West Northamptonshire Council

WEST NORTHAMPTONSHIRE COUNCIL CABINET

23 SEPTEMBER 2022

CABINET MEMBER WITH RESPONSIBILITY FOR FINANCE: COUNCILLOR MALCOLM LONGLEY

Report Title	**Treasury Management Update Quarter 1, 2022-23**
Report Author	**Martin Henry, Executive Finance Director**

Contributors/Checkers/Approvers

West MO	Cath Whitehead	14/09/2022
West S151	Martin Henry	14/09/2022
Other Director/SME	Audra Stratham	07/09/2022
Communications	Becky Hutson	14/09/2022

List of Appendices

Appendix A – Treasury and Prudential Indicators

1. Purpose of Report

1.1. The purpose of this report is to provide a first quarter update position on the Council's Treasury Management Strategy.

2. Report Background

2.1 Capital Strategy

2.2 In December 2021, 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.

2.3 Treasury management

2.3.1 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.

2.3.2 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.

2.3.3 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."

3. Introduction

3.1 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 2021) and covers the following

- An economic update for the first quarter of the 2022/23 financial year updated to reflect the most recent developments in the economy.
- 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 to in the first quarter.
- A review of compliance with Treasury and Prudential Limits for 2022/23

4. Recommendations

4.1 It is recommended that the Cabinet note the report and treasury activity for the first quarter of the 22-23 financial year.

5. Reasons for Recommendations

5.1 To ensure that the Authority complies with its financial regulations and Treasury management policies.

6. Economics update

The second (calendar year) quarter (Apr -Jun) of 2022 saw:

- GDP fall by 0.1% in March and by 0.3% in April.
- An easing rather than a collapse in the composite Purchasing Managers Index (PMI);
- A further rise in Consumer Price Index (CPI) inflation to a new 40-year high of 9.1% in May (currently 9.9% as at August)
- The first signs that the weakening in economic activity is filtering into a slightly looser labour market.
- Bank Rate rose to 1.25% back in June and is currently 1.75%, taking it to its highest level since the Global Financial Crisis.
- Gilt yields caught up in the global surge in bond yields triggered by May's strong rise in US inflation.
- Rising global bond yields and concerns overgrowth drive a global sell-off in equity markets

It is acknowledged that the following economic update is backward looking and indicating future action, which has now recently been superseded by the change of Prime Minister, a new Cabinet, inflation being higher, utility prices being substantially higher and the increase in base rate in August.

The new Prime Minister Liz Truss announced that the government would cap domestic energy prices for households at £2,500 while limiting them for businesses to ease the ongoing cost-of-living crisis and the FTSE 250 moved 0.36% higher on the news. Further economic updates will be reported in subsequent reports in the year as we continue to monitor the markets to review the impact on the finances of WNC

6.1.1. Following the 0.1% fall in GDP in March and the 0.3% contraction in April, the economy is now moving towards a recession (two quarters of falling output in a row). Indeed, GDP would need to rise by 0.4-0.5% m/m in both May and June to prevent the economy from contracting in Q2 as a whole. That said, without the joint wind down of the COVID-19 Test and Trace and vaccination programme, GDP would have risen by 0.2% m/m and 0.1% m/m in March and April respectively.

That's hardly strong, but it suggests the underlying momentum is not quite as weak as the headline figures imply.

6.1.2. There is not much evidence that higher inflation and higher interest rates have yet become a big drag on activity. Services output did fall by 0.3% in April. But output in consumer-facing services, conversely, rose by a solid 2.3% in April. And although the Office for National Statistics (ONS) said that some of the 1.0% fall in manufacturing output was linked to the drag on activity from higher prices, it also said that some of the 0.4% drop in construction output in April was a drop back after the boost in the wake of February's Storm Eunice.

6.1.3. The fact that the composite PMI didn't fall in June also suggests that in Q2 (Apr – June) real GDP has softened rather than collapsed. The S&P Global/CIPS all-sector PMI for June was unchanged from its level of 53.1 in May, signalling tepid but positive growth. According to the Lloyd's barometer, business confidence in May also remained remarkably resilient.

6.1.4. Despite the fall in the GfK (Gesellschafts fur Konsumforschung -German society for consumer research) composite measure of consumer confidence to a new record low of -41 in June, April's £1.4bn rise in consumer credit suggests households appear to have turned to credit to support their spending as the cost-of-living squeeze has intensified. Meanwhile, the household saving rate held steady at 6.8% in Q1 in line with its long-term average and we expect households to lower their saving rate further when the bigger falls in real incomes come in Q2 and Q3 to cushion the blow to spending.

