Appendix A

Treasury Management Report Q1 2022/23

1. Introduction

1.1 The Authority has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports. This quarterly report provides an additional update.

1.2 The Authority's treasury management strategy for 2022/23 was approved at a Council on the 24 February 2022. The Authority has invested substantial sums of money 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 Authority's treasury management strategy.

1.3 CIPFA published its revised Treasury Management Code of Practice [the TM Code] and Prudential Code for Capital Finance in December 2021. The key changes in the two codes are around permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments. The principles within the two Codes took immediate effect although local authorities could defer introducing the revised reporting requirements within the revised Codes until the 2023/24 financial year if they wish. The Authority adopted the revised reporting requirements with effect from 2022/23.

1.4 Treasury risk management at the Authority is conducted within the framework of the TM Code. This Code now also includes extensive additional requirements for service and commercial investments, far beyond those in the 2017 version.

2. External Context

2.1 **Economic background:** Following Russia's invasion of Ukraine in February, global inflationary pressures have intensified sharply, leading to a sizeable deterioration in the outlook for world and UK growth.

2.2 The economic backdrop in the April-June quarter was characterised by higher oil, gas and commodity prices, fears of rising and persistent inflation and its damaging impact on consumers' cost of living, little indication of an imminent end to Russia-Ukraine hostilities and supply chain bottlenecks exacerbated by war in Ukraine and lockdowns in China.

2.3 Added to this was tough rhetoric and action by central bankers globally on fighting inflation through higher interest rates and quantitative tightening even as financial conditions became increasingly difficult for consumers, more so for those whose wages have not kept pace with inflation.

2.4 In the UK inflation remained elevated. Ofgem, the energy regulator, increased the energy price cap by 54% in April, equivalent to around £700 for a household with average energy consumption (the cap had already increased 12% back in October 2021). May data showed CPI edging higher to 9.1% while the core CPI rate, which removes energy, fuel and food was 5.9%. RPI rose to 11.7%.

2.5 The labour market continued to show signs of tightness as employers struggled to fill vacancies with workers with skill sets matching their requirements. The unemployment rate 3m/year for April fell to 3.8% and is now below pre-pandemic levels. Pay growth was 6.8% for total pay (including bonuses) and 4.2% for regular pay; however, adjusted for inflation, growth in total pay was just 0.4%, whilst regular pay fell 2.2%.

2.6 Unsurprisingly, with disposable income squeezed and another energy cap increase due in October, consumer confidence plummeted to the level last seen during the 2008/09 financial crisis. Quarterly GDP growth was 0.8% in the January-March quarter and the Bank of England now expects a decline of 0.3% in Q2 2022.

2.7 Having increased interest rates by 0.25% in April, the Bank of England's Monetary Policy Committee on the 15th of June 2022 voted 6-3 to increase the official Bank Rate by 0.25% to 1.25%. Those members in the minority preferred to increase Bank Rate by 0.5%. Rises in the input and output producer price measures suggest further inflationary pressure is in the pipeline. The Bank of England is therefore unlikely to become complacent, so further rate rises look likely in the near term.

2.8 Annual inflation in the US rose to 8.6% in May, the highest in nearly 40 years. The Federal Reserve also stepped up its fight against inflation with a 0.5% hike in rates in May followed by a further increase of 0.75% in June, the latter its most aggressive hike since 1994 and higher than markets expected, taking policy rates to a range of 1.5% - 1.75%.

2.9 Inflation in the Eurozone also pushed higher to 8.1%, with energy price pressures a major contributor. Europe is heavily impacted by the energy crisis following the Russian invasion of Ukraine, but concerns about the Eurozone's peripheral members and highly indebted members states complicates the European Central Bank's response as it seeks to normalise monetary policy. The ECB stated it would end quantitative easing at the beginning of July and then increase interest rates by 0.25% later in the month, the first hike since 2011. The central bank's Governing Council also convened an emergency meeting in June to address 'fragmentation' risks.

2.10 **Financial markets:** Heightened uncertainty characterised financial market sentiment and bond yields were similarly volatile but with a general upward trend as concern over higher inflation and higher interest rates dominated.

2.11 Over the quarter the 5-year UK benchmark gilt yield rose from 1.41% to 1.89%, the 10-year gilt yield rose from 1.61% to 2.35% and the 20-year yield from 1.82% to 2.60%. The Sterling Overnight Rate (SONIA) averaged 0.89% over the period.

