| GOVERNANCE AND AUDIT COMMITTEE |
| --- |

| | |
| --- | --- |
| **Date of Meeting** | Wednesday 22nd March 2023 |
| **Report Subject** | Treasury Management Quarter 4 Update 2022/23 |
| **Report Author** | Corporate Finance Manager |

## EXECUTIVE SUMMARY

The Governance and Audit Committee is responsible for scrutinising the Council's treasury management activity and this report provides an update on matters relating to the Council's Treasury Management Policy, Strategy and Practices 2022/23 to the end of February 2023.

The report details the Council's position in respect of investments and long and short term borrowing at the end of February, and provides an update on the economic context and an interest rate forecast.

| **RECOMMENDATIONS** | |
| --- | --- |
| 1 | Members review and endorse the Treasury Management 2022/23 quarterly update. |

## REPORT DETAILS

| **1.00** | **EXPLAINING THE QUARTERLY UPDATE** |
| --- | --- |
| 1.01 | On 15th February 2022, following the recommendation of the Cabinet and consideration by the Governance and Audit Committee, the Council approved the Treasury Management Strategy 2022/23, together with the Treasury Management Policy Statement 2022/23 – 2024/25 and Treasury Management Practices 2022/23 – 2024/25. |

| | |
|---|---|
| 1.02 | The Council has nominated the Governance and Audit Committee to be responsible for ensuring effective scrutiny of Treasury Management Strategy and Policies and the Governance and Audit Committee has previously agreed to include treasury management as a standing item on each quarterly agenda to receive an update. The Quarter 4 update is detailed in the following paragraphs. |
| 1.03 | <u>Investments update</u><br><br>A schedule setting out the Council's investments as at 28th February is attached as Appendix 1. The investment balance at this time was £28.3m across 8 counterparties with an average interest rate of 3.70%. |
| 1.04 | <u>Borrowing update</u><br><br>Appendix 2 shows the Council's long-term borrowing portfolio as at 28th February, a total of £296.6m with a weighted average interest rate of 4.53%. During quarter 4 the Council took out a new long-term loan with the Public Works Loan Board to support its strategy of fixing a portion of its long term borrowing requirement. The loan was an 18-year Equal Instalments of Principal loan for £5m, with an interest rate of 3.91%.<br><br>Appendix 3 shows the Council's short-term borrowing portfolio as at 28th February - there were no short term loans outstanding.<br><br>The Council has a forecast borrowing requirement over and above the additional long-term borrowing already undertaken during the year which will continue into the new financial year.<br><br>The borrowing strategy in 2022/23 has been to monitor capital expenditure to confirm the Council's long-term borrowing need, ensuring that the Council does not commit to long-term borrowing too early and borrow unnecessarily, which will be costly. This is balanced against not compromising the long-term stability of the debt portfolio by securing low long-term interest rates when available.<br><br>The borrowing requirement will continue to be reviewed and monitored closely during the remainder of 2022/23 and into 2023/24 with support from Arlingclose, the Council's treasury management advisors. |
| 1.05 | <u>Economic update from Arlingclose, the Council's treasury management advisors</u><br><br>Market expectations are that global central banks are at or nearing peak interest rates.<br><br>This was further underlined by the Bank of England's rate decision, which saw Bank Rate rise to 4%. While the Monetary Policy Committee (MPC) remains concerned that domestic inflationary pressure will remain elevated, the CPI rate is projected to fall below target in the medium term as monetary tightening takes its toll on economic activity.<br><br>The UK economy has perhaps proved more resilient than expected, but a recession and/or stagnant growth is likely in 2023 and subsequent |

| | |
|---|---|
| | years, as higher interest rates, low investment and rising unemployment depress overall activity.<br><br>The lagged effect of the sharp tightening of monetary policy, higher mortgage rates, widespread strike action, alongside high inflation, will continue to put pressure on household disposable income and wealth. It is difficult to see households providing any support to GDP growth in 2023.<br><br>Workforce shortage in the labour market is contributing to low unemployment (albeit with higher inactivity) and higher wages. While real wage growth is negative, high nominal wage growth has increased company costs and allowed them to pass these through to consumers, particularly in the services sector. We expect to see a weaker labour market as demand for labour ebbs, but Bank Rate will remain high until both services inflation and nominal wage growth declines. |
| 1.06 | <u>Interest rate forecast</u><br><br>The MPC raised Bank Rate by 50bps to 4.0% in February and we believe there will only be one further rise to 4.25% in March.<br><br>The MPC will cut rates in the medium term to stimulate a stuttering UK economy, but will be reluctant to do so until services inflation and wage growth eases. We see rate cuts in the first quarter of 2024 to a low of 3% by 2025, although the timing and extent of rate cuts remains highly uncertain.<br><br>Arlingclose expects gilt yields to remain broadly steady over the medium term, although with continued volatility across shorter time periods. |

