worcestershire
countycouncil

CABINET
27 OCTOBER 2022

TREASURY MANAGEMENT MID-YEAR UPDATE TO 30 SEPTEMBER 2022

Relevant Cabinet Member
Mr S E Geraghty

Relevant Officer
Chief Financial Officer

Recommendation

1. **The Cabinet Member with Responsibility for Finance (who is also the Leader of the Council) recommends that Cabinet:**

    (a) notes this report, recognising that the Council is operating within its approved Treasury Management Strategy; and

    (b) endorses his conclusions that the Treasury Management activities continue to be cost effective.

Introduction

2. This mid-year report to 30 September 2022 has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first part of the 2022/23 financial year
- 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 compliance with Treasury and Prudential Limits for 2022/23.

Economic Update

3. The Council's in-house team of qualified finance staff monitor and maintain the Council's Treasury Management activity in line with the Council's Strategy. The Council employs Link Group as its treasury management advisor and officers hold regular meetings with them concerning existing and future potential economic circumstances regarding both investments and short/long-term borrowing.

4. The last two quarters have undergone a significant change in the economic position and outlook. The Country was already experiencing a period of growing inflation and economic impact from the conflict in Ukraine, as well as other global factors such as the strength of the US Dollar whilst others have seen a quickening of monetary policy tightening. Recently the UK has also seen a significant increase in its interest rates, and more rises are forecast by advisors.

5. The Monetary Policy Committee (MPC) - Bank of England Monetary Policy Report August 2022 has stated that the UK is in for five quarters of recession starting in Quarter 4 2022 and running all the way through to the end of 2023. In the interim, it is projected that CPI inflation will exceed 11% in Quarter 4 2022. Half of this increase can be attributed directly to gas/electricity price inflation and a further 2% - 2.5% to the indirect knock-on effects of higher energy on production/services.

6. A Government "mini-budget" took place on 23 September 2022 followed by a further Chancellor's Statement to the House of Commons issued on the of 17th October 2022. The Government has announced that the OBR will scrutinise their spending plans and in the Statement on 31st October. At this stage therefore it is too soon to assess the impact this will have on our Treasury Management Policy or funding for the Council. Further updates will thus be given to Cabinet it is expected in November 2022 and January 2023.

7. In putting together our interest rate forecasts it is worth noting that should US inflation continue to be high for a longer period (currently the CPI reading is 8.8%) and the jobs reports continue to be on the upside (315,000 new jobs reported in August and unemployment at near to a record low of 3.7%), there is the prospect that any downward momentum in UK yields could be offset by Treasury yields shifting higher. Conversely, yield falls could also be supported by the Fed's determination to get inflation down in the US through robust monetary policy tightening.

8. Regarding gilt yields, these have been increasing since the turn of the year, but that march has been accompanied by significant bouts of volatility that have sometimes been not only hard to explain but also difficult to predict, including the direction of travel. Our best judgment is that gilt yields across the curve have a little further to rise but only by 20 – 30bps, so a lower peak than our advisers were forecasting back in June.

9. Further down the road, our advisors anticipate the Bank of England will be keen to loosen monetary policy when we should see inflation fall, but that timing will be one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and the forecast recession may be prolonged.

10. The CPI measure of inflation our advisors and the MPC suggest will peak at upwards of 11% in Q4 2022 with the MPC noting the influence gas/electricity price increases have on this number, and whether wages data is normalising. Currently wages are rising at above 5.2%, excluding bonuses, and above 5.5%, including bonuses. Despite the cost-of-living squeeze that is still taking shape, the Bank will want to see evidence that wages are not spiralling upwards in what is evidently a very tight labour market, where employers are out-bidding each other to ensure they have the pick of a limited labour pool.

11. A consequence of all of that has seen PWLB rates fluctuate. Since our last update and PWLB 5 to 50 years Certainty Rates are, generally, in the range of 4.1% to 4.4%. Although, without the Bank of England intervening to start a form of additional Quantitative Easing, targeting long term gilt yields, we could have been seeing rates of between 5% and 6%.

12. We view the markets have now built in already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the poor inflation outlook. But the situation is still very volatile.

13. Overall therefore the balance of risks to economic growth in the UK is to the downside at this stage which we feel will see a period of rising interest rates.

