Item: 6.2

Policy and Resources Committee: 22 November 2022.

Treasury Management – Mid-Year Update.

Report by Head of Finance.

1. Purpose of Report

To provide a mid-year update in respect of the Council's treasury management function for the period 1 April to 30 September 2022.

2. Recommendations

The Committee is invited to scrutinise:

2.1.

The mid-year update, attached as Appendix 1 to this report, prepared by Link Treasury Services, the Council's Treasury Adviser, which covers the following elements of treasury management, in order to obtain assurance that the Treasury Management Practices are operating effectively:

- An economic update for the first half of the 2022/23 financial year.
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy.
- The Council's capital expenditure, as set out in the Capital Strategy and prudential indicators.
- A review of the Council's investment portfolio for 2022/23.
- A review of the Council's borrowing strategy for 2022/23.
- A review of compliance with Treasury and Prudential Limits for 2022/23.

3. Background

3.1.

Regulation 21 of the Council's Financial Regulations confirms that the Council has adopted the key recommendations of the Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in the Public Services (the Code).

3.2.

The Code defines treasury management to include investment activities.

3.3.

The Council's investment priorities can be summarised as maintaining:

- The security of capital.
- The liquidity of its investments.

3.4.

The Council aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of the Council is low in order to give priority to security of its investments. This is in keeping with the nature of the Strategic Reserve Fund, which is to provide for the benefit of Orkney and its inhabitants, whilst having regard to the Fund's long-term obligations in terms of the decline and decommissioning of the Flotta Oil Terminal in the future.

3.5.

The Financial Regulations refer to maintenance of the Treasury Management Policy Statement and Treasury Management Practices as the cornerstone for effective treasury management and the requirement to report annually on the Treasury Management function.

4. Treasury Management Performance

4.1.

A detailed analysis of the Treasury Management Performance for financial year 2022/23, as at 30 September 2022, is attached as Appendix 1 to this report, and covers the following activities:

- Borrowing activity.
- Temporary loans.
- Strategic Reserve Fund.

4.2.

The conclusion of the analysis of performance is that existing treasury management practices have operated effectively over the first six months of financial year 2022/23.

4.3.

Recurring slippage continues to be a feature within the approved capital programmes. The Treasury Management Strategy for 2022/23 reflected a reprofiling exercise that was approved by Policy and Resources Committee on 1 March 2022, whereby £12.803,000 was reprofiled into financial year 2022/23 and beyond. Further slippage of £235,000 was approved on 20 September 2022, resulting in overall slippage for financial year 2021/22 of works valued at £13,038,000. Not only does this impact on the cost of delivering the capital programme works, it also delays the timescale over which the capital finance is required.

4.4.

As part of its Treasury Management Strategy for 2022 to 2025, the Council has established an authorised limit for external debt of £75,000,000 for financial year 2022/23, increasing to £85,000,000 in years 2023/24 to 2024/25, together with an operational boundary of £65,000,000 in 2022/23, increasing to £70,000,000 in 2023/24 and 2024/25.

4.5.

The Council supports its capital financing requirement through a combination of borrowings and use of internal reserves. In determining this combination, the cost of raising additional finance or borrowing is compared against the opportunity cost of using internal reserves and balances, in that these funds could otherwise be generating an investment return for the Council. On the basis the capital financing requirement can be externalised through borrowings, and investment returns generated in excess of the cost of any borrowings to meet the requirements of the capital programme, the potential exists for a net saving to be realised by the treasury management function over the longer term.

4.6.

As at 30 September 2022, the Council's debt portfolio stood at £35,071,000, with loan maturities ranging over periods from one to 39.5 years. Overall this represents an average cost of borrowing of 2.28% per annum, with an average weighted duration of 44.91 years.

4.7.

The cost of this debt is managed as part of the loan charges associated with the capital programme and has been offset in the short term with surplus funds placed on deposit for periods of up to one year at an average rate of 0.93% for the first half of financial year 2022/23.

4.8.

Although there remains much uncertainty over interest rates, with the long-term trend prediction for rates to rise, which will impact on future borrowing requirements, the Council is still well placed to benefit from savings on existing debt with an average interest rate of 2.28%.

4.9.

The prime objective for the managed funds remains to maintain or increase their real value over time, while at the same time generating an annual return which meets the targets set by the Council. These objectives normally require to be measured over a number of years while acknowledging that abnormal fluctuations in the short term do create a cause for concern.

