

Report to: **Audit and Governance Committee**
Date: **9 March 2023**
Title: **Treasury Management Mid-Year Review**
Portfolio Area: **Cllr H Bastone – Finance and Assets**
Wards Affected: **All**
Urgent Decision: **N** Approval and clearance obtained: **Y**
Date next steps can be taken: **N/A**

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RECOMMENDATION:

It is RECOMMENDED that the Audit Committee resolves to endorse the contents of the report.

1. Executive summary

1.1 As at 30 September 2022, the Council underperformed against the industry benchmark by 0.05%. The Council achieved a rate of return of 1.14%, against the Sterling Overnight Interbank Average (SONIA) rate of 1.19% at the mid-year point. The Council's budget for investment interest in 2022/23 is £123,000. The current forecast is £1,000,000 which will exceed the budget by £877,000 and therefore the year end position is looking very healthy against budgeted income levels.

2. Background

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

2.2 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 operations.

This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses.

2.3 Treasury management is defined as:

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

2.4 The Council’s Finance Procedure Rules require that a report be taken to the Audit Committee three times a year on Treasury Management. The specific reporting requirements are:

- An annual treasury strategy in advance of the year (Council 31/03/2022 – 76/21)
- A mid-year (minimum) treasury update report (This report)
- An annual review following the end of the year describing the activity compared to the strategy

2.5 The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that Members be updated on treasury management activities regularly (i.e. Treasury Management Strategy Statement (TMSS), annual and midyear reports). This report therefore ensures this Council is implementing best practice in accordance with the Code.

3. Interest Rates

Interest Rate Forecast

3.1 The Council’s treasury advisor, Link Group, has provided the following forecast.

Link Group Interest Rate View		07.02.23											
	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26
BANK RATE	4.25	4.50	4.50	4.25	4.00	3.75	3.25	3.00	2.75	2.75	2.50	2.50	2.50
3 month ave earnings	4.30	4.50	4.50	4.30	4.00	3.80	3.30	3.00	2.80	2.80	2.50	2.50	2.50
6 month ave earnings	4.40	4.50	4.40	4.20	3.90	3.70	3.20	2.90	2.80	2.80	2.60	2.60	2.60
12 month ave earnings	4.50	4.50	4.40	4.20	3.80	3.60	3.10	2.70	2.70	2.70	2.70	2.70	2.70
5 yr PWLB	4.00	4.00	3.90	3.80	3.70	3.60	3.50	3.40	3.30	3.20	3.10	3.10	3.10
10 yr PWLB	4.20	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.50	3.40	3.30	3.30	3.20
25 yr PWLB	4.60	4.60	4.40	4.30	4.20	4.10	3.90	3.80	3.70	3.60	3.50	3.40	3.40
50 yr PWLB	4.30	4.30	4.20	4.10	3.90	3.80	3.60	3.60	3.40	3.30	3.20	3.20	3.10

3.2 The Bank Rate stands at 4.0% currently but as shown in the forecast table above, it is expected to reach a peak of 4.5% during the first half of 2023.

3.3 Further down the road, we anticipate the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures are behind us – but that timing will be one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.

3.4 In the upcoming months, our forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but the on-going conflict between Russia and Ukraine. (More recently, the heightened tensions between China/Taiwan/US also have the potential to have a wider and negative economic impact.)

3.5 On the positive side, consumers are still estimated to be sitting on over £160bn of excess savings left over from the pandemic so that will cushion some of the impact of the above challenges. However, most of those are held by more affluent people whereas lower income families already spend nearly all their income on essentials such as food, energy and rent/mortgage payments.

3.6 **PWLB rates** – The yield curve movements have become less volatile of late and PWLB 5 to 50 years Certainty Rates are, generally, in the range of 4.10% to 4.60%.

4. Treasury Management Strategy Statement

4.1 The Treasury Management Strategy Statement (TMSS) for 2022/23, was approved by the Council on 31/03/22 – 76/21. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield.

