



**FLINTSHIRE COUNTY COUNCIL**  
DRAFT

**TREASURY MANAGEMENT**

**MID YEAR REPORT 2022/23**

## **1.00 PURPOSE OF REPORT**

- 1.01 To provide Members with a mid-year update on matters relating to the Council's Treasury Management function.

## **2.00 BACKGROUND**

- 2.01 Treasury management comprises the management of the Council's 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.
- 2.02 The Council's primary objectives for the investment of its surplus funds are to protect the principal sums invested from loss, and to ensure adequate liquidity so that funds are available for expenditure when needed. The generation of investment income to support the provision of local authority services is an important, but secondary, objective.
- 2.03 The Council's policy is to appoint external consultants to provide advice on its treasury management function. In September 2021 Arlingclose Ltd were reappointed as the Council's advisors for a period of 3 years, following a competitive tendering exercise. This period can be extended a further 2 years as per the contract terms to September 2026.
- 2.04 The Council has adopted the 2017 edition of the CIPFA Treasury Management in the Public Services: Code of Practice, which requires the Council to approve a treasury management strategy before the start of each financial year, a mid-year report, and an annual report after the end of each financial year.
- 2.05 In addition, the Welsh Government (WG) issues guidance on local authority investments that requires the Council to approve an investment strategy before the start of each financial year.
- 2.06 This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the WG Guidance.
- 2.07 The Council approved the 2022/23 Treasury Management Strategy at its meeting on 15<sup>th</sup> February 2022.

### **3.00 ECONOMIC & INTEREST RATE REVIEW APRIL – OCTOBER 2022.**

*Provided by Arlingclose Ltd, the Council's treasury management advisors.*

**Economic background:** The ongoing conflict in Ukraine has continued to put pressure on global inflation and the economic outlook for UK and world growth remains weak. The UK political situation towards the end of the period following the 'fiscal event' increased uncertainty further.

The economic backdrop during the April to September period continued to be characterised by high oil, gas and commodity prices, ongoing high inflation and its impact on consumers' cost of living, no imminent end in sight to the Russia-Ukraine hostilities and its associated impact on the supply chain, and China's zero-Covid policy.

Central Bank rhetoric and action remained robust. The Bank of England, Federal Reserve and the European Central Bank all pushed up interest rates over the period and committed to fighting inflation, even when the consequences were in all likelihood recessions in those regions.

UK inflation remained extremely high. Annual headline CPI hit 10.1% in July, the highest rate for 40 years, before falling modestly to 9.9% in August. RPI registered 12.3% in both July and August. The energy regulator, Ofgem, increased the energy price cap by 54% in April, while a further increase in the cap from October, which would have seen households with average energy consumption pay over £3,500 per annum, was dampened by the UK government stepping in to provide around £150 billion of support to limit bills to £2,500 annually until 2024.

The labour market remained tight through the period but there was some evidence of easing demand and falling supply. The unemployment rate 3m/year for April fell to 3.8% and declined further to 3.6% in July. Although now back below pre-pandemic levels, the recent decline was driven by an increase in inactivity rather than demand for labour. Pay growth in July was 5.5% for total pay (including bonuses) and 5.2% for regular pay. Once adjusted for inflation, however, growth in total pay was -2.6% and -2.8% for regular pay.

With disposable income squeezed and higher energy bills still to come, consumer confidence fell to a record low of -44 in August, down -41 in the previous month. Quarterly GDP fell -0.1% in the April-June quarter driven by a decline in services output, but slightly better than the 0.3% fall expected by the Bank of England.

The Bank of England increased the official Bank Rate to 2.25% over the period. From 0.75% in March, the Monetary Policy Committee (MPC) pushed through rises of 0.25% in each of the following two MPC meetings, before hiking by 0.50% in August and again in September. August's rise was voted by a majority of 8-1, with one MPC member preferring a more modest rise of 0.25%. The September vote was 5-4, with five votes for a 0.5% increase, three for a 0.75% increase and one for a 0.25% increase. The Committee noted that domestic inflationary pressures are expected to remain strong and so given ongoing strong rhetoric around tackling inflation further Bank Rate rises should be expected.

On 23rd September the UK government, following a change of leadership, announced a raft of measures in a 'mini budget', loosening fiscal policy with a view to boosting the UK's trend growth rate to 2.5%. With little detail on how government borrowing would be returned to a sustainable path, financial markets reacted negatively. Gilt yields rose dramatically by between 0.7% - 1% for all maturities with the rise most pronounced for shorter dated gilts. The swift rise in gilt yields left pension funds vulnerable, as it led to margin calls on their interest rate swaps and risked triggering large scale redemptions of assets across their portfolios to meet these demands. It became necessary for the Bank of England to intervene to preserve market stability through the purchase of long-dated gilts, albeit as a temporary measure, which has had the desired effect with 50-year gilt yields falling over 100bps in a single day.