4.10.

The Head of Finance developed an Action Plan, in consultation with Hymans Robertson, to commence the process of implementing revisions to the investment strategy agreed by the Investments Sub-committee on 25 February 2019, including further diversification. Interviews with potential fund managers took place in August and October 2019 after which fund managers were appointed to three new mandates, as follows:

- Global Alpha.
- Global Private Loan Fund III.
- UK Strategic Alternative Income Fund.

4.11.

The process of diversification commenced in financial year 2019/20 and continued in 2020/21, albeit at a slower pace than originally envisaged due to COVID-19 related volatility being experienced in the markets. The diversification process continued in financial year 2021/22 and is ongoing in 2022/23.

5. Corporate Governance

This report relates to the Council complying with scrutiny and its financial processes and procedures and therefore does not directly support and contribute to improved outcomes for communities as outlined in the Council Plan and the Local Outcomes Improvement Plan.

6. Financial Implications

The financial implications are contained within the body of the report.

7. Legal Aspects

7.1.

Treasury Management arrangements help the Council meet its statutory obligation to secure best value.

7.2.

Section 40 of the Local Government in Scotland Act 2003 provides local authorities with the power to invest money. This power may be exercised in accordance with regulations made by Scottish Ministers under this section.

7.3.

Section 95 of the Local Government (Scotland) Act 1973 states that every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that the proper officer has responsibility for the administration of those affairs.

8. Contact Officers

Erik Knight, Head of Finance, extension 2128, Email erik.knight@orkney.gov.uk

Shonagh Merriman, Service Manager (Corporate Finance), extension 2105, Email shonagh.merriman@orkney.gov.uk

9. Appendix

Appendix 1: Treasury Management Update – Mid-year review 2022/23.

Treasury Management Strategy Statement and Annual Investment Strategy

Mid-Year Review Report
2022/23
Orkney Islands Council

1. Background

1.1 Capital Strategy
In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. These require all local authorities to prepare a Capital Strategy which is to provide the following: -

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- an overview of how the associated risk is managed;
- the implications for future financial sustainability.

1.2 Treasury management
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 optimising investment return.

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, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly, treasury management is defined as:

> "The management of the local authority's borrowing, 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. Introduction

This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).
The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report, (stewardship report), covering activities during the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Policy and Resources Committee:

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first half of the 2022/23 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of the Council's investment portfolio for 2022/23;
- A review of the Council's borrowing strategy for 2022/23;
- A review of any debt rescheduling undertaken during 2022/23;
- A review of compliance with Treasury and Prudential Limits for 2022/23.

