Amount invested £m	% of Total Investments
Property	3.9	18%
Multi-asset	7.0	32%
Bonds	6.0	27%
Equity	5.0	23%
Total	**21.9**	**100%**

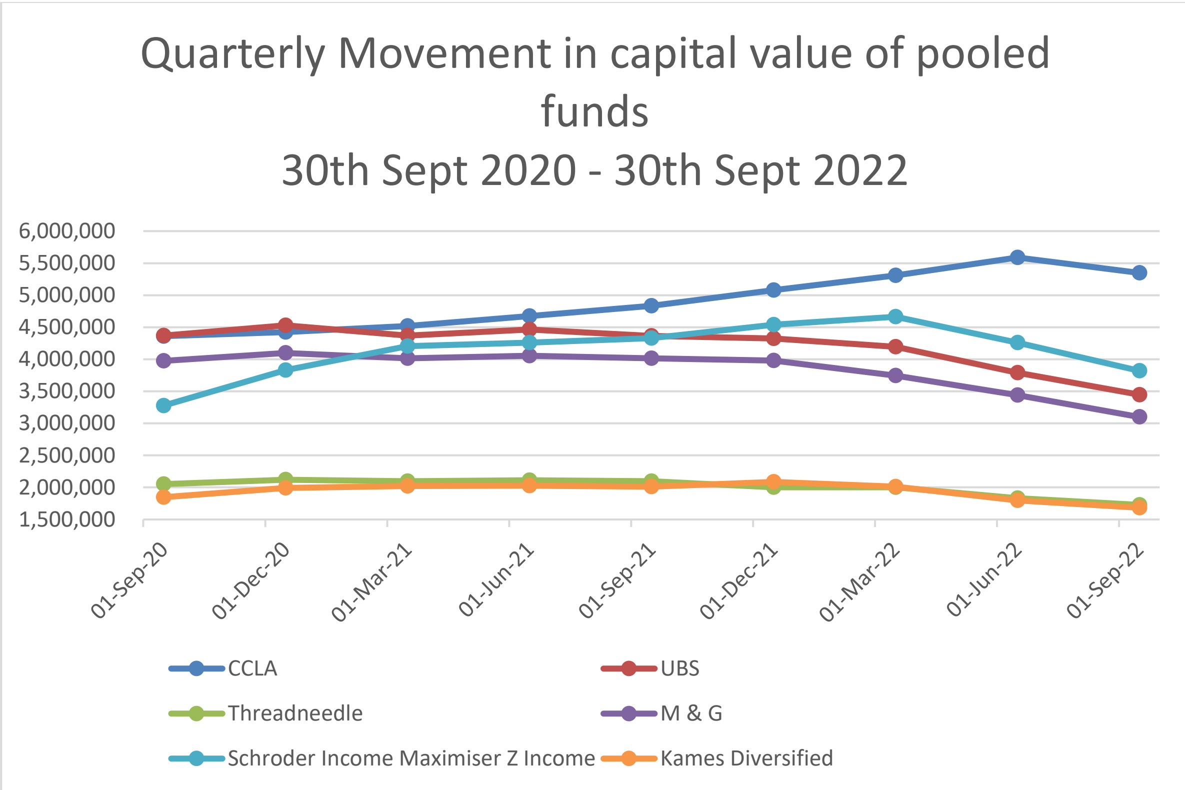
Type of return	2021/22 average return %	2022/23 average return %
Income	2.79	3.71
Capital	3.07	(11.69)
Total Return	**5.86**	**(7.98)**

6.7 As these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives is 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-/long-term and the Council's latest cash flow forecasts, investment in these funds has been increased.

6.8 Details of the Council's investment activity together with returns generated during 2022-23 are outlined as follows:

6.9 **Capital returns** – the Council's pooled fund portfolio has decreased in value during the first half of 2022-23 year. Aggregation of the Council's pooled funds resulted in an overall decrease in fair value for the first half of the year 2022-23 of £2.6m (an aggregate increase of 11.7% of overall pooled funds invested).