Interest Rate Forecast

14. The Council's treasury advisor, Link Group, has provided the following forecast in Table 1 below:

Table 1: Interest Rate View – Link Group

Link Group Interest Rate View	27.09.22											
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
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
5 yr 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
10 yr 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
25 yr 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
50 yr 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

15. **Link Group Borrowing advice**: Our long-term (beyond 10 years) forecast for Bank Rate stands at 2.5%. As all PWLB certainty rates are now above this level, borrowing strategies will need to be reviewed in that context. Better value can generally be obtained at the shorter end of the curve and short-dated fixed LA to LA monies should be considered. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive whilst the market waits for inflation, and therein gilt yields, to drop back later in 2023**.**

Council's Investment Portfolio as at 30 September 2022

16. 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. The continuing war in Ukraine and subsequent cost of living crisis caused by high energy costs, high inflation, and the anticipation that the UK could be entering a recession and uncertainty concerning calls on the Council's cash, prompts a low risk and short-term strategy.

17. We tend to hold investments with the Debt Management Office (DMO), which is part of HM Treasury, as well as highly rated Money Market Funds, highly rated bond funds and with our bank, Barclays. In addition, from time to time, when the Cashflow Forecast indicates that our cash balances will support it we place investments of up to 1 year with other local authorities.

18. There has been significant press coverage around some local authorities, who have taken these types of deposits and used them to fund their own longer-term commercial investments, some of which have been less than successful. CIPFA has now updated its Prudential Guidance to attempt to minimise this risk going forward. Worcestershire is following this guidance and practice.

19. As security of funds is the first key element of our investment strategy it should be noted that to date, none of these authorities have defaulted on their debt (our investment is their debt). In all cases the UK Government has stepped in to provide support and liquidity. There is no reason to believe that this situation will change, and therefore most Local

Authorities will be rated on a par with the UK Government by rating agencies. To date all of Worcestershire CC's investments have been repaid with full interest.

20. Against this backdrop, the Council held £45.6 million of investments as at 30 September 2022 (£62.7 million at 31 March 2022) and the investment portfolio yield for the first 6 months of the year is 0.94% against a benchmark (7-day LIBID) of 0.06%. Gross income from treasury investments for the first 6 months of the financial year was £0.2 million, which is equal to 73% of the target for the whole financial year. (Details of Investments held as at the end of September can be found in Appendix 2).

Council's Borrowing Strategy as at 30 September 2022

21. The Council's borrowing activity for the first 6 months of the financial year can be summarised as follows:

    a) £20m of new loans were taken between 1 April and 30 September 2022.
    b) £12.5 million of debt matured between 1 April and 30 September 2022.
    c) There was £492.3 million of debt outstanding as at 30 September 2022 at an average rate of 3.279%. this included £32.5m of debt taken to support Pension Prepayments, that is due to mature by March 2023.

22. Whereas the Council has previously relied on the PWLB as its main source of funding, with a potential change in rates forecast it will now need to consider alternative cheaper sources of borrowing.

23. There is a very active Local Authority to Local Authority market, which provides the opportunity to borrow short term (1 month to 3 years) from other Local Authorities, at rates which are lower than those available from the PWLB.

24. As an authority we should always be mindful that the underlying purpose of our borrowing requirement is to help fund the Capital Programme, which generally includes the creation or improvement of assets with asset lives of between 5 and 50 years. It is therefore best practice to seek out borrowing on a similar basis. However, when revenue budgets are tight it is also important to identify ways in which we can minimise debt interest costs. Provided it is carried out in moderation, borrowing a proportion of the debt pool on a short-term basis can provide interest cost savings, without exposing the authority to excessive liquidity and interest rate risk.

25. It is important to differentiate between: -

    - the underlying need to borrow which is assessed through the Capital Strategy, Capital Programme and Treasury Management Strategy Statement, which consider and include, cost benefit analysis, asset value assessments, due diligence, and affordability considerations amongst other factors, and

    - sources of finance, be those PWLB, Banks, other Local Authorities, which are assessed on credit rating, reliability, and interest rates.

