Havering
LONDON BOROUGH

Audit Committee	**19th October 2022**
Subject Heading:	**2022/23 Treasury Management Mid-Year Report.**
SLT Lead:	**Dave McNamara** **(Section 151 officer and Chief Operating Officer)**
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Policy context:	**The code of practice on treasury management 2017 requires that the Authority be provided with a Mid-year report on treasury activities**
Financial summary:	**There are no direct Financial implications from the report**
Is this a Key Decision?	**NO**
When should this matter be reviewed?	**Bi-Annually**
Reviewing OSC:	**Overview and Scrutiny Board**

The subject matter of this report deals with the following Council Objectives

Communities making Havering	[]
Places making Havering	[]
Opportunities making Havering	[]
Connections making Havering	[]

SUMMARY

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management Code ("TM Code") require authorities to produce a mid-year report on their treasury management activities.

The Authority's Treasury Management Strategy Statement (TMSS) for 2022/23 was approved at the Cabinet meeting on 16th February 2022 and at Full Council on the 2nd March 2022.

The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. This report covers activity on treasury managed investments and borrowings and the associated monitoring and control of risk.

The key highlights of the Mid-Year report are as follows:

- At the end of August 2022 the investment portfolio return was 1.00**%**
- Net interest outturn is expected to be within budget.
- There was no breach of the Authority's prudential indicators and treasury indicators.

RECOMMENDATIONS

- To note the treasury management activities to August 2022 are detailed in the report.
- To note LIBOR ceased to be supported and published by the banks from the 31st December 2021, being replaced by SONIA - this will be Treasury's benchmark reference rate from the 1st January 2022.

REPORT DETAIL

Background

1.0 Treasury management

1.1 The authority operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operation is to 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.

1.2 The other main function of authority's treasury management operation is to help fund its capital plans. These capital plans provide a guide to the borrowing need of the authority, essentially the longer term cash flow planning required to 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 the Authority's risk or cost objectives.

2.0 Introduction

2.1 This report has been written in accordance with the requirements of the CIPFA TM Code.

2.2 This is the Mid-Year Review Report required by the TM Code and covers the following:

- Economic update for the first part of the 2022/23 financial year.
- Treasury Management Summary to the end of August 2022.
- Review of the authority's borrowing strategy for 2022/23
- Review of the authority's investment portfolio for 2022/23
- Review of compliance with Treasury and Prudential Limits for 2022/23.

3.0 Economics and interest rates

3.1 Economics update

The Bank of England's Monetary Policy Committee (MPC) increased Bank Rate to 2.25% from 1.75% on the 22nd of September. The increase reflected a split vote – five members voting for a 50 basis points increase, three for 75 basis points and one for 25 basis points. The MPC continues to grapple with getting inflation back on track over a three-year horizon. The Government has announced that the OBR will scrutinise their spending plans on 23rd November, whilst the Bank of England held off from making an emergency

Bank Rate increase and instead confirmed that it would do everything necessary to ensure headline inflation, on the CPI measure, drops back to 2% over a three-year timeframe. Furthermore, there is every chance that the on-going steep rises in gas, electricity and food inflation, when added to significant increases in fixed rate mortgages and rents, may see the UK head into recession despite the Government's best intention to prevent this occurrence. Markets will be looking closely at the upcoming inflation, employment and growth numbers for early signs as to how the new policies are performing, accepting that many of the announcements (outside of the support for caps on household and energy costs) have yet to be implemented.

3.2 *Interest rate forecasts*
The authority's treasury advisor, Link Asset Services (LAS), has provided the following updated interest rate forecast for base rate and medium term PWLB issuance in **Appendix A**:

4.0 Treasury Management Summary

4.1 The mid year treasury management position is shown in table 1 below.

Table 1: Treasury Management Summary as at 31st August 2022

Investments	01.04.22 £m	Movement £m	31.08.22 £m	Weighted Average Rate %
Fixed Deposit	133.0	-6.0	127.0	**1.03**
Money Market Funds	0	0	0	**0**
Call Account	20.0	-20.0	0	**0.64**
Total investments	**153.0**	**-26.0**	**127.0**	**1.00**
Loans				
PWLB	307.1	0	307.1	**2.89**
Banks (LOBO)	7.0	0	7.0	**3.60**
Temporary Borrowing	0	0	0	**0**
Other L/T borrowings	0.8	0	0.8	**0.38**
Total Loans	**314.9**	**0**	**314.9**	**2.89**

4.2 The Authority's treasury investments as at 31st August 2022 totalled **£127m** and comprised of **£15m** deposited with local authorities, **£70m** with banks, **£42m** with the Government's Debt Management Office (DMO).

