Brent	**Audit & Standards Advisory Committee** 7th December 2022
	Report from the Corporate Director of Finance and Resources

TREASURY MANAGEMENT MID-YEAR REPORT 2022-23

Wards Affected:	All
Key or Non-Key Decision:	Non-key
Open or Part/Fully Exempt: (If exempt, please highlight relevant paragraph of Part 1, Schedule 12A of 1972 Local Government Act)	Open
No. of Appendices:	One Appendix 1 - Treasury Management Indicators
Background Papers:	Treasury Management Strategy – Report to Full Council as part of the Budget Report (Appendix I) – February 2022.
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1.0 Purpose of the Report

1.1 This report updates Members on Treasury activity for the first half of the financial year 2022-23.

2.0 Recommendation(s)

2.1 The Committee is asked to note the 2022-23 Mid-Year Treasury report for reference on to Cabinet and Council, along with the fact that the Council has been fully compliant with the Council's Treasury Management indicators

3.0 Detail

Background

3.1 The Council's Treasury Management Strategy is underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's Code of Practice (the CIPFA Code) on Treasury Management 2011. This requires the Council to approve Treasury Management mid-year and annual reports. The update report is presented here in-line with CIPFA's recommendations.

3.2 CIPFA published its revised Treasury Management Code of Practice (the TM Code) 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.

3.3 The principles within the Code 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 wished. The Council has elected to fully adopt the revised reporting requirements from 2023/24.

3.4 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."

3.5 The Council's Treasury Management Strategy for 2022/23 was approved by Full Council on 24th February 2022.

3.6 In addition to reporting on risk management, the Code requires the Council to report on any financial instruments entered into to manage treasury risks.

Economic Background

3.7 There are ongoing impacts to the UK from the war in Ukraine, together with higher inflation, higher interest rates, uncertain economic policy and a deteriorating economic outlook.

3.8 The Bank of England increased the official Bank Rate to 3.0% in November 2022, the largest single rate hike since 1989 and the eighth successive rise since December 2021. This was voted for by a 7-2 majority of the Monetary Policy Committee (MPC).

3.9 The November quarterly Monetary Policy Report (MPR) forecast a prolonged but shallow recession in the UK with CPI inflation remaining elevated at over 10% in the near-term. While the projected peak of inflation is lower than in the August report, due in part to the government's support package for household energy costs, inflation is expected remain higher for longer over the forecast horizon and the economic outlook remains weak, with unemployment projected to start rising.

3.10 CPI inflation is expected to peak at around 11% in the last calendar quarter of 2022 and then fall sharply to 1.4%, below the 2% target, in two years' time and to 0% in three years' time if the Bank Rate follows the path implied by financial markets with a peak of 5.25%. However the BoE has stated it considers this path to be too high, suggesting that the peak in interest rates will be lower, reducing the risk of inflation falling too far below target.

3.11 The labour market remains tight for now, with the most recent statistics showing the unemployment rate fell to 3.5%, driven mostly by a shrinking labour force. Earnings were up strongly in nominal terms by 6% for total pay and 5.4% for regular pay but factoring in inflation means real total pay was -2.4% and regular pay -2.9%. Looking forward, the MPR shows the labour market weakening in response to the deteriorating outlook for growth, leading to the unemployment rate rising to around 6.5% in 2025.

3.12 Interest rates have also been rising sharply in the US, with the Federal Reserve increasing the range on its key interest rate by 0.75% in November 2022 to 3.75%-4.0%. This was the fourth successive 0.75% rise in a pace of tightening that has seen rates increase from 0.25%-0.50% in March 2022. Annual inflation has been slowing in the US but remains above 8%. GDP grew at an annualised rate of 2.6% between July and September 2022, a better-than-expected rise, but with official interest rates expected to rise even further in the coming months, a recession in the region is widely expected at some point during 2023.

3.13 Inflation has been rising consistently in the Euro Zone since the start of the year, hitting an annual rate of 10.7% in October 2022. Economic growth has been weakening with an expansion of just 0.2% in the three months to September 2022. As with the UK and US, the European Central Bank has been on an interest rate tightening cycle, pushing up its three key interest rates by 0.75% in October, the third major increase in a row, taking its main refinancing rate to 2% and deposit facility rate to 1.5%.

Financial Markets

3.14 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.

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

3.16 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.

3.17 The movement in standard rates at which local authorities can borrow from the Public Works Loans Board (PWLB) on maturity loans is shown in the table below including the highest and lowest rates during the period.