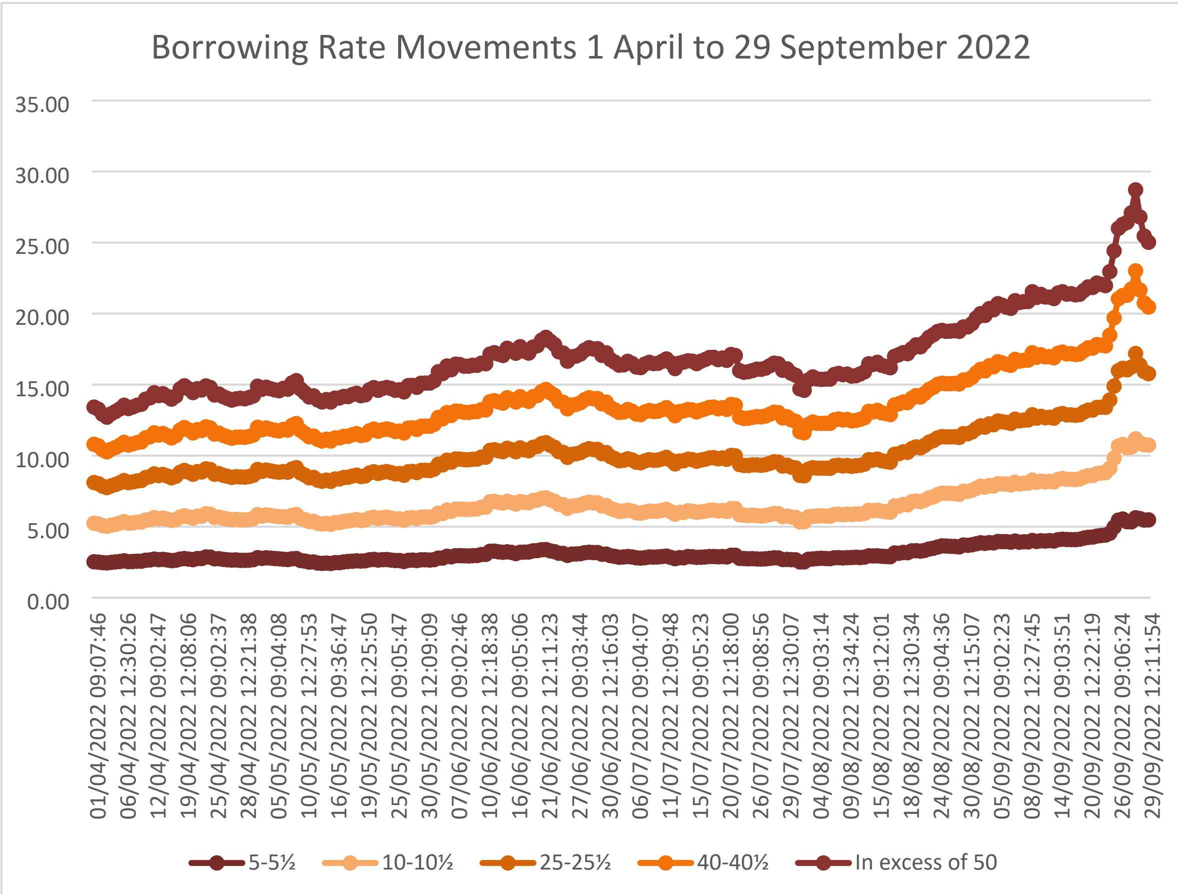
26. It is possible that the Municipal Bond Agency will be offering loans to the wider local authorities' market in the future. This Authority may make use of this new source of borrowing as and when appropriate.

27. The Authority also minimises debt costs by delaying the externalisation of its debt. This is known as internal borrowing or under borrowing. The Authority effectively manages down its cash and investment balances before seeking to take on further external debt. This strategy is highly effective at reducing interest costs (especially as borrowing rates tend to be higher than investment rates, which creates a cost of carry for the Authority), however, at some point, if the planned capital expenditure takes place, or the reserves balances fall, the cash and investments alone cannot fund it. At that point further external debt is taken. As an Authority we manage our cash flow with great care and attention, to minimise the liquidity and interest rate risks involved in applying this strategy, whilst maximising revenue savings.

28. Further detail of Council Debt as at the 30 September 2022 can be found in Appendix 3.

29. Borrowing rate estimates provided by our Treasury Advisers for this Financial Year to date can be seen in the following chart and reflect the steady rise in rates so far.