Bank of England policymakers noted that any resulting inflationary impact of increased demand would be met with monetary tightening, raising the prospect of much higher Bank Rate and consequential negative impacts on the housing market.

After hitting 9.1% in June, annual US inflation eased in July and August to 8.5% and 8.3% respectively. The Federal Reserve continued its fight against inflation over the period with a 0.5% hike in May followed by three increases of 0.75% in June, July and September, taking policy rates to a range of 3% - 3.25%.

Eurozone CPI inflation reached 9.1% y/y in August, with energy prices the main contributor but also strong upward pressure from food prices. Inflation has increased steadily since April from 7.4%. In July the European Central Bank increased interest rates for the first time since 2011, pushing its deposit rate from -0.5% to 0% and its main refinancing rate from 0.0% to 0.5%. This was followed in September by further hikes of 0.75% to both policy rates, taking the deposit rate to 0.75% and refinancing rate to 1.25%.

**Financial markets:** 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.

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

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.

**Credit review:** In July Fitch revised the outlook on Standard Chartered from negative to stable as it expected profitability to improve thanks to the higher interest rate environment. Fitch also revised the outlook for Bank of Nova Scotia from negative to stable due to its robust business profile.

Also in July, Moody's revised the outlook on Bayerische Landesbank to positive and then in September S&P revised the GLA outlook to stable from negative as it expects the authority to remain resilient despite pressures from a weaker macroeconomic outlook coupled with higher inflation and interest rates.

Having completed its full review of its credit advice on unsecured deposits at UK and non-UK banks, in May Arlingclose extended the maximum duration limit for five UK banks, four Canadian banks and four German banks to six months. The maximum duration for unsecured deposits with other UK and non-UK banks on Arlingclose's recommended list is 100 days. These recommendations were unchanged at the end of the period.

Arlingclose continued to monitor and assess credit default swap levels for signs of credit stress but made no changes to the counterparty list or recommended durations. Nevertheless, increased market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remains under constant review.

## Outlook for the remainder of 2022/23

Arlingclose expects Bank Rate to rise further during 2022/23 to reach 5% by the end of the year.

The MPC is particularly concerned about the demand implications of fiscal loosening, the tight labour market, sterling weakness and the willingness of firms to raise prices and wages.

The MPC may therefore raise Bank Rate more quickly and to a higher level to dampen aggregate demand and reduce the risk of sustained higher inflation. Arlingclose now expects Bank Rate to peak at 5.0%, with 200bps of increases this calendar year.

This action by the MPC will slow the economy, necessitating cuts in Bank Rate later in 2024.

Gilt yields will face further upward pressure in the short term due to lower confidence in UK fiscal policy, higher inflation expectations and asset sales by the BoE. Given the recent sharp rises in gilt yields, the risks are now broadly balanced to either side. Over the longer term, gilt yields are forecast to fall slightly over the forecast period.

	Current	Dec 22	Mar 23	Jun 23	Sept 23	Dec 23	Mar 24	Jun 24	Sept 24	Dec 24	Mar 25	Jun 25	Sept 25
Upside Risk (%)	0.00	0.50	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Interest Rate (%)	2.25	4.25	5.00	5.00	5.00	5.00	5.00	5.00	5.00	4.75	4.25	3.75	3.25
Downside Risk (%)	0.00	-1.00	-1.00	-0.75	-0.50	-0.50	-0.50	-0.75	-1.25	-1.50	-1.75	-1.75	-1.75

## 4.00 BORROWING REQUIREMENTS AND DEBT MANAGEMENT

### 4.01 PWLB (Public Works Loans Board) Certainty Rate Update.

The Authority submitted its application to WG along with the 2022-23 Capital Estimates Return to access this reduced rate for a further 12 months from 1st April 2022.

### 4.02 The long term borrowing outstanding at 30<sup>th</sup> September 2022 totals £292.5 million.

- 4.03 Loans with the Public Works Loans Board are in the form of fixed rate (£268.9m). £18.95m is variable in the form of LOBOs (Lender's Option, Borrower's Option) and £4.64m are interest free loans from government. The Council's average long term borrowing rate is currently 4.53%.