6.10 There is variation in performance across the portfolio over the last two years as shown below.



6.11 **Income Returns** – The income returned by fund for the period to 30 September 2022 is analysed below:

- CCLA's Local Authorities' Mutual Investment Trust - £3.9 million investment at commencement of the year. The Property Fund is designed to achieve long-term capital growth and income from investments in the commercial property sector. The fund has returned 3.46% annualised income during 2022-23.

- UBS Multi-Asset Income Fund - £5 million investment. This fund follows a strategy of reducing volatility exposure levels by spreading investments across a diversified range of asset classes. This fund has returned 4.82% annualised income during 2022-23.

- Threadneedle Strategic Bond Fund - £2 million investment. The fund aims to provide income and capital appreciation through investment grade and high yield bonds. This fund has returned 2.62% annualised income during 2022-23

- M & G Corporate Bond Fund - £4m investment. This fund aims for a target total return of 3-5% from a combination of investment income or capital appreciation. This fund has returned 2.77% annualised income during 2020/221.

- Schroder Income Maximiser Fund - £5m investment made in December 2018. The fund aims to provide both income and capital growth, delivering a target income of 7.77% per annum. The fund has returned 6.78% annualised during 2022-23.

- Kames Diversified Monthly Income Fund - £2m investment made in February 2019. The fund aims is to provide income with the potential for capital growth over the medium term. The fund has returned 5.343% annualised during 2022-23.

7 TREASURY MANGEMENT COMPLIANCE PERFORMANCE

7.1 The Council measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates.

7.2 **Compliance -** The Chief Finance Officer reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy with the exception of current account balance limits.

7.3 Compliance with specific investment limits is demonstrated in the table below.

	30-Sep-22 Actual £m	2022-23 Limit £m	Complied ?
Any group of pooled funds under the same management	21.9	25.0	Yes
Money Market Funds	11.4	25.0	Yes

8 TREASURY MANAGEMENT INDICATORS

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

8.2 **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.

	30-Sep-22 Actual	2022-23 Target	Complied ?
Portfolio average credit rating	A+	A-	Yes

8.3 **Liquidity:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount it can borrow each period without giving prior notice.

	30-Sep-22 Actual £m	2022-23 Target £m	Complied ?
Total sum borrowed in past 3 months without prior notice	-	1.0	Yes

8.4 **Interest Rate Exposures**: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

	30-Sep-22 Actual £m	2022-23 Limit £m	Complied ?
Upper limit on one-year impact of a 1% **rise** in interest rates	0.4	0.5	Yes
Upper limit on one-year impact of a 1% **fall** in interest rates	0.3	0.5	Yes

8.5 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

8.6 **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 all borrowing were:

	30-Sep-22 Actual %	2022-23 Upper Limit %	 Lower Limit %	Complied ?
Under 12 months	100	100	-	Yes
12 months and within 24 months	-	100	-	Yes
24 months and within 5 years	-	100	-	Yes
5 years and within 10 years	-	100	-	Yes
10 years and above	-	100	-	Yes

8.7 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.

8.8 **Principal Sums Invested for Periods Longer than a year:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2022-23 £m	2021-22 £m	2020-21 £m
Actual principal invested beyond year end	21.9	21.9	21.9
Limit on principal invested beyond year end	90.0	90.0	90.0
Complied	Yes	Yes	Yes

8.9 **Total Investment Yield:** The Council’s revised estimates regarding investment yields and costs compared to the actual outturn for 2020/201 is shown in the table below.

Budgeted income and outturn	**2022-23**		**Variance**
	Budget £m	**Forecast £m**	**£m**
Interest receivable	(1.46)	(1.32)	0.15
Interest payable	1.25	1.75	0.50
Net amount	**(0.21)**	**0.44**	**0.65**

APPENDIX B

NON-TREASURY INVESTMENT OPERATIONS FOR FIRST HALF OF 2022-23

1 INTRODUCTION

1.1 The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

1.2 The purpose of non-treasury investment management operations is to ensure that all investment decisions that are made primarily to generate a profit have a suitable level of security and liquidity. Ensuring risks and rewards are monitored regularly.