4.3 Appendix B shows the breakdown of the authority's investments.

5.0 Borrowing Strategy

5.1 Detail

Due to the volatility in long term borrowing rates and the uncertainty around inflation over the medium term, the strategy is to borrow < 5 years primarily via the PWLB, and via short term borrowing < 1 year from local authorities and banks, although other sources of finance will be considered. The Authority's cash balances remain high due to capital slippage which has limited the need for further long term debt and will be used in part to fund the 2022/23 borrowing requirement in the capital programme. PWLB debt remained the most economical source of long term capital finance, although officers constantly evaluate other sources of finance.

5.2 Debt Rescheduling

The possibility of debt rescheduling is regularly discussed with our treasury adviser. However opportunities have been almost non-existent in the current economic climate. The current PWLB rules on redemption are prohibitive and costly.

5.3 LOBO's

The Authority holds a £7m LOBO loan with Danske Bank at 3.60% that has the option to propose an increase in the interest rate at set dates, while the Authority has the option to either accept the new rate or to repay the loan at no additional cost. LAS stated there is a high probability that the lender will propose an increase in the rate in November 2022. If called, this will be financed from current cash balances, officers will continue to monitor and discuss with Danske Bank going forward.

6.0 Budgeted Income and Return

6.1 The Authority measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 2 below:

Table 2: 2021-22 Treasury Investment Performance to 31st August 2022

Period	Benchmark Average 3 month SONIA compounded, looking back	Budget Rate %	Actual Rate %
1/4/22 to 31/08/22	1.14	0.25	1.00

6.2 The authority underperformed its benchmark during the period. This was due in part to the steepness of the yield curve, and the need to keep a proportion of our funds in near dated liquid investments to meet cash calls as they fall due and the rapid increase in bank rate during the period. The strategy of keeping investments in short term maturities leaves our portfolio able to reinvest at high rates as rates are forecast to increase further during 2022-23.

6.3 It is expected that the average 3 month SONIA rate will rise significantly by financial year end as the bank of England continues to fight inflationary pressures and offset the fiscal expansion announced in the recent mini budget. Accordingly investments are being kept in shorter maturities < 6 months for the remainder of the financial year.

6.4 The continued delays to capital expenditure has meant investment balances are running higher than planned earlier in the year. Both investment income and borrowing cost are expected to be within the budget forecast.

6.5 Since the 1st January 2022 LIBOR ceased to be supported and published by the banks being replaced by SONIA, see explanation in **appendix D.** Accordingly treasury will use SONIA going forward to benchmark activities and performance.

7.0 Current Investment Opportunities

7.1 The Authority is occasionally made aware of long term investment opportunities within OneSource, brokers or investment advisers. By extending the number of regulated brokerage firms it provided more competition and resulted in deals being agreed that best meets the authority's requirements.

7.2 Cabinet on the 26th February 2021 approved changes to the Treasury Management Strategy Statement (TMSS) which facilitate investment in a wider range of products.

8.0 Changes in risk appetite

8.1 The 2017 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 will be brought to members' attention in treasury management update reports.

9.0 Compliance with Prudential and Treasury Indicators

9.1 It is a statutory duty for the Authority to determine and keep under review the affordable borrowing limits. The Authority's approved 2022/23 Treasury and

Prudential Indicators (affordability limits) were included and approved by Full Council as part of the TMSS 2nd March 2022.

9.2 During the period, the Authority has operated within the treasury limits and Prudential Indicators set out in the authority TMSS and in compliance with the authority's Treasury Management Practices. An update on indicators and limits are reported in **Appendix C** of this report.

IMPLICATIONS AND RISKS

Financial implications and risks:

Year to date treasury activity is in accordance with the Authority's approved TMSS. There have been no breach in the Authority's treasury indicators and prudential indicators set out in the TMSS.

It is expected that the authority's net interest costs will be within budget in 2022/23 and any new borrowing undertaken for the capital programme for remainder of 2022/23 will be in accordance with the Authority's treasury limits and prudential indicators.

Legal implications and risks:

Cabinet is required to have a full understanding of all financial risks and be satisfied that they are propitiate to its overall budget and that the Council is not exposed to any unacceptable, unnecessary or disproportional risk in the management of its financial affairs.

Members also need to feel assured that there has been no breach of the Authority's prudential indicators and treasury indicators.