2.12 **Credit review:** In May Moody's affirmed the long-term rating of Guildford Borough Council at Aa3, a reflection of the Council's solid track record of budgetary performance and high level of usable reserves, but changed the 'outlook' (the longer-term direction of travel) to negative. The agency downgraded the long-term rating of Warrington Borough Council from A2 to A3 and that of Transport for London (TfL) from A3 to Baa1.

2.13 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.

2.14 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.

3. Local Context

3.1 The treasury management position on 30 June 2022 and the change during over the year is shown in Table 2 below.

Table 1: Treasury Management Summary

	31.3.22 Balance £m	Movement £m	30.06.22 Balance £m	30.06.22 Rate %
Long-term borrowing	62,577	0	62,577	3.57%
Short-term borrowing	2,206	0	2,206	4.35%
Total borrowing	**64,783**	**0**	**64,783**	**3.60%**
Long-term investments	0	0	0	0
Short-term investments	31,000	5,000	36,000	0.89%
Cash and cash equivalents	18,000	- 1,700	16,300	0.96%
Total investments	**49,000**	**3,300**	**52,300**	**0.91%**
Net borrowing	**15,783**	**- 3,300**	**12,483**	

3.2 The increase in short term investments is largely due to an increased treasury balance partly as a result of receipts of Council tax, Rates and Rents receipts. Additionally there are a number of grants and reimbursements awaiting repayment to Leicestershire County Council and Central Government bolstering treasury balances.

4. Borrowing

4.1 PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield. The Authority intends to avoid this activity in order to retain its access to PWLB loans.

On 31 March 2022 the Authority held £9.1m in commercial investments that were purchased prior to the change in the CIPFA Prudential Code. Before undertaking further additional borrowing the Authority will review the options for exiting these investments.

5. Borrowing strategy and activity

5.1 As outlined in the treasury strategy, the Authority'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 Authority's long-term plans change being a secondary objective. The Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

5.2 Over the April-June quarter, short-term rates rose between 0.5% and 0.9% and long-term rates rose between 0.6% and 0.8%.

5.3 In keeping with the Authority's objectives, no new borrowing was undertaken. Additionally, loans will be allowed to mature without replacing them. This strategy enabled the Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

6. Borrowing Strategy during the period

6.1 At 30 June 2022 the Authority held £65m of loans (the same as at 31st March 2022) as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30 June 2022 are summarised in Table 2 below.

Table 2: Borrowing Position

	31.03.22 Balance £m	Net Movement £m	30.06.22 Balance £m	30.06.22 Weighted Average Rate %	30.06.2022 Weighted Average Maturity (years)
Public Works Loan Board	56	0	56	3.41%	16.23
Banks (LOBO)	4	0	4	4.80%	32.63
Banks (fixed-term)	4	0	4	4.74%	31.64
Local authorities (long-term)	0	0	0	0	0
Local authorities (short-term)	1	0	1	6.88%	0.22
Total borrowing	**65**	**0**	**65**	**3.62%**	**17.81**

6.2 The Authority'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 Authority's long-term plans change being a secondary objective.

6.3 In keeping with these objectives no new borrowing was undertaken. This strategy enabled the Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

6.4 LOBO loans: The Authority continues to hold £3.5m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during the year.

7. Treasury Management Investment Activity

7.1 CIPFA revised TM Code defines treasury management investments as those which arise from the Authority'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.

7.2 The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held and money borrowed in advance of need. During the reporting period, the Authority's investment balances ranged between £44 and £59 million due to timing differences between income and expenditure. The investment position is shown in table 3 below.

Table 3: Treasury Investment Position

	31.03.22 Balance £m	Net Movement £m	30.06.22 Balance £m	30.06.22 Income Return %	30.06.22 Weighted Average Maturity days
Banks & building societies (unsecured)	3	-0.7	2.30	0.82%	82.74
Government (incl. local authorities)	29	5.0	34.00	0.95%	98.12
Money Market Funds	17	-1.0	16.00	0.96%	1.00
Total investments	**49**	**3.30**	**52.30**	**0.95%**	**67.73**

7.3 Both the CIPFA Code and government guidance require the Authority 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 Authority'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.

7.4 The 0.25% increases in Bank Rate at the MPC's meetings in May and June and with the prospect of more increases to come, short-dated cash rates, which had ranged between 0.7% - 1.5% at the end of March, rose on average by 0.65% over the quarter.