1.3 The second main function of investment management is to generate potential returns and monitor performance of returns on a regular basis.

1.4 The Council also holds £134.5m of such investments at as 30 September 2022 in:

- directly owned property £126.6m
- loans to local businesses and landlords £6.7m
- loans to subsidiaries and partnerships £1.2m

2 PROPORTIONALITY

2.1 The Council is dependent on profit generating investment activity to achieve a balanced revenue budget. The table below shows the forecast proportion of gross service expenditure funded by investment activity.

	2021-22	2022-23	
	Actual £m	Estimate £m	Forecast £m
Gross Service Expenditure	58.9	64.9	64.9
Investment Income	8.8	9.2	9.2
Proportion	14.9%	14.2%	14.2%

3 SERVICE IMPROVEMENT LOANS

3.1 The Council lends money to its subsidiaries, local businesses, and its employees to support local public services and stimulate local economic growth. The Council is a funding partner of Farnborough International Limited. The loans have enables to development of the Farnborough International exhibition and conference centre. Expanding the exhibition and conferencing capabilities in Farnborough brings increased economic capacity to the Borough and is a reinvestment in local business.

3.2 The Council performance and upper limits on the outstanding loans to each category of borrower have been set as follows:

Category of Borrower	**2020/21 Approved Limit £m**	**2020/21 Actual £m**
Local businesses	6.7	6.7
Subsidiaries & Partnerships	3.5	1.2
Employees	0.1	0.1
Total	**10.3**	**8.0**

Service loans have generated a lower return for the Council during the first 6 months of 2022-23 financial year due to the postponement of loan interest to local businesses

4 SERVICE INVESTMENTS: SHAREHOLDING IN SUBSIDIARIES

4.1 The Council invests in the shares of its subsidiary and holds a financial share in a development partnership and Rushmoor Homes to support local public services and stimulate local economic growth.

5 COMMERCIAL INVESTMENT: PROPERTY

5.1 The Council invests in local and regional commercial and residential property with the intention of making a profit that will be spent on local public services. The forecast transactions during 2022-23 will decrease the overall portfolio to £107.4m as outline in table 4 below.

Property by Type	2022 Carry Forward	2022/23 transactions		
		Purchase Cost	Sales	Year end value
Mixed Use	4.5	-		4.5
Industrial Units	24.3	-	(0.6)	23.7
Retail	49.9	-		49.9
Offices	29.3	-		29.3
Total	**108.0**	**-**	**(0.6)**	**107.4**

5.2 Commercial property investments generated £1.1m of net investment income in the first half of the year for the Council after taking account of direct costs, cost of borrowing and Minimum Revenue Provision (MRP)

6 NON-TREASURY INVESTMENT INDICATORS

6.1 The Council measures and manages its exposures to non-treasury investment risks using the following indicators.

6.2 **Total risk exposure:** This indicator shows the Council's total exposure to potential investment losses. This includes amounts the Council is contractually committed to lend but have yet to be drawn down and guarantees the Council has issued over third-party loans.

Total Investment Exposure	31-Mar-23 Estimate £m	31-Mar-23 Forecast £m
Treasury Management Investments	23.9	26.9
Service Investments: Loans	14.5	8.0
Service Investments: Shares	0.6	-
Commercial Investments: Property	123.7	126.1
Total Investment	**162.7**	**161.0**
Commitment to lend	2.9	-
Total Exposure	**165.6**	**161.0**

6.3 **How investments are funded:** Government guidance is that these indicators should include how investments are funded. Since the Council does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as being funded by borrowing. The remainder of the Council's investments are funded by usable reserves and income received in advance of expenditure.