Human Resources implications and risks:

There are no HR implications from this report

Equalities Implications and Risks:

The Public Sector Equality Duty (PSED) under section 149 of the Equality Act 2010 requires the Council, when exercising its functions, to have due regard to:

(i) The need to eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Equality Act 2010;
(ii) The need to advance equality of opportunity between persons who share protected characteristics and those who do not, and;
(iii) Foster good relations between those who have protected characteristics and those who do not.

The Council is committed to all of the above in the provision, procurement and commissioning of its services, and the employment of its workforce.

Health and Wellbeing Implications and Risks:

The Council is committed to improving the quality of life and wellbeing for all Havering employees and residents in respect of socio-economics and health determinants. There are no direct implications to the Council's workforce and resident's health and wellbeing as a result of this report.

BACKGROUND PAPERS

None

Appendix A

Interest Rate Forecast

Provided by Link asset services (LAS)

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

Appendix B

Table 1 breakdown of Investments as at 31st August 2022

Class	Start Date	Maturity Date	Counterparty	Profile	Rate	Principal O/S (£)
Deposit	31/08/22	01/09/22	DMADF (Debt Management Account Deposit Facility)	Maturity	1.55%	27,000,000
Deposit	25/08/22	07/09/22	Leeds City Council	Maturity	1.60%	5,000,000
Deposit	23/08/22	23/09/22	DMADF (Debt Management Account Deposit Facility)	Maturity	1.69%	15,000,000
Deposit	25/07/22	26/09/22	Gloucester City Council	Maturity	1.52%	5,000,000
Deposit	14/02/22	14/11/22	Fife Council	Maturity	0.85%	5,000,000
Deposit	20/07/22	30/12/22	Goldman Sachs International	Maturity	2.20%	15,000,000
Deposit	08/02/22	08/02/23	National Westminster Bank plc	Maturity	1.31%	25,000,000
Deposit	08/08/22	08/02/23	Goldman Sachs International	Maturity	2.46%	5,000,000
Deposit	22/08/22	22/02/23	Santander UK plc	Maturity	2.75%	25,000,000
Fixed Total					**1.8413%**	**-127,000,000**

Appendix C

Compliance Report

All treasury management activities undertaken during the period complied fully with the CIPFA Code of Practice and the authority's approved Treasury Management Strategy. Compliance with specific treasury limits is demonstrated in tables below.

1.1 Interest Rate Exposure

1.1.1 This indicator is set to limit and control the Authority's exposure to adverse movements in short term interest rates during the current financial year and over the forecasted period. The upper limit on fixed and variable rate interest rate exposures, expressed as the proportion of gross principal borrowed are as follows:

Table1: Interest rate exposure activity

	2022/23 Limit %	2022/23 Actual 31/08/22 %	2023/24 Limit %	2024/25 Limit %
Upper limit on fixed interest rate exposure	100	99.7	100	100
Upper limit on variable interest rate exposure	25	0.3	30	35

Fixed rate borrowings are those borrowings where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

1.1.2 Having larger amounts of fixed interest rate borrowing gives the Authority greater stability with regards to its interest payments and reduces the risk of higher interest costs should interest rates rise. Traditionally local authorities have taken advantage of fixing interest rates long term to reduce interest rate exposure. The table excludes Salix Finance loans as these are held at zero interest hence no interest rate exposure.