PWLB Rates %

Period	Mar 22	Jun 22	Sep 22	YTD Low	YTD High
1-year	2.05	2.91	4.28	2.15	5.31
5-year	2.34	3.12	4.41	2.41	5.63
10-year	2.54	3.42	4.46	2.58	5.67
20-year	2.77	3.68	4.73	2.75	6.08
30-year	2.70	3.59	4.63	2.65	5.98

Debt Management

3.18 CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return. Councils that intend to borrow to invest primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing. This restriction does not prevent regeneration activities where "debt-for-yield" is not the primary purpose of the investment. The Council is not planning to purchase any investment assets primarily for yield and so is able fully access the PWLB borrowing facilities.

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

3.20 The UK Infrastructure Bank (UKIB) which is wholly owned and backed by HM Treasury has earmarked £4bn for lending to local authorities. The Bank is currently operating in interim form, without its full suite of staff and functions. The Treasury has provided £22bn in funding to the Bank over its first 5 years.

3.21 To date, the Bank has invested in eight deals worth £760m, including subsidy-free solar farms, gigabit broadband infrastructure and green buses. Loans are available for qualifying projects at gilt yields plus 0.6%, which is 0.2% lower than the PWLB certainty rate.

3.22 UKIB borrowing proposals must meet a strict set of criteria to be eligible. These include alignment with the government's net zero objectives and the project being an infrastructure asset or network. The UKIB does not support predominantly social infrastructure projects.

3.23 The UK Municipal Bonds Agency (UK MBA) is working to deliver loans to UK local authorities to fund capital expenditure. Funding is provided through three lending programmes; long term pooled loans, standalone loans of over £250m, and short term pooled loans. Any authority wishing to engage in long-term borrowing must accept the UK MBA Framework Agreement.

3.24 A summary of the Council's borrowing in the first half of 2022/23 is provided below:

	Balance on 01/04/2022 £m	Debt repaid* £m	New Borrowing £m	Balance on 30/09/2022 £m
Short Term Borrowing	119.4	96.2	15.0	38.2
Long Term Borrowing	565.2	0	60.0	625.2
TOTAL BORROWING	**684.6**	**96.2**	**75.0**	**663.4**
Average Rate of Borrowing %	3.24%	1.03%	2.64%	3.55%

3.25 The Council's main 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.

3.26 In keeping with these objectives, new external borrowing was kept to a minimum of £90m to meet cash flow requirements. This has included borrowing to support the viability and affordability of the Capital Programme during this time of market volatility.

3.27 Borrowing costs on new borrowing have increased steadily through the year alongside increased market rates (see 3.7). In light of the increased market volatility, we have worked closely with our Treasury advisors in suggesting optimal points at when to enter the market and borrow. The highest borrowing rate that has been agreed YTD was at 4.1%, significantly below the market peaks shown in 3.16. Subsequent borrowing has been achieved at below 4%.

3.28 The Council has an increasing Capital Financing Requirement due to the elements of the capital programme funded by borrowing. An estimated borrowing requirement is determined by the liability benchmark, which takes into account the Council's usable reserves, planned capital expenditure and minimum revenue provision. This has shown that further borrowing in excess of £50m will be required during 2022/23.

3.29 Whilst PWLB funding margins have increased in 22/23, there has been no evidence that lower rates can be achieved through alternative sources of long-term funding.

3.30 The Council has considered and will continue to monitor the possibility of agreeing forward funded deals if these are at advantageous rates. The Council will continue to monitor alternative sources of funding and pursue the lower cost solutions and opportunities as they arise. The Council will evaluate and pursue these lower cost solutions and opportunities as they arise and will look to take advantage of the low borrowing rates for the HRA to provide certainty for its business plan.

3.31 Higher interest rates mean that it would be uneconomic to restructure existing PWLB debt, because interest rates are now higher than those secured on existing borrowing. However this will be kept under review should interest rates be reduced in future.

3.32 The Authority continues to hold £70.5m 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 Council has the option to either accept the new rate or to repay the loan at no additional cost. No lender exercised their option in the first half of the year. However, due to higher market rates, there is now a significant risk that some existing LOBO's may now require refinancing at higher rates or will require repaying. £15m of LOBO's have break points in the second half of the year and may require repayment and refinancing at higher rates.

Treasury Investment Activity

3.33 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Council's investment balances ranged between £33.3m and £129.0m due to timing differences between income and expenditure.