Chart 1: borrowing rates 1 April to 30 September 2022



Compliance with Treasury and Prudential Limits for 2022/23

30. Original and latest projections for external debt and the Capital Financing Requirement, against the Operational Boundary and Authorised Limit are shown in Table 2 below:

Table 2: Prudential Indicator Monitoring

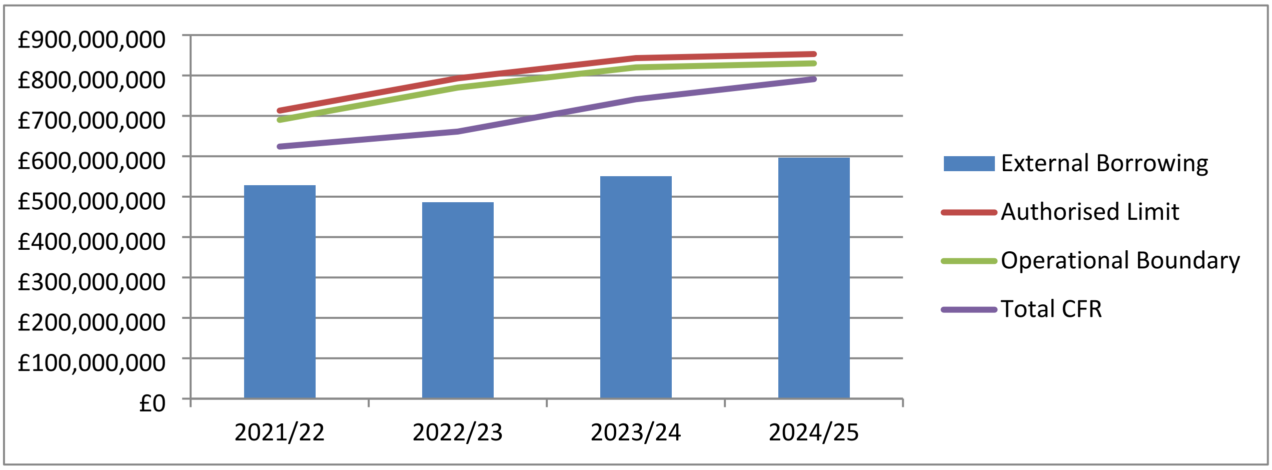
	2022/23 Original Estimate £m	**Current Position £m**	**2022/23 Revised Estimate £m**
Prudential Indicator – Capital Financing Requirement	**Prudential Indicator – Capital Financing Requirement**	**Prudential Indicator – Capital Financing Requirement**	**Prudential Indicator – Capital Financing Requirement**
CFR	**748.2**	**741.1**	**741.1**
Prudential Indicator – the Operational Boundary for external debt	**Prudential Indicator – the Operational Boundary for external debt**	**Prudential Indicator – the Operational Boundary for external debt**	**Prudential Indicator – the Operational Boundary for external debt**
Borrowing	770.0	760.0	760.0
Other long term liabilities	10.0	10.0	10.0
Total	**780.0**	**770.0**	**770.0**
Prudential Indicator – the Authorised Limit for external debt	**Prudential Indicator – the Authorised Limit for external debt**	**Prudential Indicator – the Authorised Limit for external debt**	**Prudential Indicator – the Authorised Limit for external debt**
Borrowing	790.0	780.0	780.0
Other long term liabilities*	13.0	13.0	13.0
Total	**803.0**	**793.0**	**793.0**
Total debt (year end position)	**550.3**	**492.3**	**585.0**

31. The Council is well within the Limits for outstanding debt and is projected to remain so for 2022/23.

32. The following table, Table 3, shows the relationship between the Authority's Capital Financing Requirement (CFR - which is the past and future capital expenditure which will be funded through borrowing), the Approved Limit, Operational Boundary and External Borrowing.