3. Economics and interest rates

3.1 Economics update

- The second quarter of 2022/23 saw:
  - GDP revised upwards in Q1 2022/23 to +0.2% q/q from -0.1%, which means the UK economy has avoided recession for the time being;
  - Signs of economic activity losing momentum as production fell due to rising energy prices;
  - CPI inflation ease to 9.9% y/y in August, having been 9.0% in April, but domestic price pressures showing little sign of abating in the near-term;
  - The unemployment rate fall to a 48-year low of 3.6% due to a large shortfall in labour supply;
  - Bank Rate rise by 100bps over the quarter, taking Bank Rate to 2.25% with further rises to come;
  - Gilt yields surge and sterling fall following the "fiscal event" of the new Prime Minister and Chancellor on 23rd September.
- The UK economy grew by 0.2% q/q in Q1 2022/23, though revisions to historic data left it below pre-pandemic levels.
- There are signs of higher energy prices creating more persistent downward effects in economic activity. Both industrial production (-0.3% m/m) and construction output (-0.8% m/m) fell in July 2022 for a second month in a row. Although some of this was probably due to the heat wave at the time, manufacturing output fell in some of the most energy intensive sectors (e.g., chemicals), pointing to signs of higher energy prices weighing on production. With the drag on real activity from high inflation having grown in recent months, GDP is at risk of contracting through the autumn and winter months.
- The fall in the composite PMI from 49.6 in August to a 20-month low preliminary reading of 48.4 in September points to a fall in GDP of around 0.2% q/q in Q3 and consumer confidence is at a record low. Retail sales volumes fell by 1.6% m/m in August, which was the ninth fall in 10 months. That left sales volumes in August just 0.5% above their pre-Covid level and 3.3% below their level at the start of the year. There are also signs that households are spending their excess savings in response to high prices. Indeed, cash in households' bank accounts rose by £3.2bn in August, which was below the £3.9bn rise in July and much smaller than the 2019 average monthly rate of £4.6bn.
- The labour market remained exceptionally tight. Data for July and August provided further evidence that the weaker economy is leading to a cooling in labour demand. Labour Force Survey (LFS) employment rose by 40,000 in the three months to July (the smallest rise since February). But a renewed rise in inactivity of 154,000 over the same period meant that the unemployment rate fell from 3.8% in June to a new 48-year low of 3.6%. The single-month data showed that inactivity rose by 354,000 in July itself and there are now 904,000 more inactive people aged 16+ compared to before the pandemic in February 2020. The number of vacancies has started to level off from recent record highs but there have been few signs of a slowing in the upward momentum on wage growth. Indeed, in July, the 3my/y rate of average earnings growth rose from 5.2% in June to 5.5%.
- CPI inflation eased from 10.1% in July to 9.9% in August, though inflation has not peaked yet. The easing in August was mainly due to a decline in fuel prices reducing fuel inflation from 43.7% to 32.1%. And with the oil price now just below $90pb, we would expect to see fuel prices fall further in the coming months.
- However, utility price inflation is expected to add 0.7% to CPI inflation in October when the Ofgem unit price cap increases to, typically, £2,500 per household (prior to any benefit payments). But, as the government has frozen utility prices at that level for two years, energy price inflation will fall sharply after October and have a big downward influence on CPI inflation.
- Nonetheless, the rise in services CPI inflation from 5.7% y/y in July to a 30-year high of 5.9% y/y in August suggests that domestic price pressures are showing little sign of abating. A lot of that is being driven by the tight labour market and strong wage growth. CPI inflation is expected to peak close to 10.4% in November and, with the supply of workers set to remain unusually low, the tight labour market will keep underlying inflationary pressures strong until early next year.
- During H1 2022, there has been a change of both Prime Minister and Chancellor. The new team (Liz Truss and Kwasi Kwarteng) have made a step change in government policy. The government's huge fiscal loosening from its proposed significant tax cuts will add to existing domestic inflationary pressures and will

potentially leave a legacy of higher interest rates and public debt. Whilst the government's utility price freeze, which could cost up to £150bn (5.7% of GDP) over 2 years, will reduce peak inflation from 14.5% in January next year to 10.4% in November this year, the long list of tax measures announced at the "fiscal event" adds up to a loosening in fiscal policy relative to the previous government's plans of £44.8bn (1.8% of GDP) by 2026/27. These included the reversal of April's national insurance tax on 6th November, the cut in the basic rate of income tax from 20p to 19p in April 2023, the cancellation of next April's corporation tax rise, the cut to stamp duty and the removal of the 45p tax rate, although the 45p tax rate cut announcement has already been reversed.

- Fears that the government has no fiscal anchor on the back of these announcements has meant that the pound has weakened again, adding further upward pressure to interest rates. Whilst the pound fell to a record low of $1.035 on the Monday following the government's "fiscal event", it has since recovered to around $1.12. That is due to hopes that the Bank of England will deliver a very big rise in interest rates at the policy meeting on 3rd November and the government will lay out a credible medium-term plan in the near term. This was originally expected as part of the fiscal statement on 23rd November but has subsequently been moved forward to an expected release date in October. Nevertheless, with concerns over a global recession growing, there are downside risks to the pound.

- The MPC has now increased interest rates seven times in as many meetings in 2022 and has raised rates to their highest level since the Global Financial Crisis. Even so, coming after the Fed and ECB raised rates by 75 basis points (bps) in their most recent meetings, the Bank of England's latest 50 basis points hike looks relatively dovish. However, the UK's status as a large importer of commodities, which have jumped in price, means that households in the UK are now facing a much larger squeeze on their real incomes.

- Since the fiscal event on 23rd September, we now expect the Monetary Policy Committee (MPC) to increase interest rates further and faster, from 2.25% currently to a peak of 5.00% in February 2023. The combination of the government's fiscal loosening, the tight labour market and sticky inflation expectations means we expect the MPC to raise interest rates by 100bps at the policy meetings in November (to 3.25%) and 75 basis points in December (to 4%) followed by further 50 basis point hikes in February and March (to 5.00%). Market expectations for what the MPC will do are volatile. If Bank Rate climbs to these levels the housing market looks very vulnerable, which is one reason why the peak in our forecast is lower than the peak of 5.50% - 5.75% priced into the financial markets at present.