6.1.5. There have been early signs that the recent weakening in economic activity is filtering through into a slightly looser labour market. The unemployment rate edged up from 3.7% in the three months to March to 3.8%. The single-month data showed that employment fell by 254,000 in April and the unemployment rate rose from 3.5% to 4.2%. And the upward march in the number of job vacancies slowed, with the three-month average only rising from 1.296m in April to 1.300m in May. A seasonal adjustment of the single-month data implies that vacancies fell in May for the first time since COVID-19 was rife in December.

6.1.6. At the same time, a 1.8% fall back in average earnings in April meant that the 3myy rate of earnings eased from 7.0% in March to 6.8% in April. And a lot of the 0.5% m/m rise in earnings excluding bonuses was probably due to the 6.6% rise in the National Living Wage on 1st April. The 3myy rate of earnings excluding bonuses stayed at 4.2%.

6.1.7. That said, conditions in the labour market remain exceptionally tight. The unemployment rate is still close to its recent 47-year low, and there is the same number of unemployed people as job vacancies and at 6.8% in April, the 3myy rate of average earnings is at a 10-year high (although it is still falling in real terms) and is well above the 3.0-3.5% that is broadly consistent with the 2.0% inflation target (assuming that productivity growth is 1.0-1.5%).

6.1.8. CPI inflation rose from 9.0% in April to a new 40-year high of 9.1% in May and it is not yet close to its peak. The increase in CPI inflation in May was mainly due to a further leap in food price inflation from 6.7% to a 13-year high of 8.5%. With the influence of increases in agricultural commodity prices yet to fully feed into prices on the supermarket shelves, we think that food price inflation will rise above 10% in September. And with two-thirds of the observation period for the Ofgem price cap having now passed, something like a 40% rise in utility prices is pretty much baked in the cake for October. The further rise in core producer price inflation, from 13.9% to 14.8%, suggests that core goods CPI inflation will probably rise to 14% before long. We think that will take CPI inflation to a peak of around (currently 10.1%) 10.5% in October. The recently published position at August shows CPI is currently 9.9%.

6.1.9. There now seems to be an even greater likelihood that second-round effects, whereby high inflation feeds back into higher price and wage expectations, keep inflation higher for longer. For some time, the Monetary Policy Committee (MPC) has placed a lot of weight on the results of the Bank of England's monthly Decision Maker Panel which asks businesses how they expect to change their prices and wages over the next year. May's survey revealed that businesses still expect to raise their selling prices by 6.0% and their wages by 4.8% over the next year. Meanwhile, XpertHR said that pay settlements across the economy stayed at a 30-year high of 4.0% in May. The government appears to be contemplating raising public sector pay by up to 5%. And the 7.1% pay rise granted to some railway workers sets a high bar for the negotiations that led to train strikes across large parts of the country in mid-June.

6.1.10. As of June, The MPC has increased interest rates five times in as many meetings and raised rates to their highest level since the Global Financial Crisis. Even so, coming after the Fed raised rates by 75 basis points (bps) in June and a handful of other central banks have recently raised rates by 50bps, the Bank of England's action is relatively dovish. Since June, The MPC has increased the rate to 1.75%. The decision was supported by 9 members of the MPC showing a commitment to act forcefully amid growing concerns about the upside risks for inflation with headline CPI rate forecast to rise above 13% in the last quarter of this year.

6.1.11. The MPC's new guidance is that if there are signs of "more persistent inflationary pressures" it will, "if necessary, act forcefully in response". We expect the MPC to continue to raise rates in steps of 25bps rather than 50bps. We think the MPC will raise rates from 1.75% now to a peak of 2.75% next year. That's higher than the peak of 2.00% forecast by economists, but lower than the peak priced into the financial markets.

6.1.12. Gilt yields have been 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. And in response to signs that central banks (particularly the US Fed) are going to raise interest rates faster to get on top of inflation, we now think that 10-year gilt yields will reach a peak of 2.70% (up from 2.39% currently) this year and into 2023.

6.1.13. Finally, the pound has already weakened from \$1.37 and €1.21 earlier this year to \$1.21 and €1.16 (currently \$1.16 and €1.15) . A lot of these moves have been driven by concerns over the outlook for the global economy and the resulting poor performance of risky assets, which has increased the demand for the dollar relative to sterling.

7. Interest rate forecasts

7.1. 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.

