CITY OF YORK COUNCIL

Agenda Item

Executive **22 November 2022**

Report of the Chief Finance Officer

Portfolio of the Executive Member for Finance and Performance

Treasury Management Mid-Year Review and Prudential Indicators 2022/23

Summary

1. The Council is required through legislation to provide members with a mid-year update on treasury management activities. This report provides an update on activity for the period 1 April 2022 to 30 September 2022.

Recommendations

2. Members are required, in accordance with the Local Government Act 2003 (revised), to:
   - Note the Treasury Management activities to date in 2022/23
   - Note the Prudential Indicators set out at Annex A and note the compliance with all indicators.

Reason: to ensure the continued performance of the Council's Treasury Management function.

Background

3. The Treasury Management function is responsible for the effective management of the Council's investments, cash flows, banking, and money market transactions. It also considers the effective control of the risks associated with those activities and ensures optimum performance within those risk parameters.

4. This mid-year report has been prepared in compliance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) 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 Treasury Management Strategy Statement and Annual Investment Strategy;
   - The prudential indicators;
   - A review of the Council's investment portfolio;

- A review of the Council’s borrowing strategy;
- A review of compliance with the Treasury and Prudential Limits.

Economic Update

5. The second quarter of 2022/23 saw signs of economic activity losing momentum as production fell, inflation increased with domestic price pressures showing little sign of abating in the near-term, and bank base rate was raised to 2.25%. The unemployment rate has fallen to a 48-year low of 3.6% due to a large shortfall in labour supply.

6. In September and October 2022 there had been a step change in government policy and the fiscal loosening from its proposed tax cuts were likely to add to existing domestic inflationary pressures and could have potentially left a legacy of higher interest rates and public debt. Gilt yields had increased, and sterling had fallen following the “fiscal event” of the new Prime Minister and Chancellor on 23rd September 2022 adding further upward pressure to interest rates.

7. However, following the reversal of the Truss/Kwarteng fiscal policies and Rishi Sunak’s appointment as the UK’s new Prime Minister has ushered in a period of calm in UK financial markets. Much of the extra political risk percentages on gilts that emerged in the wake of the mini-budget on 23rd September appears to have unravelled.

8. The new Chancellor, Jeremy Hunt, will unveil in his Autumn Statement on 17th November a fiscal tightening of up to £50bn by 2026/27 (1.7% of GDP) suggesting that after a period in which fiscal policy has provided the economy with support, it is about to become a major drag.

9. Market interest rate expectations have been pared back in recent weeks as announced fiscal policy has become less loose. And although tighter fiscal policy may go some way to reducing the upward pressure on interest rates, stickier inflation means that Bank Rate is still expected to peak at 5.00%.

10. The Bank of England Monetary Policy Committee has increased interest rates to their highest level since the Global Financial Crisis to date.

Interest Rate Forecast

11. Table 1 is Link Asset Services Interest Rate forecast for both the bank base rate and long-term Public Works Loans Board (PWLB) Certainty borrowing rates (note all figures are percentages):

	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
5 Year PWLB rate	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 Year PWLB rate	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 Year PWLB rate	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 Year PWLB rate	4.80	4.60	4.50	4.20	4.00	3.80	3.60	3.40	3.30	3.30	3.20	3.10

Table 1: Link Asset Services Interest Rate Forecast (%) 28th September 2022

12. Currently Bank base rate is at 2.25% and, as shown in the forecast table above, is expected to peak in 2023/24 at 5% before steadily decreasing back to a similar level by the middle of 2025/26.

13. The table above shows short and long-dated interest rates will be elevated for some time, as the Bank of England seeks to squeeze inflation out of the economy, whilst the government is providing a package of fiscal loosening to try and protect households and businesses from the ultra-high wholesale gas and electricity prices.

14. The increase in PWLB rates reflects a broad sell-off in sovereign bonds internationally and the disaffection investors have with the position of the UK public finances after September's "fiscal event". The Bank of England's Monetary Policy Committee has tightened short-term interest rates with a view to trying to slow the economy sufficiently to keep the secondary effects of inflation – as measured by wage rises – under control.

Annual Investment Strategy Update

15. Council approved the Treasury Management Strategy Statement for 2022/23 on 17th February 2022. There are no policy changes and the details in this report do not amend the Statement.