Investments funded by borrowing	31-Mar-23 Estimate £m	Actual £m
Treasury Management investment	-	-
Service Investments: Loans	9.1	8.0
Service Investments: Shares	0.6	-
Commercial Investments: Property	90.3	110.6
Total Funded by Borrowing	**100.0**	**118.6**

6.4 **Rate of return received:** This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Investments rate of return (net of all costs)	31-Mar-23 Estimate %	Actual %
Treasury Management investment	4.0	4.6
Service Investments: Loans	0.2	5.5
Service Investments: Shares	-	-
Commercial Investments: Property	2.6	2.6

6.5 The above table shows a forecast reduction in Treasury management investments and Service Investment Loans net of all finance costs in 2022-23. This is due to the economic downturn as a result of COVID-19. Commercial Property shows a forecast improvement in return net of all finance costs in 2022-23. This is due to the reduced cost of borrowing as a result of lower bank of England interest rates..

APPENDIX C

PRUDENTIAL INDICATORS

1.1 **Prudential Indicators:** The following indications are required by the CIPFA "Prudential Code" 2017 edition

1.2 **Estimates of Capital Expenditure:** The Council's planned capital expenditure and financing may be summarised as follows.

	2022-23	
	Budget £m	**Forecast £m**
General Fund services	40.0	27.9
Total	**40.0**	**27.9**
External Sources	8.9	8.9
Own Resources	1.0	0.4
Debt	30.1	18.6
Total	**40.0**	**27.9**

1.3 Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue, which is known as minimum revenue provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP and use of capital receipts are as follows:

	2022-23	
	Budget £m	**Forecast £m**
Own Resources	3.2	2.5

1.4 **Estimates of Capital Financing Requirement:** The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose.

	2022-23	
	Budget £m	**Forecast £m**
General Fund services	170.7	143.0
Minimum Revenue Provision	(3.2)	(2.5)
IFRIC 4 Lease Adjustment	(0.3)	(0.3)
Total CFR	**167.2**	**140.2**

1.5 **Gross Debt and the Capital Financing Requirement:** In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

	2022-23	
	Budget £m	**Forecast £m**
Debt (inc. leases)	155.6	120.5
Capital Financing Requirement	167.2	140.2
Difference	11.6	19.7

1.6 **Affordable borrowing limit:** The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year. In line with statutory guidance, a lower “operational boundary” is also set as a warning level should debt approach the limit.

	2022-23	
	Budget Limit £m	**Forecast Limit £m**
Authorised Limit - total external debt	200.8	200.8
Operational Boundary - total external debt	195.8	195.8

APPENDIX D

Market commentary regarding the year 2022-23 from the Council's treasury management advisors Arlingclose

External Context

Economic commentary

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.

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

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

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

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

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

The Bank of England increased the official Bank Rate to 2.25% over the period. From 0.75% in March, the Monetary Policy Committee (MPC) pushed through rises of 0.25% in each of the following two MPC meetings, before hiking by 0.50% in August and again in September. August's rise was voted by a majority of 8-1, with one MPC member preferring a more modest rise of 0.25%. the September vote was 5-4, with five votes for an 0.5% increase, three for an 0.75% increase and one for an 0.25% increase. The Committee noted that domestic inflationary pressures are expected to remain strong and so given ongoing strong rhetoric around tackling inflation further Bank Rate rises should be expected.

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.

Bank of England policymakers noted that any resulting inflationary impact of increased demand would be met with monetary tightening, raising the prospect of much higher Bank Rate and consequential negative impacts on the housing market.
After hitting 9.1% in June, annual US inflation eased in July and August to 8.5% and 8.3% respectively. The Federal Reserve continued its fight against inflation over the period with a 0.5% hike in May followed by three increases of 0.75% in June, July and September, taking policy rates to a range of 3% - 3.25%.

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

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

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

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

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

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

Having completed its full review of its credit advice on unsecured deposits at UK and non-UK banks, in May Arlingclose extended the maximum duration limit for five UK banks, four Canadian banks and four German banks to six months. The maximum duration for unsecured deposits with other UK and non-UK banks on Arlingclose's recommended list is 100 days. These recommendations were unchanged at the end of the period.

Arlingclose continued to monitor and assess credit default swap levels for signs of credit stress but made no changes to the counterparty list or recommended durations. Nevertheless, increased market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remains under constant review