7.2. The latest forecast on 13 Sept is compared to the previous forecast in the first quarter (26th June & 10th May). A comparison of these forecasts shows that PWLB rates have increased generally and show a speed up in the rate of increase in Bank Rate as inflation is now posing a greater risk. The increase in PWLB rates reflects a broad sell-off in sovereign bonds internationally as inflation concerns abound. 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 without pushing the economy into recession.

7.3.

Link Group Interest Rate View 13.09.22								
	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24
BANK RATE	2.25	2.50	2.75	2.75	2.75	2.50	2.50	2.25
5 yr PWLB	2.80	3.00	3.10	3.00	3.00	3.00	2.90	2.90
10yr PWLB	3.00	3.20	3.30	3.30	3.20	3.10	3.10	3.00
25yr PWLB	3.40	3.50	3.50	3.50	3.50	3.40	3.40	3.30
50 yr PWLB	3.10	3.20	3.20	3.20	3.20	3.10	3.10	3.10

Link Group Interest Rate View 21.06.22												
	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25
BANK RATE	1.75	2.25	2.75	2.75	2.75	2.75	2.50	2.50	2.25	2.25	2.25	2.25
3 month ave earnings	2.00	2.50	2.80	2.80	2.80	2.80	2.60	2.50	2.30	2.30	2.20	2.20
6 month ave earnings	2.50	2.80	3.00	3.00	2.90	2.90	2.80	2.70	2.60	2.50	2.40	2.30
12 month ave earnings	3.10	3.20	3.20	3.20	3.00	2.90	2.80	2.60	2.50	2.40	2.40	2.40
5 yr PWLB	3.20	3.30	3.30	3.30	3.30	3.20	3.10	3.00	3.00	3.00	2.90	2.90
10 yr PWLB	3.40	3.50	3.50	3.50	3.50	3.40	3.30	3.20	3.20	3.20	3.10	3.10
25 yr PWLB	3.70	3.70	3.70	3.70	3.70	3.70	3.60	3.50	3.50	3.40	3.40	3.30
50 yr PWLB	3.40	3.40	3.50	3.50	3.40	3.40	3.30	3.20	3.20	3.10	3.10	3.00

Link Group Interest Rate View 10.5.22													
	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25
BANK RATE	1.25	1.50	1.75	2.00	2.00	2.00	2.00	2.00	1.75	1.75	1.75	1.75	1.75
3 month ave earnings	1.20	1.50	1.70	2.00	2.00	2.00	2.00	2.00	1.70	1.70	1.70	1.70	1.70
6 month ave earnings	1.60	1.90	2.10	2.20	2.20	2.20	2.20	2.10	2.00	1.90	1.90	1.90	1.90
12 month ave earnings	2.00	2.20	2.30	2.40	2.40	2.30	2.30	2.20	2.20	2.10	2.10	2.10	2.10
5 yr PWLB	2.50	2.50	2.60	2.60	2.60	2.60	2.60	2.60	2.50	2.50	2.50	2.50	2.50
10 yr PWLB	2.80	2.80	2.90	2.90	2.90	2.90	2.90	2.90	2.80	2.80	2.80	2.80	2.80
25 yr PWLB	3.00	3.10	3.10	3.20	3.20	3.20	3.10	3.10	3.00	3.00	3.00	3.00	3.00
50 yr PWLB	2.70	2.80	2.80	2.90	2.90	2.90	2.80	2.80	2.70	2.70	2.70	2.70	2.70

LIBOR and LIBID rates ceased at the end of 2021. In a continuation of our previous forecasts, our money market yield forecasts are based on expected average earnings by local authorities for 3 to 12 months.

Our forecasts for average earnings are averages i.e., rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short-term cash at any one point in time.

8. Summary WNC Treasury Portfolio Position

8.1 The highlight for the treasury portfolio position for the period to June 2022 is the council is forecasting net borrowing position of £330m compared to the approved budget of £344m. The forecast for 2022/23 shows a £14m improvement mainly as a result of a reduction in new borrowing requirement that was forecasted.

8.2 The expected borrowing requirement to fund the capital programme is lower than expected during the year to date hence the overall forecast performance.