4.2 The Council will also aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with highly credit rated financial institutions, using our suggested creditworthiness approach, including a minimum sovereign credit rating, and Credit Default Swap (CDS) overlay information.

4.3 There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

5. Investment Portfolio 2022/23

5.1 The Council held £54.116m of investments as at 30 September 2022 (£56.52m at 31 March 2022) and the investment portfolio yield for the first six months of the year is 1.14% against a benchmark (SONIA rate) of 1.19%. The £54.116m of investments is made up of Money Market Funds, Fixed Term Deposits and Property Funds.

A full list of investments held as at 30 September 2022 is shown below:

Money Market Funds

Amount £	Investment	Average Interest rate
6,000,000	Aberdeen Standard Investments	1.16%
4,900,000	BlackRock ICS-Inst GBP	1.16%
6,000,000	LGIM Sterling Liquidity Fund	1.08%
16,900,000	Total Money Market Funds	

The Council currently has three Money Market Funds. The money market funds allow immediate access to the Council's funds and spreads risk as it is pooled with investments by other organisations and invested across a wide range of financial institutions.

Fixed Term Deposits – Current

Counterparty	Fixed to	£	Interest Rate
Barclays Banks Plc	19/10/2022	3,500,000	1.06%
Barclays Banks Plc	18/01/2023	2,500,000	2.00%
Standard Chartered	06/01/2023	6,000,000	2.12%
Lloyds Bank Plc	31/03/2023	6,000,000	4.28%
Debt Management Office	24/11/2022	4,700,000	1.55%
Debt Management Office	20/10/2022	3,000,000	1.75%
Debt Management Office	20/10/2022	1,400,000	1.89%
Debt Management Office	04/01/2023	4,000,000	2.45%
Debt Management Office	20/10/2022	2,500,000	1.97%
Total Fixed Term Deposits		33,600,000	

5.2 The Council's Investments mid-way through the year are always higher than at the end of the year (at 31st March) due to the cash flow advantage that the Council benefits from part way through the year.

This is, in part, due to the timing differences between the Council collecting council tax income and paying this over to major precepting authorities such as Devon County Council, the Police and the Fire Authority

The Council's current counterparty limit is £6 million (£7 million for Lloyds plc).

Property Funds

Amount £	Investment	Dividend Yield
1,572,857	CCLA – Property Fund	3.25%
2,032,292	CCLA – Diversified Income Fund	2.39%
3,605,149	Total Property Funds	

5.3 The Chief Financial Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2022/23.

5.4 The Council’s budgeted investment return for 2022/23 is £123,000 and based on performance for the year to date, this is expected to be exceeded by £877,000.

Investment Counterparty Criteria

5.5 The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

Borrowing Position

5.6 The Council’s capital financing requirement (CFR) for 2022/23 is £19.6million. The CFR denotes the Council’s underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.

A summary of the Council’s debt position at 30 September 2022 compared with 31 March 2021 is shown in the table below:

Lender	Maturity	Interest Rate %	Principal held at 31 March 2022 £’000	Principal held at 30 Sept 2022 £’000
PWLB – Maturity Borrowed in May 2018 (23 maturity loans)	5-19 Years	2.41*	5,490	5,490
PWLB – Annuity Borrowed in September 2019	50 Years	1.97	3,879	3,854
PWLB – Annuity Borrowed in December 2019	50 Years	3.09	5,011	4,988
Total			14,380	14,332

*Average interest rate

5.7 Local Authorities are required to submit a summary of their planned capital spending and PWLB borrowing for the following three years. This is updated on at least an annual basis. In March of each year, Council approves its Capital Strategy, Investment Strategy and Treasury Management Strategy. PWLB borrowing is permitted in the future for the four categories of regeneration, service delivery, housing and refinancing.