- Throughout 2022/23, gilt yields have been on an upward trend. They were initially caught up in the global surge in bond yields triggered by the surprisingly strong rise in CPI inflation in the US in May. The rises in two-year gilt yields (to a peak of 2.37% on 21st June) and 10-year yields (to a peak of 2.62%) took them to their highest level since 2008 and 2014 respectively. However, the upward trend was exceptionally sharply at the end of September as investors demanded a higher risk premium and expected faster and higher interest rate rises to offset the government's extraordinary fiscal stimulus plans. The 30-year gilt yield rose from 3.60% to 5.10% following the "fiscal event", which threatened financial stability by forcing pension funds to sell assets into a falling market to meet cash collateral requirements. In response, the Bank did two things. First, it postponed its plans to start selling some of its quantitative easing (QE) gilt holdings until 31st October. Second, it committed to buy up to £65bn of long-term gilts to "restore orderly market conditions" until 14th October. In other words, the Bank is restarting QE, although for financial stability reasons rather than monetary policy reasons.

- Since the Bank's announcement on 28th September, the 30-year gilt yield has fallen back from 5.10% to 3.83%. The 2-year gilt yield dropped from 4.70% to 4.30% and the 10-year yield fell back from 4.55% to 4.09%.

- There is a possibility that the Bank continues with QE at the long-end beyond 14th October or it decides to delay quantitative tightening beyond 31st October, even as it raises interest rates. So far at least, investors seem to have taken the Bank at its word that this is not a change in the direction of monetary policy nor a step towards monetary financing of the government's deficit. But instead, that it is a temporary intervention with financial stability in mind.

- After a shaky start to the year, the S&P 500 and FTSE 100 climbed in the first half of Q2 2022/23 before falling to their lowest levels since November 2020 and July 2021 respectively. The S&P 500 is 7.2% below its level at the start of the quarter, whilst the FTSE 100 is 5.2% below it as the fall in the pound has boosted the value of overseas earnings in the index. The decline has, in part, been driven by the rise in global real yields and the resulting downward pressure on equity valuations as well as concerns over economic growth leading to a deterioration in investor risk appetite.

3.2 Interest rate forecasts

The Council has appointed Link Group as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. The PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1st November 2012.

The latest forecast on 27th September sets out a view that both short and long-dated interest rates will be elevated for some little while, 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 ravages of ultra-high wholesale gas and electricity prices.

The increase in PWLB rates reflects a broad sell-off in sovereign bonds internationally but more so the disaffection investors have with the position of the UK public finances after September's "fiscal event". To that end, the MPC 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, but its job is that much harder now.

Our PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps, calculated as gilts plus 80bps) which has been accessible to most authorities since 1st November 2012.

Link Group Interest Rate View	27.09.22											
	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
3 month ave earnings	4.50	5.00	5.00	5.00	4.50	4.00	3.80	3.30	3.00	2.80	2.80	2.50
6 month ave earnings	4.70	5.20	5.10	5.00	4.60	4.10	3.90	3.40	3.10	3.00	2.90	2.60
12 month ave earnings	5.30	5.30	5.20	5.00	4.70	4.20	4.00	3.50	3.20	3.10	3.00	2.70
5 yr PWLB	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 yr PWLB	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 yr PWLB	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 yr PWLB	4.80	4.60	4.50	4.20	4.00	3.80	3.60	3.40	3.30	3.30	3.20	3.10

4. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy Statement, (TMSS), for 2022/23 was approved by this Council on 1 March 2022.

- 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. The Council's Capital Position (Prudential Indicators)

This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

5.1 Prudential Indicator for Capital Expenditure

This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Capital Expenditure by Service	2022/23 Original Estimate £m	2022/23 Revised Estimate £m	Current Position £m
Social Care	6.150	6.159	0.836
Roads and Transportation	3.018	3.767	1.268
Education and Leisure	3.613	4.448	2.096
Marine Services	10.405	11.356	3.919
Other Services	5.515	7.030	1.924
Non-HRA	**28.701**	**32.760**	**10.024**
HRA	5.681	6.840	(0.081)
Total capital expenditure	**34.382**	**39.600**	**9.962**

The revised budget for 2022/23 reflects the following changes since the TMSS was approved in March 2022:

- Acceleration of £0.418M from financial year 2022/23 added to the 2021/22 capital programme.
- Slippage of £0.915M from financial year 2021/22 added to the 202/23 capital programme.
- Addition of £1.348M of COVID-19 Recovery Funding.
- Addition of £0.500M and £0.490M in respect of an Integrated Waste Facility and HRA Infrastructure respectively.
- Various other additions totalling £2.383M

5.2 Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2022/23 Original Estimate £m	2022/23 Revised Estimate £m
Total capital expenditure	**34.382**	**39.600**
Financed by:		
Capital receipts	**0.150**	**0.150**
Capital grants	**9.260**	**13.065**
Capital reserves	**6.448**	**9.099**
Revenue	**1.009**	**1.688**
Total financing	**14.930**	**24.002**
Borrowing requirement	**19.452**	**15.598**

5.3 Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary

The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary.

Prudential Indicator – Capital Financing Requirement

We are no longer on target to achieve the forecast Capital Financing Requirement with current estimates for slippage on the capital programme being £11,768M by 31 March 2023, against a revised budget for financial year 2022/23 of £39.600m.

Prudential Indicator – the Operational Boundary for external debt

	2022/23 Original Estimate £m	2022/23 Revised Estimate £m
Prudential Indicator – Capital Financing Requirement		
CFR – non housing	55.538	56.069
CFR – housing	10.401	12.518
Total CFR	65.939	68.587
Net movement in CFR	**12.778**	**15.426**
Prudential Indicator – the Operational Boundary for external debt		
Borrowing	65.000	65.000
Total debt (year end position)	**35.085**	**30.051**

5.4 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose*. **Gross external borrowing** should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2022/23 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

	2022/23 Original Estimate £m	2022/23 Revised Estimate £m
Borrowing	0	0
Total debt	35.085	30.051
CFR* (year end position)	65.939	68.587

A further prudential indicator controls the overall level of borrowing. This is **the Authorised Limit** which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt	2022/23 Original Indicator	2022/23 Revised Indicator
Borrowing	75.000	75.000
Total	**75.000**	**75.000**

6. Borrowing

The Council's capital financing requirement (CFR) for 2022/23 is £68.587m. 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. Table 5.4 shows the Council has borrowings of £35.051m and has utilised £33.536m of cash flow funds in lieu of borrowing. This is a prudent and cost-effective approach in the current economic climate but will require ongoing monitoring in the event that any upside risk to gilt yields prevails.

Due to the overall financial position and the underlying need to borrow for capital purposes (the CFR), no new external borrowing was undertaken. The capital programme is being kept under regular review due to the effects of inflationary pressures, shortages of materials and labour. Our borrowing strategy will, therefore, also be regularly reviewed and then revised, if necessary, in order to achieve optimum value and risk exposure in the long-term.

PWLB maturity certainty rates (gilts plus 80bps) year to date to 30th September 2022

Gilt yields and PWLB rates were on a generally rising trend throughout H1 2022, the exception being a short rally in gilts in July/August. However, they rose exceptionally sharply towards the end of September.

The 50-year PWLB target certainty rate for new long-term borrowing started 2022/23 at 2.20% and finished the half year at 4.80%, albeit we forecast rates to fall back to 3.10% by the end of September 2025.

PWLB maturity certainty rates year to date to 30th September 2022

Gilt yields and PWLB rates were on a rising trend between 1st April and 30th September.

The 50-year PWLB target certainty rate for new long-term borrowing started 2022/23 at 2.20% before increasing to 4.80% in September. (Please note, however, that we see PWLB rates trending downwards through 2023 and 2024.)

PWLB RATES 01.04.22 - 30.09.22

HIGH/LOW/AVERAGE PWLB RATES FOR 01.04.22 – 30.09.22

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.95%	2.18%	2.36%	2.52%	2.25%
Date	01/04/2022	13/05/2022	04/04/2022	04/04/2022	04/04/2022
High	5.11%	5.44%	5.35%	5.80%	5.51%
Date	28/09/2022	28/09/2022	28/09/2022	28/09/2022	28/09/2022
Average	2.81%	2.92%	3.13%	3.44%	3.17%
Spread	3.16%	3.26%	2.99%	3.28%	3.26%

- The current PWLB rates are set as margins over gilt yields as follows: -.
    - **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
    - **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
    - **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

7. Debt Rescheduling

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. However, now that the whole of the yield curve has shifted higher there may be better opportunities in the future, although only prudent and affordable debt rescheduling will be considered.