Table 1

West Northamptonshire Council 2022-23					
	TREASURY PORTFOLIO 22-23				
	TMSS Approved Budget	Actual	Actual	Forecast out-turn	Forecast out-turn
		30-Jun-22	30-Jun-22	31-Mar-23	31-Mar-23
Treasury investments	**£000**	**£000**	**%**	**£000**	**%**
Total managed in house	204,035	140,174	93%	193,122	95%
Total managed externally	9,641	10,222	7%	10,222	5%
Total treasury investments	**213,676**	**150,396**	**100%**	**203,344**	**100%**
Third party loans	35,097	36,443		35,097	
Treasury external borrowing					
Local Authorities loans	0	0	0%	0	0%
PWLB	519,779	463,174	86%	493,751	87%
Market, LOBO & other loans	73,682	75,743	14%	75,336	13%
Total external borrowing	**593,461**	**538,917**	**100%**	**569,087**	**100%**
Net treasury investments / (borrowing)	**(344,688)**	**(352,078)**		**(330,646)**	

8.3 During the first quarter, the council has made £3.577m of loan repayments detailed below:

- Partial principal repayment of £0.577m on annuity PWLB loan.
- Full repayment of £3m on Growing Places Fund loan back in April 2022.

8.4 The forecast position on total external borrowing is £569m compared to the budget of £593.4m. This demonstrates a reduction in anticipated borrowing requirements than envisioned, this is being monitored and the anticipated impact will be reported in the next report.

9. Borrowing

9.1 The need for further borrowing will be reviewed in line with the capital programme delivery schedule.

9.2 Table 2 below sets out the maturity profile of the Council's borrowing portfolio at the end of Q1.

Table 2

Term Remaining	Borrowing		Limits
	£m	%	%
Under 12 months	9.5	2%	80%
1-2 years	8.8	2%	50%
2-5 years	28.8	5%	50%
5-10 years	24.9	5%	50%
10-20 years	20.0	4%	100%
20-30 years	15.3	3%	100%
30-40 years	254.7	47%	100%
40-50 years	157.0	29%	100%
Over 50 years	20.0	4%	100%
TOTAL	**538.9**	**100%**	

10. Borrowing Restructuring

10.1 Rescheduling opportunities have been limited in the current economic climate. No debt rescheduling has therefore been undertaken in the current financial year to date. Officers continue to monitor the position regularly.

11. Investments

6.1. The Treasury Management Strategy Statement (TMSS) for 2022/23, which includes the Annual Investment Strategy, was approved by the Council on the 24th Feb 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

6.2. 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.

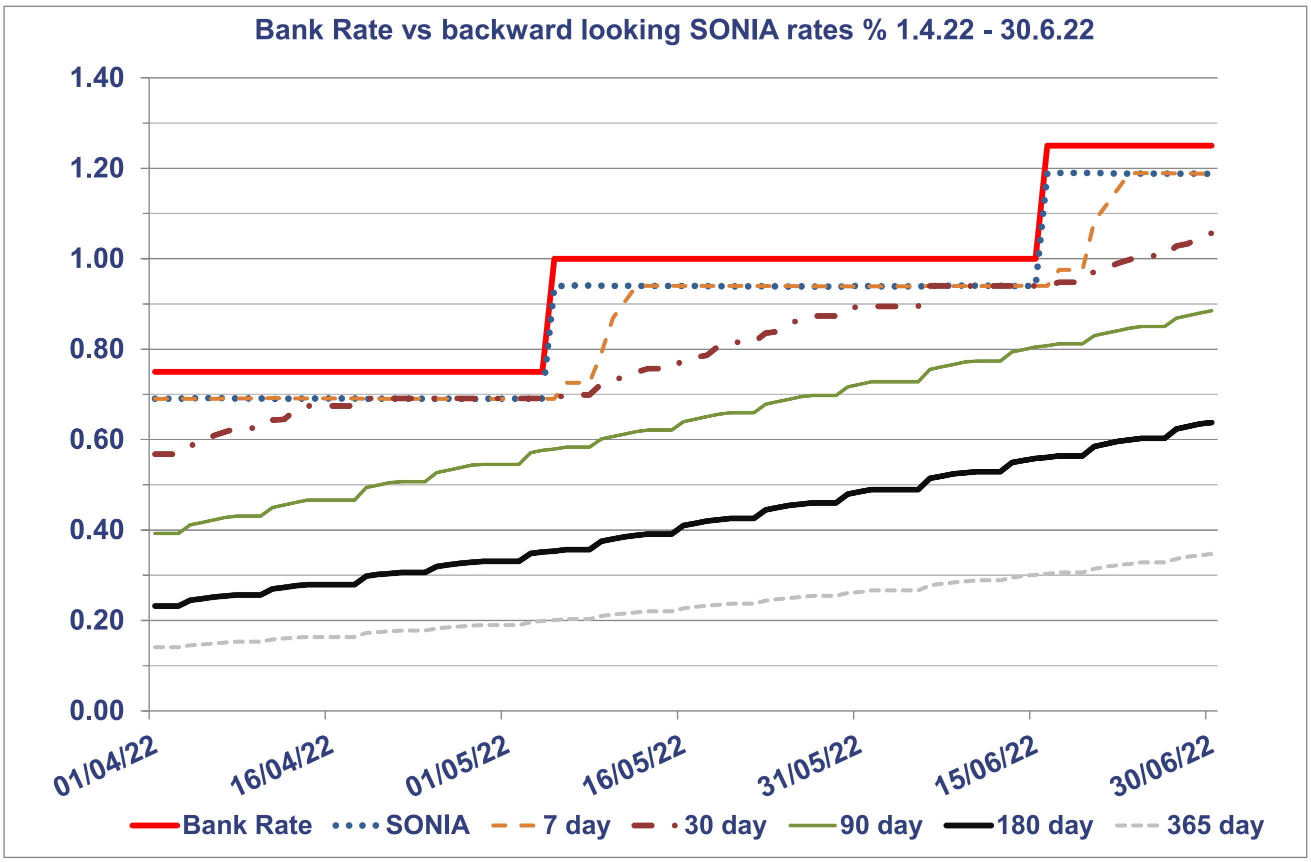
As shown by the interest rate forecasts in Section 6 above, rates have improved dramatically during Q1 and Q2 2022 and are expected to improve further as Bank Rate continues to increase over the next year or so.