7.5 At the end of June, the rates on DMADF deposits ranged between 1.05% and 1.78% and the return on sterling low volatility net asset value (LVNAV) Money Market Funds ranged between 0.9% - 1.1%

7.6 The Authority's investments are diversified into more secure and/or higher yielding asset classes as shown in table 3 above. No funds are invested in longer term investments.

7.7 The risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking as at 30 June 2022 in Table 4 below.

Table 4: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
31.03.2022	4.00	AA-	41%	71	0.39%
30.06.2022	3.76	AA-	31%	75	0.98%
Similar LAs	4.44	AA-	64%	45	1.38%
All LAs	4.46	AA-	64%	16	1.76%

7.8 The above shows a reduced rate of return between the Council and other local authorities. As can be seen in the full benchmarking information shown in Appendix A, the rate of return on internal investments which the Council portfolio entirely consists of is 0.98%. This is actually higher than other local authorities showing a good rate of return on these types of investments. The discrepancy arises from the Strategic funds which the Council does not invest in which offer a higher rate of return but do require a longer investment period and higher risk appetite.

7.9 The Authority has budgeted £11,000 income from investments in 2022/23. Income received to date is £100,000. This variance is largely due to the unexpected increase in Bank rate which was not forecasted by our treasury advisors when budgeting took place. This has also coincided with a higher treasury Investment balance than anticipated. Both leading to increased returns.

8. Non-Treasury Investments

8.1 The definition of investments in CIPFA's revised 2021 Treasury Management Code covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).

8.2 Investment Guidance issued by the Department for Levelling up Housing and Communities (DLUHC) also broadens the definition of investments to include all such assets held partially or wholly for financial return.

8.3 The Authority held £9.1m of investments made for commercial purposes. This consisted entirely of directly owned property and land. A full list of the Authority's non-treasury investments is available in the Investment Strategy 2022-23 document. These investments generated £387,800 of investment income for the Authority after taking account of direct costs.

8.4 The main purpose of these investments is regeneration of the local area rather than investment income. All commercial investments are located within the District.

9. Treasury Performance

9.1 The Authority 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.

9.2 Since the beginning of the reporting period the Council has paid £43,125 in interest. The forecasted amount to be spent on interest on loans for the financial year 22/23 in total is £2.3m. This represents an overall borrowing interest rate of 3.5%. For comparison purposes the current PWLB Maturity Loan rate for new 10 year borrowing is 3.2%.

9.3 We will be repaying one loan this year at the value of £1m in September. No further borrowing is expected to take place.

9.4 Investment interest yield during the reporting period was £100,000. The budgeted yield for the year was £11,000 as detailed above.

9.5 Investment interest return percent on 30 June 2022 was 0.98% this was higher than other local authorities for internal investments but lower when taking into account other types of investments (shown in appendix A benchmarking data). For comparison purposes the Daily Sterling Overnight Index Average (SONIA) which is used for benchmarking purposes was 1.19% on 30 June 2022.

10. Compliance

10.1 The Section 151 Officer reports that all treasury management activities undertaken during the first quarter of the year complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 5 below.

10.2 Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 5 below.

Table 5: Debt Limits

	Q1 Maximum	**30.06.22 Actual**	**2022/23 Operational Boundary**	**2022/23 Authorised Limit**	**Complied?**
Borrowing	£64.8m	£64.8m	£72.9m	£82.9m	Yes

10.3 Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure. Total debt has not gone above the operational boundary since 1 April 2022.

Table 6: Investment Limits

	Q1 Maximum	**30.06.2022 Actual**	**2022/23 Limit**	**Complied?**
The UK Government	Unlimited	£24m	Unlimited	Yes
Local authorities & other government entities	£5m	£5m	£5m	Yes
Secured investments	£5m	£0	£5m	Yes
Banks (unsecured)	£2.5m	£2.3m	£2.5m	Yes
Building societies (unsecured)	£2.5m	£0	£2.5m	Yes
Registered providers (unsecured)	£2.5m	£0	£2.5m	Yes
Money market funds	£5m	£5m	£5m	Yes
Strategic pooled funds	£5m	£0	£5m	Yes
Real estate investment trusts	£5m	£0	£5m	Yes
Other investments	£2.5m	£0	£2.5m	Yes

11. Treasury Management Indicators

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

11.2 **Security:** The Authority 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.