3.34 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.

3.35 The Council's investment position is shown in the table below.

	Balance b/f 01/04/2022	**Investments Repaid**	**Investments Made**	**Balance c/f 30/09/2022**
	£m	**£m**	**£m**	**£m**
Debt Management Account Deposit Facility	0.0	43.6	53.1	9.5
Money Market Funds	98.6	386.8	368.5	80.3
TOTAL INVESTMENTS	**98.6**	**430.4**	**421.6**	**89.8**
Average Rate of Investments	0.52%	0.92%	1.16%	1.99%

3.36 The Council holds most of its cash in Money Market Funds. The return on Money Market Funds has increased reflecting the higher interest rate environment. As at 30th September our Funds were paying rates between 1.8% - 2.09%. The Council also uses the Debt Management Agency's Deposit Facility (DMADF) for short-term cash deposits, which pays comparable rates.

3.37 The inter-local authority market has also seen higher interest rates. The return on our deposits vary significantly, reflecting the higher rates achieved on our more recent fixed term deposits. As at 30th September these funds were paying rates between 0.1% and 3.1%.

3.38 There was a modest reduction of £8.8m in short term investments in the first half of the year. Investment balances are expected to remain low over the next 6 months as the Council's internal resources have been utilised however may increase as external borrowing is undertaken. The Council is reviewing its borrowing options which may include short-term local authority borrowing, longer-term PWLB borrowing and forward borrowing (agreement to borrow at an agreed future date and rate in the future).

3.39 Security of capital has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2022/23. In accordance with the policy, new investments can be made with the following classes of institutions:

- A+ or above rated banks;
- AAA rated Money Market Funds;
- Other Local Authorities;
- Housing Associations;
- UK Debt Management Office;
- Corporate Bonds
- Collective Investment Schemes (Pooled Funds)
- Real Estate Investment Trusts

A short summary of the investment products available to the council along with an indication of relative risk is provided below:

3.40 The table below shows the different assets classes available to the council for its investment portfolio together with the major driver of the return and a summary of the key risks for each asset class.

Asset Classes (approx. return)	**Cash (2.9%)**	**Bonds (3.9%)**	**Equities (3.4%)**	**Property (4.0%)**
Income driven by	Short term interest rates	Medium term interest rates	Dividends / share prices	Rental income / vacancies
Key Risk(s)	Bank defaults	Company defaults	Company performance and perception of future performance	Property prices, least liquid asset class

3.41 Investments in Equities and Property classes tend to be considered over a longer time frame, which are not currently suitable for the Council given its significant capital spending plans.

Risks

3.42 Regardless of the approach taken, the Council will be required to manage significant risks in relation to its treasury investment portfolio. Some key risks are: -

- Credit risk - the risk that a bank or other institution will not be able to pay back the money invested with it. For longer term investments, the council is more exposed to credit risk. Should a counterparty's credit worthiness change, the council may not be able to get all their money back or may face heavy penalties if it can do so.

  Mitigation – see Prudential Indicator 1 – Appendix 1

- Liquidity risk - that is the council having funds tied up in long-term investments when it needs to use that money. Increasing the duration of fixed cash deposits increases liquidity risk, however this can be mitigated through good cash flow management.