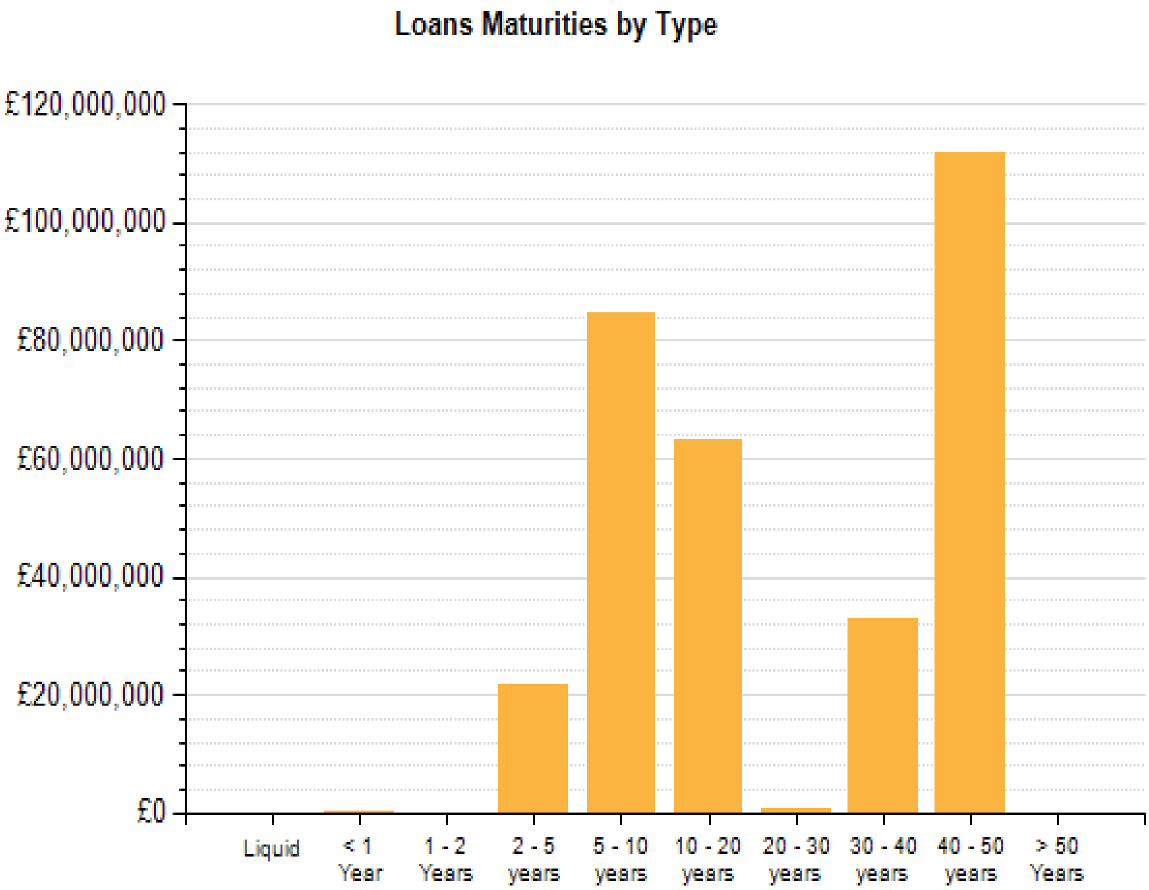
1.2 Maturity Structure of Borrowing

1.2.1 This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing are as follows:

Table 2: Loan maturity structure as at 31st August 2022

	Upper %	Lower %	Actual %
Under 12 months	40	0	0.03
12 months and within 24 months	60	0	0.00
24 months and within 5 years	80	0	6.84
5 years and within 10 years	100	0	26.86
10 years and above	100	0	66.27

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.



1.3 Principal Sums Invested for Periods Longer than 365 days

1.3.1 The purpose of this indicator is to control the authority's exposure to the risk of incurring losses by seeking early repayment of its investments.

1.3.2 The limits set in the 2022/23 treasury management strategy in comparison to the half year are set below. It is the authority's policy to classify available for sale investments with maturities exceeding one year as long term investments.

Table 3: Investments for periods longer than 365 days

	2022/23 Limit £m	**2022/23 Actual 30.08.22 £m**	**2023/24 Limit £m**
Limit on principal invested beyond year end	120	0	120

1.4 Gross Debt and the Capital Financing Requirement (CFR)

1.4.1 In order to ensure that over the medium term debt will only be for a capital purpose, the Authority should ensure that debt does not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. This is a key indicator of prudence.

Table 4: Gross debt and the CFR

	31.03.22 Actual £m	31.03.23 Estimate £m	31.03.24 Estimate £m	31.03.25 Estimate £m
Long Term External Debt	314.9	314.9	314.9	314.9
CFR	468.9	672.6	905.6	1097.3
Internal Borrowing	154.0	357.7	590.7	782.4

1.4.2 Total debt is expected to remain below the CFR during the year. The actual debt levels are monitored against the Operational Boundary and authorised Limit for External Debt, below. Officers will replace internal borrowing with external borrowing when it is favourable to do so.

1.5 Operational Boundary for External Debt

1.5.1 The operational boundary is based on the authority's estimate of most likely, i.e. prudent, but not worst case scenario for external debt. The Authority long term debt as at 31.08.2022 is £314.9m and no limit has been exceeded.