| **2.00** | **RESOURCE IMPLICATIONS** |
|---|---|
| 2.01 | Financial implications are set out within this report and supporting appendices; there are no other resource implications directly as a result of this report. |

| **3.00** | **CONSULTATIONS REQUIRED / CARRIED OUT** |
|---|---|
| 3.01 | Arlingclose Ltd, being the Council’s treasury management advisors. |

| **4.00** | **RISK MANAGEMENT** |
|---|---|
| 4.01 | Risk Management directly addressed within the appendices including identification of risks and measures to mitigate likelihood and impact of risks identified. |

| 5.00 | **APPENDICES** |
|---|---|
| 5.01 | 1. Investment Portfolio as at 28 February 2023<br>2. Long-term Borrowing Portfolio as at 28 February 2023<br>3. Short-term Borrowing Portfolio as at 28 February 2023 |

| 6.00 | **LIST OF ACCESSIBLE BACKGROUND DOCUMENTS** |
|---|---|
| 6.01 | **Contact Officer:** Chris Taylor - Strategic Finance Manager<br>**Telephone:** 01352 703309<br>**E-mail:** christopher.taylor@flintshire.gov.uk |

| 7.00 | **GLOSSARY OF TERMS** |
|---|---|
| 7.01 | **Authorised Limit:** A statutory limit that sets the maximum level of external debt for the Council.<br><br>**Balances and Reserves**: Accumulated sums that are held, either for specific future costs or commitments (known as earmarked) or generally held to meet unforeseen or emergency expenditure.<br><br>**Bank Rate:** The official interest rate set by the Bank of England's Monetary Policy Committee and what is generally termed at the "base rate".<br><br>**Basis Point:** A unit of measure used in finance to describe the percentage change in the value or rate of a financial instrument. One basis point is equivalent to 0.01% (1/100th of a percent). In most cases, it refers to changes in interest rates and bond yields. For example, if interest rates rise by 25 basis points, it means that rates have risen by 0.25% percentage points.<br><br>**Bond:** A certificate of debt issued by a company, government, or other institution. The bond holder receives interest at a rate stated at the time of issue of the bond. The price of a bond may vary during its life.<br><br>**Capital Expenditure:** Expenditure on the acquisition, creation or enhancement of capital assets.<br><br>**Capital Financing Requirement (CFR):** The Council's underlying need to borrow for capital purposes representing the cumulative capital expenditure of the local authority that has not been financed.<br><br>**Certificates of Deposits (CD's**): A savings certificate entitling the bearer to receive interest. A CD bears a maturity date, a specified fixed interest rate and can be issued in any denomination. CDs are generally issued by commercial banks. The term of a CD generally ranges from one month to five years.<br><br>**Consumer Price Index (CPI):** The UK's main measure of inflation (along with Retail Price Index or 'RPI') The Monetary Policy Committee of the Bank |

of England set the Bank Rate in order to try and keep CPI at or close to the target set by the Government. The calculation of CPI includes many items of normal household expenditure but excludes some items such as mortgage interest payments and Council Tax.

**Corporate Bonds:** Corporate bonds are bonds issued by companies. The term is often used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies.

**Cost of Carry:** The “cost of carry” is the difference between what is paid to borrow compared to the interest which could be earned. For example, if one takes out borrowing at 5% and invests the money at 1.5%, there is a cost of carry of 3.5%.

**Counterparty List:** List of approved financial institutions with which the Council can place investments.

**Credit Rating**: Formal opinion by a registered rating agency of a counterparty’s future ability to meet its financial liabilities; these are opinions only and not guarantees.

**Debt Management Office (DMO**): The DMO is an Executive Agency of Her Majesty's Treasury and provides direct access for local authorities into a government deposit facility known as the Debt Management Account Deposit Facility (DMADF). All deposits are guaranteed by HM Government and therefore have the equivalent of a sovereign credit rating.

**Federal Reserve:** The US central bank, the equivalent of the Bank of England. (Often referred to as “the Fed”).

**Financial Instruments**: Financial instruments are tradable assets of any kind. They can be cash, evidence of an ownership interest in an entity, or a contractual right to receive or deliver cash or another financial instrument.

**Gilts:** Gilts are bonds issued by the UK Government. They take their name from ‘gilt-edged’. They are deemed to be very secure as the investor expects to receive the full face value of the bond to be repaid on maturity.

**IFRS**: International Financial Reporting Standards.

**LIBID:** The London Interbank Bid Rate (LIBID) is the rate bid by banks on Eurocurrency deposits (i.e. the rate at which a bank is willing to borrow from other banks).