	Balance 01/04/2022 £m	Debt Maturing £m	New Debt £m	Balance 30/09/2022 £m
Long Term Borrowing	289.6	(1.98)	0.00	287.88
Government Loans	4.81	(0.25)	0.07	4.63
<b>TOTAL BORROWING</b>	<b>294.67</b>	<b>(2.23)</b>	<b>0.07</b>	<b>292.51</b>
Other Long Term Liabilities *	3.43	0.00	0.00	3.43
<b>TOTAL EXTERNAL DEBT</b>	<b>298.10</b>	<b>(2.23)</b>	<b>0.07</b>	<b>295.94</b>
Increase/ (Decrease) in Borrowing £m				(2.16)

\* relates to finance leases in respect of Deeside Leisure Centre and Jade Jones Pavilion

- 4.04 No new long or short term borrowing was undertaken during the period.
- 4.05 The Authority holds £18.95m of LOBO loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. The option to change the terms on £18.95m of the Council's LOBOs was not exercised by the lender during the period, however, as rates increase so does the likelihood of the loans having to be repaid.
- 4.06 Borrowing Strategy

As outlined in the treasury strategy, the Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective. The Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

Over the April-September period short term PWLB rates rose dramatically, particular in late September after the Chancellor's 'mini-budget' prompted a fall in

sterling and rise in market interest rate expectations. Interest rates rose by over 2% during the period in both the long and short term. As an indication the 5-year maturity certainty rate rose from 2.30% on 1<sup>st</sup> April to 5.09% on 30<sup>th</sup> September; over the same period the 30-year maturity certainty rate rose from 2.63% to 4.68%. Although interest rates across the board have risen, short-term borrowing from other local authorities remains at lower interest rates than long term borrowing.

In keeping with the Authority's objectives, no new borrowing was undertaken, while £1m of existing loans were allowed to mature without replacement. This strategy enabled the Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

#### 4.07 Debt Rescheduling

The premium charge for early repayment of PWLB debt remained relatively expensive for the loans in the Authority's portfolio and therefore unattractive for debt rescheduling activity. No rescheduling activity was undertaken as a consequence.

The Corporate Finance Manager, in conjunction with the Council's treasury advisors, will continue to review any potential opportunities for restructuring the Council's debt in order to take advantage of potential savings as interest rates change and to enhance the balance of the long term portfolio (amend the maturity profile and/or the balance of volatility).

#### 4.08 Borrowing Update

CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the Authority.

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

### **5.0 INTERIM INVESTMENT AND PERFORMANCE REPORT**

5.01 The maximum investments the Authority had on deposit at any one time totalled £74.2m. The average investment balance for the period was £57.5m and the average rate of return was 1.05%, generating investment income of £304k.

5.02 Up to 30<sup>th</sup> September, investments were made in the Debt Management Office Deposit Account, banks, other local authorities and money market funds

5.03 The average of long term borrowing was £293.9m generating interest payable of £6.655m, in line with budget forecasts to date.

	Investments		Long Term Borrowing		Short Term Borrowing	
	Interest received £k	Interest rate %	Interest paid £k	Interest rate %	Interest paid £k	Interest rate %
2022/23 Apr - Sept	304	1.05	6,655	4.53	0	n/a
2021/22 Apr - Sept	2.8	0.01	6,664	4.61	16	0.09
Difference	301.2		(9.0)		(16)	

Year-end projections are as follows:

	Investments		Long Term Borrowing		Short Term Borrowing	
	Interest received £k	Interest rate %	Interest paid £k	Interest rate %	Interest paid £k	Interest rate %
2022/23 est	925	2.61	13,258	4.53	471	2.71
2021/22 act	29.1	0.07	13,312	4.52	19	0.07
Difference	895.9		(54)		452	

#### 5.04 Credit Risk (security)

Counterparty credit quality was assessed and monitored with reference to credit ratings (the Authority's minimum long-term counterparty rating for institutions defined as having "high credit quality" is A- across rating agencies Fitch, S&P and Moody's); credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

#### 5.05 Liquidity

In keeping with the WG's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of money market funds.

#### 5.06 Yield

The Council sought to optimise returns commensurate with its objectives of security and liquidity. The Council's investment yield is outlined in 5.01.

## **6.00 COMPLIANCE**

6.01 The Council can confirm that it has complied with its Prudential Indicators for the period April to September 2022. These were approved on 15<sup>th</sup> February 2022 as part of the Council's 2022/23 Treasury Management Strategy.

6.02 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 period April – September 2022. 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.

## **7.00 OTHER ITEMS**

7.01 Other treasury management related activity that took place during April – September 2022 includes:

- The Treasury Management Annual Report 2021/22 was reported to Governance and Audit Committee on 27<sup>th</sup> July 2022, Cabinet on 20<sup>th</sup> September 2022 and Council on 18<sup>th</sup> October 2022.
- The Quarter 1 Treasury Management update was reported to the Governance and Audit Committee.

## **8.00 CONCLUSION**

8.01 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.

8.02 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.

Debt Maturity Profile - Sept 2022