Debt Rescheduling

5.8 Debt rescheduling opportunities have been very limited in the current economic climate and following the various increases in the margins added to gilt yields which have impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

6. Outcomes/outputs

6.1 Industry performance is judged and monitored by reference to a standard benchmark; this is the Sterling Overnight Interbank Average rate (SONIA). The average SONIA rate at the end of September was 1.19% which is 0.05% higher than our average return of 1.14% as at 30 September 2022. This is the mid year position.

6.2 The Council's budget for investment interest of £123,000 for 2022/23 is expected to be exceeded. A forecast of £1,000,000 will exceed this budget by £877,000. Therefore the end of year position is looking healthy against budgeted income targets.

7. Options available and consideration of risk

7.1 The Treasury Management Strategy is risk averse with no investments allowed for a period of more than a year and very high credit rating is required, together with a limit of £6m per counterparty. This has resulted in only a small number of institutions in which the Council can invest (see Appendix A).

7.2 The Council's treasury management activities and interest rates are reviewed daily to ensure cash flow is adequately planned with surplus funds being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

7.3 The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy will be brought to Members' attention in treasury management update reports.

8. Proposed Way Forward

8.1 The Council's treasury activities and interest rates will continue to be monitored daily and appropriate action taken to mitigate risk whilst optimising investment return where possible.

9. Compliance with Treasury Limits and Prudential Indicators

9.1 During the financial year the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement and annual Treasury Strategy Statement. The Council's Prudential Indicators for 2022/23 are detailed and shown in Appendix B.

10. Implications

Implications	Relevant to proposals Y/N	Details and proposed measures to address
Legal/Governance	Y	The Statutory Powers that apply to this report are the Local Government Act 1972 Section 151 and the Local Government Act 2003.
Financial implications to include reference to value for money	Y	To date, the Council has underperformed the industry benchmark by 0.05% at the mid year point. The Council has achieved a rate of return of 1.14%, against the Sterling Overnight Interbank Average rate (SONIA) of 1.19%. However the end of year position is looking very healthy against budgeted income forecasts. The Council's budget for investment interest of £123,000 for 2022/23 is expected to be exceeded. A forecast of £1,000,000 will exceed this budget by £877,000.
Risk		<p>The security risk is the risk of failure of a counterparty. The liquidity risk is that there are liquidity constraints that affect the interest rate performance. The yield risk is regarding the volatility of interest rates/inflation.</p> <p>The Council has adopted the CIPFA Code Of Practice for Treasury Management and produces an Annual Treasury Management Strategy and Investment Strategy in accordance with CIPFA guidelines.</p> <p>The Council engages a Treasury Management advisor and a prudent view is always taken regarding future interest rate movements. Investment interest income is reported quarterly to SLT and the Executive through the quarterly budget monitoring reports.</p>

Supporting Corporate Strategy		The treasury management function supports all of the Thematic Delivery Plans within ' Better Lives for all'.
Climate Change – Carbon/Biodiversity Impact		No direct carbon/biodiversity impact arising from the recommendations.
<i>Comprehensive Impact Assessment Implications</i>		
Equality and Diversity		None directly arising from this report.
Safeguarding		None directly arising from this report.
Community Safety, Crime and Disorder		None directly arising from this report.
Health, Safety and Wellbeing		None directly arising from this report.
Other implications		None directly arising from this report.

Supporting Information

Appendices:

Appendix A – Lending list as at 30th September 2022

Appendix B – Prudential and Treasury Indicators 2022/23

Background Papers:

None

Approval and clearance of report

Process checklist	Completed
Portfolio Holder briefed/sign off	Yes
SLT Rep briefed/sign off	Yes
Relevant Heads of Practice sign off (draft)	Yes
Data protection issues considered	Yes
Accessibility checked	N/A