16. The Council's Annual Investment Strategy, which is incorporated in the Strategy, outlines the Council's investment priorities as follows:
    - security of capital
    - liquidity
    - yield
    - FTSE4Good index

17. The Council continues to aim to achieve the optimum return (yield) on investments commensurate with the proper levels of security and liquidity and the Councils risk appetite.

Investment Portfolio

18. The average level of cash balances available for investment purposes in the first 6 months of 2021/22 was £58.184m (£40.376m for the same 6-month period in 21/22). The level of cash balances available is largely dependent on the timing of the Council's cash flow as a result of precept payments, receipt of grants, receipt of developer contributions, borrowing for capital purposes, payments to its suppliers of goods and services and spend progress on the Capital Programme. These funds are therefore only available on a temporary basis depending on cash flow movement.

19. The average level of cash balances has increased compared to a year ago due to a number of factors. This is in part due to cash carried over from March 2022 which included £15m of borrowing from the PWLB, an additional £7.6m of Dedicated Schools Grant (DSG), and £8.4m Zero Emission Bus Regional Areas (ZEBRA) Funding. The Council also received £11.6m for the Council Tax rebate payments.

20. With the increase in cash balances in the first half of 2022/23, the Council has been able to delay taking on further long-term debt to finance the Councils capital programme, maintaining an under-borrowed position in relation to the Capital Financing Requirement. This strategy will be kept under review during the second half of the year as cash balances for investment are projected to fall.

21. Investment return (calculated as the amount of interest earned on invested cash for the period) during the first six months of 2022/23 is shown in table 2:

	2021/22 (full year)	**2021/22 (part year to date)**
Average CYC Rate of Return	0.10	1.18
<u>**Benchmarks**</u>		

Average Overnight SONIA	n/a*	1.22
Average 7 day Backward Looking SONIA	n/a*	1.21

Table 2: CYCs investment rate of return performance vs. SONIA benchmark

* There is not a full year comparator for 2021/21 as up until 31st December 2021 LIBID rates were used as a comparable performance indicator. From 1st January 2022 the Council has used SONIA as a comparable performance indicator.

22. The average rate of return achieved for invested cash to date in 2022/23 has been steadily increasing compared to the average seen in 2021/22, due to the Bank of England raising the base rate six times in the period from 15th December 2021 to 22nd September from 0.10% to 2.25%. The Council has been keeping cash in highly liquid Money Market Funds which provide instant access to cash and therefore has used the average overnight SONIA rate to compare it's return too. There is a slight time lag between the interest earned from investing in these Money Market Funds compared to the base rate and overnight SONIA as Money Market Funds adjust their portfolios in a rising interest rate environment.

23. Opportunities for longer term investments at higher yields are now becoming more prevalent, however as stated above the Council is using its cash balances to delay taking on long-term borrowing. Opportunities that arise for notice and fixed investments are considered in terms of the Councils short to medium term cash flow requirement and under borrowed position.

24. Figure 1 shows the average SONIA rates for a number of investment durations compared with the Bank of England base rate and the rate of return that the Council has achieved on invested cash for the first six months of 2022/23. It shows that the Councils average rate of return on its instant access cash has been steadily increasing for the first six months of the year on the same trend as the Bank of England base rate and the average overnight SONIA and average 7 day backward looking SONIA rates whilst ensuring the required liquidity and security of funds for the Council.