	31.06.22 Actual	**2022/23 Target**	**Complied?**
Portfolio average credit rating	**AA-**	**A-**	**Yes**

11.3 **Liquidity:** The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

	30.06.22 Actual	**2022/23 Target**	**Complied?**
Total cash available within [3] months	£33.3m	£2.5m	Yes

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

Interest rate risk indicator	**30.06.22 Actual**	**2022/23 Limit**	**Complied?**
Upper limit on one-year revenue impact of a 1% rise in interest rates	-302,104	-200,000	No
Upper limit on one-year revenue impact of a 1% fall in interest rates	302,104	200,000	No

11.5 The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at current rates. Although the indicator has not been complied with this is not a compliance failure as it reflects the increase in investment balances over the year and the fact that all of the authority's investments are due to mature this year. Longer investments would reduce the interest rate risk but would expose the authority to higher liquidity risk.

11.6 **Maturity Structure of Borrowing:** This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	30.06.22 Actual £	**30.06.22 Actual %**	**Upper Limit**	**Lower Limit**	**Complied?**
Under 12 months	5,713,657	9%	30%	0%	Yes
12 months and within 24 months	2,740,936	4%	30%	0%	Yes
24 months and within 5 years	3,892,820	6%	30%	0%	Yes
5 years and within 10 years	3,033,321	5%	30%	0%	Yes
10 years and above	49,477,609	76%	90%	0%	Yes

11.7 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.

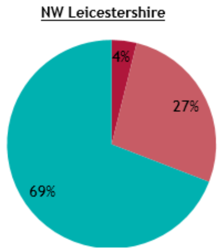
11.8 **Principal Sums Invested for Periods Longer than a year:** The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period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

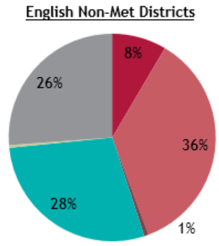
	2022/23	**2023/24**	**2024/25**
Actual principal invested beyond year end	£0	£0	£0
Limit on principal invested beyond year end	£10m	£10m	£10m
Complied?	Yes	Yes	Yes

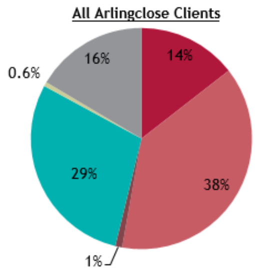
Appendix A

Investment Benchmarking
30 June 2022

	NW Leicestershire	40 English Non-Met Districts Avera	109 LAs Average
Internal Investments	£59.3m	£40.2m	£81.5m
Cash Plus & Short Bond Funds	£0.0m	£2.1m	£3.0m
Strategic Pooled Funds	£0.0m	£15.2m	£13.1m
TOTAL INVESTMENTS	**£59.3m**	**£57.5m**	**£97.5m**
Security			
Average Credit Score	3.76	4.44	4.46
Average Credit Rating	AA-	AA-	AA-
Average Credit Score (time-weighted)	3.28	4.24	4.20
Average Credit Rating (time-weighted)	AA	AA-	AA-
Number of Counterparties / Funds	10	15	14
Proportion Exposed to Bail-in	31%	64%	64%
Liquidity			
Proportion Available within 7 days	33%	42%	50%
Proportion Available within 100 days	61%	60%	71%
Average Days to Maturity	75	45	16
Market Risks			
Average Days to Next Rate Reset	84	58	44
Strategic Fund Volatility	-	3.8%	5.1%
Yield			
Internal Investment Return	0.98%	0.89%	0.92%
Cash Plus Funds - Income Return	-	0.45%	0.40%
Strategic Funds - Income Return	-	3.69%	3.80%
Total Investments - Income Return	**0.98%**	**1.63%**	**1.38%**
Cash Plus Funds - Capital Gain/Loss	-	-1.40%	-1.27%
Strategic Funds - Capital Gain/Loss	-	2.84%	4.25%
Total Investments - Total Return	**0.98%**	**1.38%**	**1.76%**







Notes

• Unless otherwise stated, all measures relate to internally managed investments only, i.e. excluding external pooled funds.

• Averages within a portfolio are weighted by size of investment, but averages across authorities are not weighted.

• Credit scores are calculated as AAA = 1, AA+ = 2, etc.

• Volatility is the standard deviation of weekly total returns, annualised.