**LIBOR:** The London Interbank Offered Rate (LIBOR) is the rate of interest that banks charge to lend money to each other. The British Bankers' Association (BBA) work with a small group of large banks to set the LIBOR rate each day. The wholesale markets allow banks who need money to borrow from those with surplus amounts. The banks with surplus amounts of money are keen to lend so that they can generate interest which it would not otherwise receive.

**LOBO:** Stands for Lender Option Borrower Option. The underlying loan facility is typically very long-term - for example 40 to 60 years - and the interest rate is fixed. However, in the LOBO facility the lender has the option to call on the facilities at pre-determined future dates. On these call dates, the lender can propose or impose a new fixed rate for the remaining term of the facility and the borrower has the ‘option’ to either accept the new imposed fixed rate or repay the loan facility.

**Maturity:** The date when an investment or borrowing is repaid.

**Maturity Structure / Profile:** A table or graph showing the amount (or percentage) of debt or investments maturing over a time period.

**MiFID II (Markets in Financial Instruments Directive)**: EU legislation that regulates firms who provide services to clients linked to 'financial instruments'. As a result of MiFID II, from 3rd January 2018 local authorities will be treated as retail clients but can “opt up” to professional client status, providing that they meet certain qualitative and quantitative criteria.

**Minimum Revenue Provision (MRP**): An annual provision that the Council is statutorily required to set aside and charge to the Revenue Account for the repayment of debt associated with expenditure incurred on capital assets.

**Monetary Policy Committee (MPC):** A committee of the Bank of England, which meets to decide the Bank Rate. Its primary target is to keep CPI inflation within 1% of a central target of 2%. Its secondary target is to support the Government in maintaining high and stable levels of growth and employment.

**Money Market Funds (MMF**): Pooled funds which invest in a range of short term assets providing high credit quality and high liquidity.

**Non Specified Investment**: Investments which fall outside the WG Guidance for Specified investments (below).

**Operational Boundary:** This linked directly to the Council’s estimates of the CFR and estimates of other day to day cash flow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

**Premiums and Discounts**: In the context of local authority borrowing,
(a) the premium is the penalty arising when a loan is redeemed prior to its maturity date and
(b) the discount is the gain arising when a loan is redeemed prior to its maturity date.

**Prudential Code:** Developed by CIPFA and introduced in April 2004 as a professional code of practice to support local authority capital investment planning within a clear, affordable, prudent and sustainable framework and in accordance with good professional practice.

| | |
|---|---|
| | **Prudential Indicators:** Indicators determined by the local authority to define its capital expenditure and asset management framework. They are designed to support and record local decision making in a manner that is publicly accountable; they are not intended to be comparative performance indicators.<br><br>**Public Works Loans Board (PWLB):** The PWLB is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. The PWLB's function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments.<br><br>**Quantitative Easing (QE):** QE is a form of monetary policy where a Central Bank creates new money electronically to buy financial assets, like government bonds. This cash injection lowers the cost of borrowing and boosts asset prices to support spending.<br><br>**Retail Price Index (RPI):** A monthly index demonstrating the movement in the cost of living as it tracks the prices of goods and services including mortgage interest and rent.<br><br>**Revenue Expenditure:** Expenditure to meet the continuing cost of delivery of services including salaries and wages, the purchase of materials and capital financing charges.<br><br>**Specified Investments:** Term used in the Welsh Assembly Guidance for Local Authority Investments. Investments that offer high security and high liquidity, in sterling and for no more than one year. UK government, local authorities and bodies that have a high credit rating.<br><br>**Supported Borrowing:** Borrowing for which the costs are supported by the government or third party.<br><br>**Supranational Bonds:** Instruments issued by supranational organisations created by governments through international treaties (often called multilateral development banks). The bonds carry an AAA rating in their own right. Examples of supranational organisations are the European Investment Bank, the International Bank for Reconstruction and Development.<br><br>**Temporary Borrowing:** Borrowing to cover peaks and troughs of cash flow, not to fund capital spending.<br><br>**Term Deposits:** Deposits of cash with terms attached relating to maturity and rate of return (Interest).<br><br>**Treasury Bills (T-Bills):** Treasury Bills are short term Government debt instruments and, just like temporary loans used by local authorities, are a means to manage cash flow. They are issued by the Debt Management Office and are an eligible sovereign instrument, meaning that they have an AAA-rating.<br><br>**Treasury Management Code**: CIPFA’s Code of Practice for Treasury Management in the Public Services, initially brought in 2003, subsequently updated in 2009 and 2011. |

| | |
|---|---|
| | **Treasury Management Practices (TMP):** Treasury Management Practices set out the manner in which the Council will seek to achieve its policies and objectives and prescribe how it will manage and control these activities.<br><br>**Unsupported Borrowing**: Borrowing which is self-financed by the local authority. This is also sometimes referred to as Prudential Borrowing.<br><br>**Yield:** The measure of the return on an investment instrument. |