APPENDIX A

Counterparty as at 30th Sept 2022		Fitch Rating				Moody's Ratings			S&P Ratings			Suggested Duration				
		Long Term	Short Term	Viability	Support	Long Term	Short Term	Long Term	Short Term	Long Term	Short Term					
United Kingdom																
AAA Rated and Government Backed Securities	Collateralised LA Deposit*											Y - 60 mths				
	Debt Management Office											Y - 60 mths				
	Multilateral Development Banks											Y - 60 mths				
	Supranationals											Y - 60 mths				
	UK Gilts											Y - 60 mths				
													Y - 60 mths			
	Al Rayan Bank PLC						SB	A1		P-1			R - 6 mths			
	Bank of Scotland PLC (RFB)	SB	A+	F1	a		WD	SB	A1		P-1	SB	A+	A-1	R - 6 mths	
	Barclays Bank PLC (NRFB)	SB	A+	F1	a		WD	SB	A1		P-1	PO	A	A-1	R - 6 mths	
	Barclays Bank UK PLC (RFB)	SB	A+	F1	a		WD	SB	A1		P-1	PO	A	A-1	R - 6 mths	
	Close Brothers Ltd	SB	A-	F2	a-		WD	NO	Aa3		P-1				R - 6 mths	
	Clydesdale Bank PLC	SB	A-	F2	bbb+		WD	SB	A3		P-2	SB	A-	A-2	G - 100 days	
	Co-operative Bank PLC (The)	SB	B+	B	b		WD	SB	Ba2		NP					N/C - 0 mths
	Goldman Sachs International Bank	SB	A+	F1			WD	SB	A1		P-1	SB	A+	A-1	R - 6 mths	
	Handelsbanken Plc	SB	AA	F1+			WD					SB	AA-	A-1+		O - 12 mths
	HSBC Bank PLC (NRFB)	SB	AA-	F1+	a		WD	SB	A1		P-1	SB	A+	A-1		O - 12 mths
	HSBC UK Bank Plc (RFB)	SB	AA-	F1+	a		WD	SB	A1		P-1	SB	A+	A-1		O - 12 mths
	Lloyds Bank Corporate Markets Plc (NRFB)	SB	A+	F1			WD	SB	A1		P-1	SB	A	A-1		R - 6 mths
	Lloyds Bank Plc (RFB)	SB	A+	F1	a		WD	SB	A1		P-1	SB	A+	A-1		R - 6 mths
	National Bank of Kuwait (International) PLC	SB	A+	F1			WD					SB	A	A-1		R - 6 mths
	NatWest Markets Plc (NRFB)	SB	A+	F1	WD		WD	SB	A1		P-1	SB	A-	A-2		R - 6 mths
	Santander Financial Services Plc (NRFB)	SB	A+	F1			WD	SB	A1		P-1	SB	A-	A-2		R - 6 mths
	Santander UK PLC	SB	A+	F1	a		WD	SB	A1		P-1	SB	A	A-1		R - 6 mths
	SMBC Bank International PLC	NO	A	F1			WD	SB	A1		P-1	SB	A	A-1		R - 6 mths
	Standard Chartered Bank	SB	A+	F1	a		WD	SB	A1		P-1	SB	A+	A-1		R - 6 mths
	Building Societies	Coventry Building Society	SB	A-	F1	a-		WD	SB	A2		P-1				R - 6 mths
Leeds Building Society		SB	A-	F1	a-		WD	SB	A3		P-2				G - 100 days	
Nationwide Building Society		SB	A	F1	a		WD	SB	A1		P-1	SB	A+	A-1		R - 6 mths
Principality Building Society		SB	BBB+	F2	bbb+		WD	SB	Baa2		P-2					N/C - 0 mths
Skipton Building Society		SB	A-	F1	a-		WD	SB	A2		P-1					R - 6 mths
West Bromwich Building Society								SB	Ba3		NP					N/C - 0 mths
Yorkshire Building Society		SB	A-	F1	a-		WD	SB	A3		P-2					G - 100 days
Nationalised and Part Nationalised Banks	National Westminster Bank PLC (RFB)	SB	A+	F1	a		WD	SB	A1		P-1	SB	A	A-1		B - 12 mths
	Royal Bank of Scotland Group Plc (RFB)	SB	A+	F1	a		WD	SB	A1		P-1	SB	A	A-1		B - 12 mths