8. Compliance with Treasury and Prudential Limits

It is a statutory duty for the Council to determine and keep under review the affordable capital expenditure limits. During the half year ended 30th September 2022, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2022/23. The Director of Finance reports that no difficulties are envisaged for the current or future years in complying with these indicators.

All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

9. Annual investment strategy

The Treasury Management Strategy Statement (TMSS) for 2022/23, which includes the Annual Investment Strategy, was approved by the Council on 1 March 2022. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. 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 high credit rated financial institutions, using the Link suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

Creditworthiness.
Following the Government's fiscal event on 23rd September, both S&P and Fitch have placed the UK sovereign debt rating on Negative Outlook, reflecting a downside bias to the current ratings in light of expectations of weaker finances and the economic outlook.

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

CDS prices
It is noted that sentiment in the current economic climate can easily shift, so it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances.

Investment balances
The average level of funds available for investment purposes during the first half of the financial year was £19.336m. The temporary loans portfolio has operated within policy during financial year 2022/23 and has realised a return of 0.93% as at 30 September 2022. This is ahead of the average 3 months LIBOR (London Inter-bank Offered Rate) performance benchmark (0.26%) and is therefore considered an acceptable return.

Treasury Portfolio investments held at 30 September 2022:

Treasury Investments – Managed in house	Principal (£m)	Interest Rate	Maturity Date
Santander UK Plc	1.000	1.69%	05/10/2022
Standard Chartered Bank London	1.000	1.90%	09/12/2022
Santander UK Plc	1.000	2.03%	14/12/2022
Lloyds Bank PLC	1.000	2.01%	22/12/2022
National Westminster Bank Plc	3.000	2.01%	13/01/2022
Aberdeen Standard Investments Money Market Fund	4.000	2.14%	Call
Blackrock ICS Heritage Shared Money Market Fund	4.2000	2.01%	Call
Insight Liquidity Funds PLC	4.000	2.03%	Call
The Royal Bank of Scotland	0.043	0.30%	Call
Total investments	19.243		

Non-Treasury Strategic Reserve Fund Local Investments – Managed in-house	Actual (£m)	Performance in 21/221
Fishing Quota	3.333	4.58%
Private Companies	5.874	5.0%
Other	0.013	0.0%
Total Strategic Reserve Fund Investments – Managed in-house	9.220	

Treasury Strategic Reserve Fund – Managed externally	Actual (£m)	Performance Quarter ending 30/09/22	Benchmark
Equity Portfolio	57.000	-3.9%	-8.7%
Global Equity Portfolio	42.500	-11.8%	-7.9%
Diversified Growth Fund	30.100	-7.8%	1.0%
High Yield Credit Strategies Fund	20.000	-8.7%	1.3%
Private Loan Fund	9.000	n/a	n/a
UK Property Fund	2.900	3.0%	3.9%
Secured Income Fund	27.800	n/a	n/a
Corporate Bonds Fund	37.400	-6.1%	-5.8%
Total investments	**226.600**		

Approved limits
Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the period ended 30th September 2022.

No performance figures are provided where full drawdown of the Council's commitment has not been concluded.

10. Other

1. Changes in risk appetite
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 should be brought to members' attention in treasury management update reports.

No changes have taken place during financial year 2022/23 however it should be noted that the on 28 February 2019, the Investments Sub-committee reviewed the current investment strategy and resolved to further diversify into Illiquid Debt and Secured Income by way of direct investment to a pooled fund. It was further resolved that the equity allocation be split on a 50/50 basis between funds held on a growth basis, with a newly appointed Fund Manager, whilst retaining the existing Fund Manager on a simplified single global equity strategy with the existing value style bias. The Corporate Bonds allocation will be transferred to a specialist passive manager. These diversifications will be matched by a proportionate reduction in growth assets.

The onboarding process for the new mandates commenced in 2019/20 and is on-going in 2022/23. The process has moved at a slower rate than originally envisaged due to volatility experienced in the markets relating to COVID-19 and the more recent impact of the war in Ukraine. To date the full transfers to a growth style Fund Manager and a specialist Passive Bond Manager are complete. The drawdown of commitments in a Private Loan Fund and an Income Fund have commenced and will continue during 2022/23.

APPENDIX 1: Approved countries for investments as of 30th September 2022

Based on lowest available rating

AAA

- Australia
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Canada
- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- France

AA-

- Belgium
- Hong Kong
- Qatar
- **U.K.**