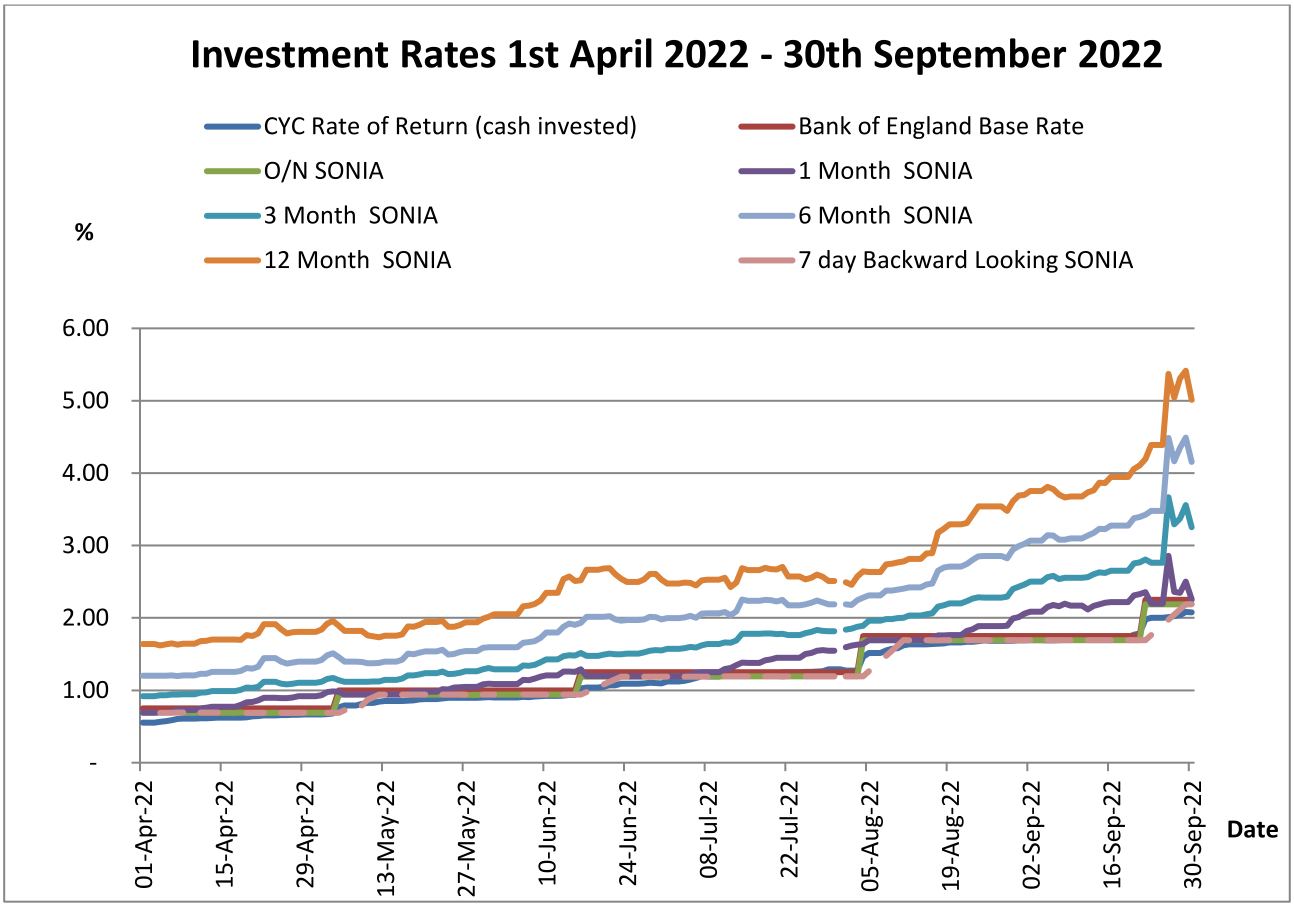

Figure 1 CYC Investments vs Bank of England base rate and SONIA up to 30th September 2022

25. Figure 2 shows the investments portfolio split by cash in bank, deposits in short term call accounts, fixed term investments and Money Market Funds. All of the Money Market Funds have an AAAm credit rating and the cash bank account is A+.