Table 5: Operational Boundary

Operational Boundary	**2022/23 £m**	**2023/24 £m**	**2024/25 £m**
Borrowing	696.3	770.7	852.5
Other long-term liabilities	10.0	10.0	10.0
Regeneration Programme	168.7	259.3	277.5
Total	875.0	1,040.0	1,140.0

1.6 Authorised Limit for External Debt

1.6.1 The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Table 6: Authorised limit for external debt

Authorised Limit	2022/23 £m	2023/24 £m	2024/25 £m
Borrowing	805.0	853.0	903.0
Other long-term liabilities	10.0	10.0	10.0
Regeneration Programme	248.0	300.0	350.0
Total Debt	1,063.0	1,163.0	1,263.0
Long Term Debt	314.9	314.9	314.9
Headroom	**748.1**	**848.1**	**948.1**

Appendix D

Glossary of Terms

A bond is a debt instrument in which an investor lends money for a specified period of time at a fixed rate of interest. The issuing entity could be corporate, financial or government.

A floating rate note (FRN) is a money market instrument with a Floating/variable rate of interest, which re-fixes over a reference rate, for example 3 month LIBOR.

Bail in is rescuing a financial institution on the brink of failure by making its creditors and depositors take a loss on their holdings. A bail-in is the opposite of a bail-out, which involves the rescue of a financial institution by external parties, typically governments using taxpayer's money.

Certificates of deposit (CDs) are a negotiable form of fixed deposit, ranked pari passu with fixed deposits. The difference is that you are not obligated to hold the CD to maturity, you can realise the cash by selling in the secondary market.

Coupon is the total amount of interest a security will pay. The coupon period depends on the security. A CD will often pay interest at maturity, while a bond may pay semi-annually or annually and an FRN will most likely pay every 3 months.

Covered bond Covered bonds are conventional bonds (fixed or floating) issued by financial institutions, that are backed by a separate group of loans, usually prime residential mortgages. This lowers the creditor's exposure to default risk, enhancing the credit. This is why the issue is usually rated AAA, higher than the rating given to the issuer reduces exposure to bail-in risk.

Credit rating A measure of the credit worthiness of a borrower. A credit rating can be assigned to country, organisation or specific debt issue/ financial obligation. There are a number of credit ratings agencies but the main 3 are Standard & Poor's, Fitch or Moody's.

GDP the monetary value of all finished goods and services made within a country during a specific period.

MIFID is the Markets in Financial Instruments Directive. A European Union Directive.

Principal is the total amount being borrowed or lent.
Spread is the difference between the buy and sell price of a security. It can also be the gap, usually in basis points, between the yield of a security and the benchmark security.
Monetary Policy Committee (**MPC**) is a committee of the Bank of England, which meets for three and a half days, eight times a year, to decide the official interest rate in the United Kingdom (the Bank of England Base Rate).

CPIH (Consumer Prices Index including owner occupiers' housing costs) The new additional measure of consumer price inflation including a measure of owner occupiers' housing costs (OOH).

Treasury bills (T-bills) are UK government rated, short-dated form of Government debt, issued by the Debt Management Office (DMO) via a weekly tender. T-bills are normally issued for one, three or six month duration.

Borrowing Requirements The principal amount the Council requires to borrow to finance capital expenditure and loan redemptions.

Capital Financing Requirement (CFR) Capital Financing Requirement- a measure of the Council's underlying need to borrow to fund capital expenditure.

Counterparties Organisations or Institutions the Council lends money to e.g. Banks; Local Authorities and MMFs.

Credit Default Swap (CDS) A kind of protection that can be purchased by MMF companies from insurance companies (for their investment) in exchange for a payoff if the organisation they have invested in does not repay the loan i.e. they default.

Credit Watch A scoring system issued by credit rating agencies such as Fitch, Moody's and Standard & Poors that indicate the financial strength and other factors of a bank or similar Institution.

Interest Rate Exposures A measure of the proportion of money invested and what impact movements in the financial markets would have on them.

LIBOR London interbank offer rate, the average of a daily submission by various banks for where they offer funds in different maturities.

Market Loans Loans from banks available from the London Money Market including LOBOS (Lender Option, Borrowing Option) which enable the authority to take advantage of low fixed interest for a number of years before an agreed variable rate comes into force.

Money Market Fund (MMF) A 'pool' of different types of investments managed by a fund manager that invests in lightly liquid short term financial instruments with high credit rating.

Minimum Revenue Provision (MRP) This is the amount which must be set aside from the revenue budget each year to cover future repayment of loans.

SONIA sterling overnight interest average rate, the average rate at which banks offer funds in the overnight sterling market.