33. It clearly shows that the projected path of existing external debt remains within both the limits and the CFR.

Table 3: Relationship between External Debt, CFR and Approved Limits



34. The following table, Table 4, shows the extent to which the CFR has been externalised to date: -

Table 4: Breakdown of Debt

Financial Year	2020-21 Actuals (£m)	2021-22 Actuals (£M)	2022-23 Estimates (£M)	2023-24 Estimates (£M)	2024-25 Estimates (£M)
CFR	624	661	741	791	800
External Debt	528	486	585	597	603
% of CFR	84.59%	73.54%	78.95%	75.46%	75.32%
Internal Debt	96	175	156	194	198
% of CFR	15.41%	26.46%	21.06%	24.54%	24.68%

35. This shows the extent to which external debt has been avoided, however, it does rely on utilising cash backed reserves and investment balances being used. Therefore, should cash backed reserves fall, or cash balances fall, then external borrowing, or reduced expenditure will be required.

36. As mentioned in Paragraph 30 above, borrowing is usually taken to support the Capital Programme and its creation/purchase/improvement of long-term assets. As such you would expect to see a Debt Maturity Profile skewed towards the long end. As you can see below, the Authority has exactly that type of profile.

37. The Maturity Profile for the Council's debt compared with the prudential indicators for the Maturity Structure of Borrowing as at the 30 September 2022 is in Table 5 below:

Table 5: The Maturity Profile for the Council's debt as forecast at 31/03/23

Maturing within	£m	% of Total Debt	% Lower/Upper Limit for Debt
1 year	10.0	1.71	0-25
1 – 2 years	45.766	7.82	0-25
2 – 5 years	27.876	4.76	0-50
5 – 10 years	28.937	4.95	0-75
10 years and over	472.453	80.76	25-100
Total	**585.032**	**100.0**	

38. The Council remains comfortably within its limits for the Maturity Structure of Borrowing and is anticipated to remain so for the foreseeable future.

39. The Chief Financial Officer and the Cabinet Member with Responsibility for Finance confirm that the management of debt and short-term investments continues to be cost effective.

Legal Implications

40. Legal advice will be provided to support any changes in service delivery in accordance with the requirements of the Council's policies and procedures.

Financial Implications

41. Members are required under Section 25 of the Local Government Act 2003 to have regard to the Chief Financial Officer's report when making decisions about the budget calculations for each financial year. This is undertaken through the approval of the annual budget in February each year.

42. Section 25 of the Act also covers budget monitoring and this process monitors the robustness of budgets, adequacy of reserves and the management of financial risk throughout the year. This Cabinet report highlights forecast variances arising from current financial performance and the possible impact of existing pressures on future expenditure so that appropriate action may be taken.

43. In discharging governance and monitoring roles, Members are asked to consider the issues arising and the potential impact on the budget as well as the financial risks arising.

44. The Council's procedures for budget monitoring is reinforced through close financial support to managers and services on an ongoing basis to ensure processes and controls are in place to enable tight financial control.

HR Implications

45. There are no HR considerations as Council's treasury management budgets are operational financial budgets and do not include any staffing costs. Further, there are no

proposals to alter any staffing arrangements employed in the management of these services.

Equality Duty Considerations

46. The Council will continue to have due regard to proactively addressing the three elements of the Public Sector Equality Duty in all relevant areas – in particular the planning and delivery of our services. The Council will continue to assess the equality impact of all relevant transformational change programmes and will ensure that Full Council has sufficient equalities assessment information to enable it to have due regard to the three elements of the Equality Duty when considering any changes to the budget. The Council will continue to ensure best practice is followed regarding these requirements.

Risk Implications

47. The Cabinet report includes recommendations regarding endorsing the Council's activity to date for 2022/23 which specifically relates to managing interest rate risk and any risk of default in repayment of investments.

Privacy and Public Health Impact Assessment

48. This report is about confirming the treasury management activity at this stage of the year reflecting the cash implications of existing Cabinet decisions and policies.

49. Taking this into account, it has been concluded that there are no specific health impacts because of new decisions arising from this Cabinet report.

50. A similar assessment has been undertaken regarding privacy/data protection and has confirmed that there is no impact anticipated as a result of this report.

Supporting Information (available electronically)

- **Appendix 1 –** Treasury and Prudential Indicators as at 30 September 2022
- **Appendix 2** – Investment Portfolio as at 30 September 2022
- **Appendix 3** – Borrowing Portfolio as at 30 September 2022

Contact Points

Specific Contact Points for this Report

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Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) the following are the background papers relating to the subject matter of this report:

Previous Cabinet Resources Reports