11.3 The average level of funds available for investment purposes during the quarter was £150m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of payments, receipt of grants. The Council held £69m of liquid cash balances and £85.4m of short terms investments expected to mature during year.

12. Investment performance year to date as of 30th June 2022

9.1 Below is SONIA (Sterling Overnight Index Averages) indicators based on backward looking showing the performance of the market when investments were made in the past.

Graph 1



Period	SONIA benchmark performance	Council performance
3 months	0.89%	0.90%

9.2 As illustrated above, the Council outperformed the benchmark by 1 basis point. The Council's budgeted investment return for 2022/23 assumed an average of 0.30% return based on the timing of placed and future short-term investment at the time of budgets preparations and as such has outperformed the budget assumption to date.

10. Treasury Management budget

10.1 Outlined below is the Treasury budget performance to date for 22/23. The net costs is not expected will vary significantly to budget as shown in the forecast out-turn.

Table 5

Treasury revenue budget	Council Approved Budget	Forecast -out-turn	Variance - favourable/(adverse)
	£'m	£'m	£'m
Net financing costs -	14.07	14.57	(0.50)
Interest receivable on investments	(1.8)	(2.3)	0.50
Total	**12.31**	**12.31**	**0.00**

10.2 The key explanation for variance to the budgets are:

Within the net financing costs-

- **Finance charges:** We are forecasting a budget overspend of £0.5m as a result of increased bank charges which will be offset by the improvement on interest receivable on investment due to the upward trend of bank interests.

- **Interest receivable on investments –** we are expecting a better yield performance, however this is currently offset by unbudgeted finance charges highlighted above in this report. Interest rate yield are constantly changing and expected to improve further going forward.

11. Approved Limits

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

12. Compliance with Treasury & Prudential limits

12.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the first quarter ended 30th June 2022, the Council has operated within the treasury and prudential indicators set out in the Council’s Treasury Management Strategy Statement for 2022/23.

12.2 The Director of Finance reports that there are no difficulties expected for the current or future years in complying with these indicators.

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

13. Background Papers

None

Appendix A: Treasury and Prudential Indicators

Prudential Indicator	2022/23 Indicator	2022/23 Q1

Authorised limit for external debt *[Excluding PFI and Finance Lease Liabilities]*	----- £850.0m -----	
Operational boundary for external debt *[Excluding PFI and Finance Lease Liabilities]*	----- £800.0m -----	
Capital Financing Requirement (CFR) *[Excluding PFI and Finance Lease Liabilities]*	£935m	TBC
Ratio of financing costs to net revenue streams	1.6%	TBC
Principal sums invested > 365 days *[Excluding third party loans]*	£20m	£nil
Maturity structure of borrowing limits: -		
Under 12 months	Max. 80% Min. 0%	2%
12 months to 2 years	Max. 50% Min. 0%	2%
2 years to 5 years	Max. 50% Min. 0%	5%
5 years to 10 years	Max. 50% Min. 0%	5%
10 years and above	Max. 100% Min. 0%	86%