Key	
Watches and Outlooks	Duration
SB Stable Outlook	Yellow - Y 60 Months
NO Negative Outlook	Blue - B 12 Months
NW Negative Watch	Orange - O 12 Months
PO Positive Outlook	Red - R 6 Months
PW Positive Watch	Green - G 100 Days
EO Evolving Outlook	
EW Evolving Watch	

APPENDIX B

PRUDENTIAL AND TREASURY INDICATORS 2022/23

The Council's capital expenditure plans are the key driver of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members to overview and confirm capital expenditure plans.

Capital Expenditure

This prudential Indicator is a summary of the Council's capital expenditure.

	2021/22 Actual £000	*2022/23 Budget £000	2022/23 Estimate £000
General Fund services	3,991	18,649	10,669
TOTAL	3,991	18,649	10,669

*The 2022/23 original Budgeted figures contained all of the approved Capital Budgets for all of the capital projects. These capital budgets have now been profiled into the financial years in which expenditure is expected to happen. This is the reason that the estimated 22/23 figure of £10.669 million is lower than the budgeted amount as some of this expenditure will happen in 23/24 onwards.

The table below summarises the financing of the Council's capital programme.

	2021/22 Actual £000	*2022/23 Budget £000	2022/23 Estimate £000
External sources	1,156	3,198	2,656
Own resources	1,815	3,857	1,494
Debt	1,020	11,594	6,519
TOTAL	3,991	18,649	10,669

The Council's Borrowing Need (the Capital Financing Requirement)

The Council's cumulative outstanding amount of debt finance is measured by the Capital Financing Requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt.

	2021/22 Actual £000	2022/23 Budget £000	2022/23 Estimate £000
General Fund services	13,536	24,634	19,568
TOTAL CFR	13,536	31,159	19,568

The Council's Gross Debt and the Capital Financing Requirement

Statutory guidance states that debt should remain below the capital financing requirement, except in the short-term. As can be seen from the indicator below, the debt is lower than the CFR by £5.28m in the forecast for 2022/23.

	2021/22 Actual £000	2022/23 Budget £000	2022/23 Estimate £000
Debt	14,380	22,862	14,284
Capital Financing Requirement	13,536	24,634	19,568

AFFORDABILITY PRUDENTIAL INDICATORS

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans.

These provide an indication of the impact of the capital investment plans on the Council's overall finances.

Ratio of financing costs to net revenue stream

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants.

	2021/22 Actual	2022/23 Budget	2022/23* Estimate
Financing costs (£m)	711,914	727,602	(257,136)
Proportion of net revenue stream	7.2%	6.9%	(2.5%)

* the financing costs are a net income stream in 22/23 due the level of projected treasury management income

TREASURY INDICATORS: LIMITS TO BORROWING ACTIVITY

The Operational Boundary – This is the limit beyond which external debt is not normally expected to exceed. This is the maximum level of external debt for cash flow purposes.

Operational Boundary	2021/22	2022/23
	£	£
Borrowing	70,000,000	50,000,000
Other long term liabilities	-	-
Total	70,000,000	50,000,000

Note: In the Treasury Management Strategy statement for 2023/24, the Operational Boundary is recommended to be reduced to £35million for 23/24.

The Authorised Limit for External Debt – A further key prudential indicator represents a control on the overall level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by Full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

This provides headroom over and above the operational boundary for unusual cash movements. This is the maximum amount of money that the Council could afford to borrow.

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although no control has yet been exercised.

Authorised limit	2021/22	2022/23
	£	£
Borrowing	75,000,000	75,000,000
Other long term liabilities	-	-
Total	75,000,000	75,000,000

South Hams District Council's current level of borrowing as at 30 September 2022 was £14.33 million (as per 5.6).

As part of the Medium Term Financial Strategy, Members approved an overall Borrowing Limit of £75 million.