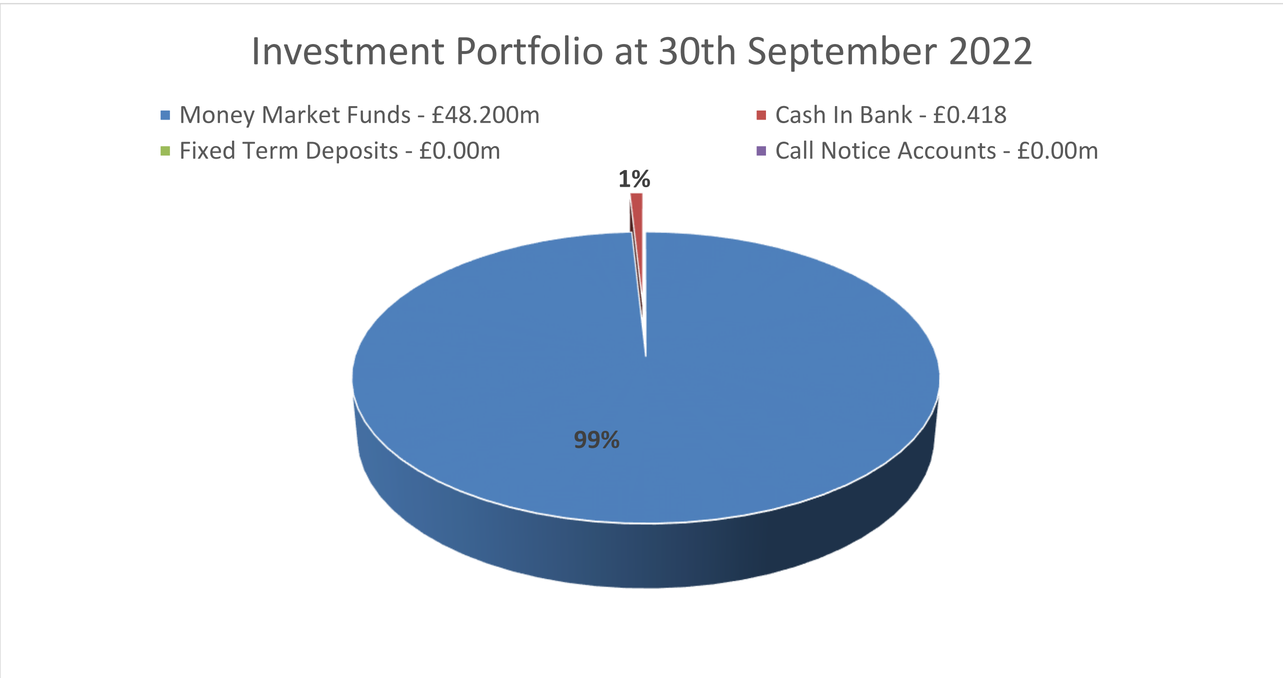

Figure 2 Investment Portfolio by type at 30th September 2022

Borrowing Portfolio

26. The Council undertakes long-term borrowing in accordance with the investment requirements of the capital programme and all borrowing is therefore secured for the purpose of its asset base.

27. The level of borrowing taken by the Council is determined by the Capital Financing Requirement (the Councils underlying need to borrow for capital expenditure purposes). Borrowing needs to be affordable, sustainable and prudent.

28. Under regulation, the Council can borrow in advance of need and Markets are therefore constantly monitored and analysed to ensure that advantage is taken of favourable rates and the increased borrowing requirement is not as dependant on interest rates in any one year.

29. On the reverse side, the Council's level of borrowing can also be below the Capital Financing Requirement. This would mean that instead of increasing the Council's level of borrowing, surplus funds held for investment purposes would be utilised.

30. The finance team continues to closely monitor the opportunities that arise and receive daily updates from Link Asset Services in respect of borrowing timings and amounts. No new loans have been taken during the first six months of the year.

31. The Councils long-term borrowing started the year at a level of £305.965m. There are 3 scheduled repayments of long-term borrowing that will occur this financial year totalling £4.7m. This is made up of a £2m PWLB loan and £1m PWLB loan, both maturing on 5th November 2022 and a £1.7m PWLB loan maturing on 28th February 2023.

32. The Housing Revenue Account debt amount is 48% of the borrowing portfolio at £146.359m (of which £121.550 is self-financing debt) and the General Fund debt is 52% at £159.606m.

33. Figure 3 illustrates the 2022/23 maturity profile of the Council's debt portfolio at 30th September 2022. The maturity profile shows that there is no large concentration of loan maturity in any one year, thereby spreading the interest rate risk dependency.