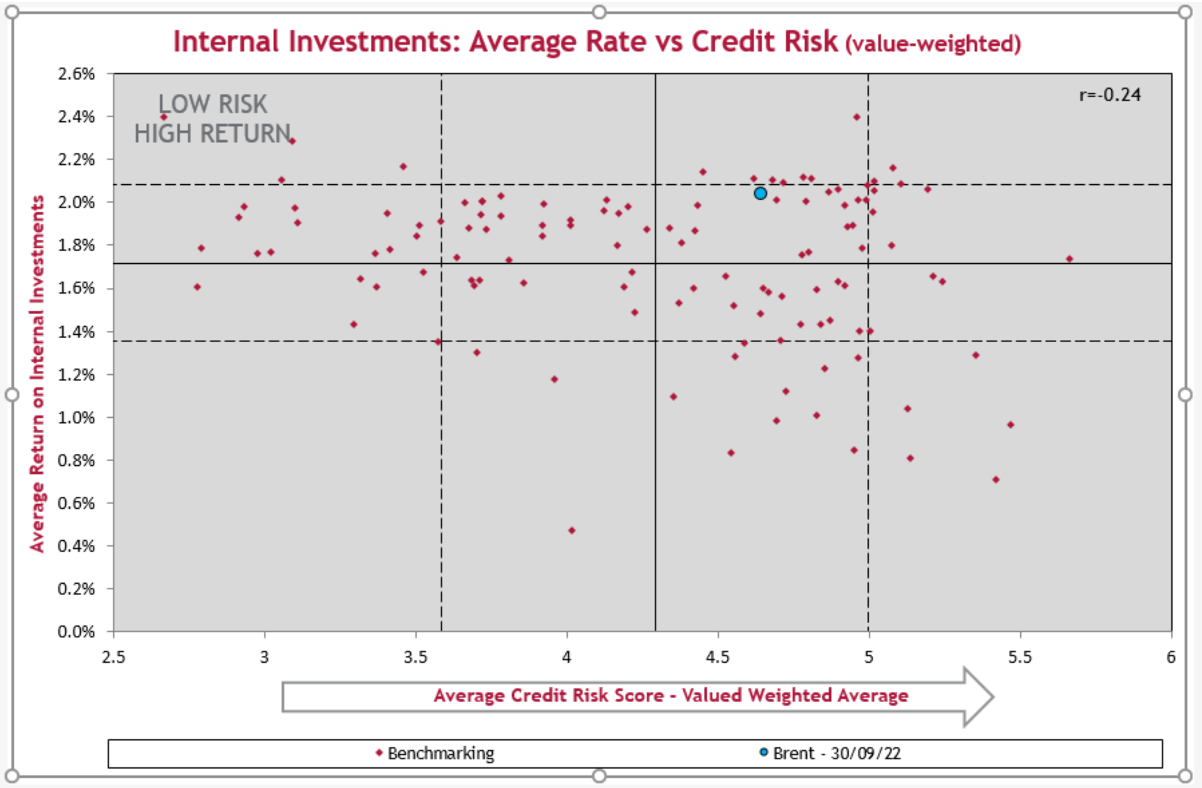
  Mitigation – see Prudential Indicator 2 – Appendix 1

- Interest rate risk – the risk of the council's budget being affected by unforeseen changes in interest rates. Longer term cash deposits increase this risk and will negatively affect the council should interest rates rise. On the other hand, the council may benefit should interest rates fall.

  Mitigation – see prudential Indicator 3 – Appendix 1

Benchmarking to other councils

3.43 The graph below shows a comparison in performance between Brent's investment portfolio and those of Arlingclose's (the Council's treasury advisor) other Local Authority clients. Brent's portfolio has a low risk profile compared with many of the others and our investments are also shorter dated, which also equates to a lower yield.



3.44 Our investment portfolio has a credit rating of A+ (equivalent to a Credit Risk Score of 4.7 in the table above). The credit rating achieved on our investments beats our target rating of A (which equates to a Credit Risk Score of 6 in the table above). The lower the Average Credit Risk score in the table above, the better the credit rating of the counterparties with which we hold investments.

3.45 A credit rating of 'A' per the Fitch agency indicates that an organisation has low default risk, but may be vulnerable to adverse economic conditions. A credit rating of 'AA' denotes that an organisation has very low default risk and is not significantly vulnerable to foreseeable events. The '+' and '-' are further delineations for each credit rating.

Budgeted Income And Outturn

3.46 The Council's external interest budget for the year is £18.2m, and for investment income is £4.7m. The average cash balances, representing the Council's reserves and working balances, were £87.8m during the period to 30 September 2022. The Council expects to receive significantly higher income from its cash and short-dated money market investments than it did in 2021/22 and earlier years due to the higher interest rate environment and the immediate cash requirements, which only allow for short-term investments.

Compliance

3.47 Officers confirm that they have complied with its Treasury Management Indicators for 2022/23, which were set in February 2022 as part of the Council's

Treasury Management Strategy Statement (TMSS). Details can be found in Appendix 1.

Summary

3.48 In compliance with the requirements of the CIPFA Code of Practice, this report provides Members with a summary report of the treasury management activity during the first half of 2022/23. As indicated in this report, none of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

4.0 Financial Implications

4.1 These are covered throughout the report.

5.0 Legal Implications

5.1 There are no direct legal implications.

6.0 Equality Implications

6.1 No direct implications.

7.0 Consultation with Ward Members and Stakeholders

7.1 None.

8.0 Human Resources/Property Implications

8.1 No direct implications.

Report sign off:

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