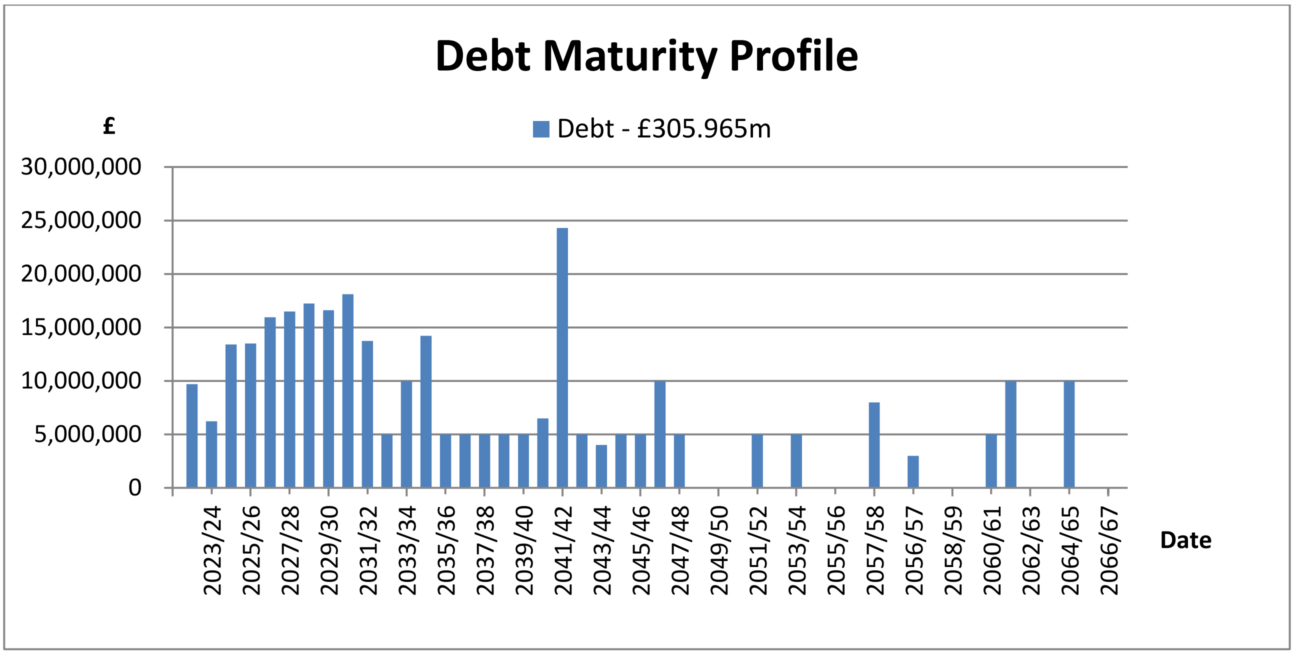

Figure 3 – Debt Maturity Profile at 30th September 2022

34. Table 3 shows PWLB Certainty borrowing rates available for selected loan durations between 1st April 2022 and 30th September 2022.

	PWLB Certainty borrowing rates by duration of loan				
	1 Year	**5 Year**	**10 Year**	**25 Year**	**50 Year**
Yr High	5.11	5.43	5.36	5.80	5.50
Yr Low	1.95	2.21	2.38	2.52	2.24
Yr Avg	2.89	3.03	3.25	3.51	3.23

Table 3 – PWLB Borrowing Rates (%) – 1st April 2022 to 30th September 2022

Compliance with Prudential Indicators

35. The Prudential Indicators for 2022/23 included in the Treasury Management Strategy Statement are based on the requirements of the Council's capital programme and approved at Budget Council on 17th February 2022.

36. It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits" included in the Prudential Indicators. The monitoring of the Prudential Indicators is attached at Annex A. During the

financial year 2022/23 to date the Council has operated within the treasury limits and Prudential Indicators set out.

Consultation and Options

37. The report shows the six-month position of the treasury management portfolio in 2022/23. The treasury management budget was set in light of the council's expenditure plans and the wider economic market conditions, based on advice from Link Asset Services. It is a statutory requirement to provide the information detailed in the report.

Council Plan

38. The treasury management function aims to achieve the optimum return on investments commensurate with the proper levels of security, and to minimise the interest payable by the Council on its debt structure. It thereby contributes to all Council Plan priorities.

Financial implications

39. The financial implications are in the body of the report.

Legal Implications

40. Treasury Management activities have to conform to the Local Government Act 2003, the Local Authorities (Capital; Finance and Accounting) (England) Regulations 2003 (SI 2003/3146), which specifies that the Council is required to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice and also the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (SI 2008/414), which clarifies the requirements of the Minimum Revenue Provision guidance.

Other Implications

41. There are no crime and disorder, information technology, property, equalities, human resources or other implications because of this report.

Risk Management

42. The Treasury Management function is a high-risk area because of the level of large money transactions that take place. As a result, there are procedures set out for day to day treasury management operations that aim to reduce the risk associated with high volume high value transactions. These are detailed in the Treasury Management Strategy Statement at the start of each financial year.

Contact Details

Authors:	**Chief Officer Responsible for the report:**			
Tony Clark Accounting Technician	Debbie Mitchell Chief Finance Officer			
	Report Approved		**Date**	
Wards Affected: *All*				
For further information please contact the author of the report				

Specialist Implications**:**
Legal – Not Applicable
Property – Not Applicable
Information Technology – Not Applicable

Annexes
Annex A – Prudential Indicators 2022/23 Mon 2 (30.09.22)

Glossary of Abbreviations used in the report:

DLUHC	Department for Levelling Up, Housing and Communities
PWLB	Public Works Loans Board
SONIA	Sterling Overnight Index Average