APPENDIX 1 – Executive Report, 2 February 2023

Report Reference Number: E/22/37

To:	**Executive**
Date:	**2 February 2023**
Status:	**Non-Key Decision**
Ward(s) Affected:	**All**
Author:	**Chris Chapman, Accountant**
Lead Executive Member:	**Councillor Cliff Lunn, Lead Executive Member for Finance and Resources**
Lead Officer:	**Karen Iveson – Chief Finance Officer, S151**

Title: Treasury Management – Quarterly Update Q3 2022/23

Summary:

This report reviews the Council's borrowing and investment activity (Treasury Management) for the period 1 April 2022 to 31 December 2022 and presents performance against the Prudential Indicators.

Investments – The Council's investments held in the NYCC Investment pool have averaged £87.8m over the quarter at an average rate of 2.79% and earned interest of £617.0k. Total interest earned to the end of December stands at £1075.2k (£775.5k allocated to the General Fund; £299.7k allocated to the HRA) which is £960.8k above the year-to-date budget. Current trends indicate that forecast returns for the year could be in the region of £1,853.7k (£1,337.1k GF, £516.6k HRA) a total budget surplus of £1,701.2k. For the General Fund, any interest earned above a £350k threshold is to be transferred to the Contingency Reserve. This figure is currently forecast to be £987.1k.

Investments have performed positively as a result of the regular and sustained rises in Bank of England base rate that have been experienced over the course of the year, as well as higher sustained cash balances. Base rate has risen from 0.25% when budgets were initially set, to their current level of 3.50%. The forecasted return for the year outlined above takes into account the tapering effect of these rises, as older investments at lower rates mature and are replaced by newer investments at higher rates. This position remains fluid as further base rate rises, currently anticipated by the market, will serve to further increase potential returns.

In addition to investments held in the pool, the council has £4.55m invested in property funds as at 31st December 2022. The funds have achieved a 3.22% revenue return and 16.75% capital loss over the course of the year, resulting in revenue income of £127.4k and an 'unrealised' capital loss of £914.6k. Following the peak in Capital value reported in the Q4 2021/22 and Q1 2022/23 treasury reports, a subsequent capital loss has been incurred as a result of the current strain on commercial property markets, driven by the

increasing cost of borrowing that has been seen as the year progressed. These funds remain long term investments and changes in capital values are realised when the units in the funds are sold.

Borrowing – Long-term borrowing totalled £52.833m at 31 December 2022, (£1.6m relating to the General Fund; £51.233m relating to the HRA), Interest payments of £1.917m are forecast to be paid in 2022/23, a saving of £59k against budget. The Council has no plans for any short-term borrowing for the year.

Prudential Indicators – the Council's affordable limits for borrowing were not breached during this period.

Looking ahead to the remainder of 2022/23, investment returns are expected to continue to rise as further base rate increases are expected. Latest estimates show an increase to 4.25% by March 2023. This position remains highly fluid and is based on the latest expectations by the Council's treasury advisors.

Recommendation:

That the Executive endorse the actions of Officers on the Council's treasury activities for Q3 2022/23 and approve the report.

Reasons for recommendation

To comply with the Treasury Management Code of Practice, the Executive is required to receive and review regular treasury management monitoring reports**.**

1. Introduction and background

1.1 This is the third monitoring report for treasury management in 2022/23 and covers the period 1 April 2022 to 31 December 2022. During this period the Council complied with its legislative and regulatory requirements.

1.2 Treasury management in Local Government is governed by the CIPFA "Code of Practice on Treasury Management in the Public Services" and in this context is the management of the Council's cash flows, its banking and its capital market transactions, the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks. This Council has adopted the Code and complies with its requirements.

1.3 The Council's Treasury Strategy, including the Annual Investment Strategy and Prudential Indicators was approved by Council on 24 February 2022.

1.4 The two key budgets related to the Council's treasury management activities are the amount of interest earned on investments £152.5k (£110k General Fund, £42.5k HRA) and the amount of interest paid on borrowing £1.976m (£75k General Fund, £1.901m HRA).

2. The Report

Market Conditions and Interest Rates

2.1 The Council's treasury advisors Link Group summarised the key points associated with economic activity in 2022/23 up to 31st December 2022:

- Latest Chartered Institute of Procurement and Supply surveys appear to be pointing towards a tailing off in domestic housebuilding, with falling prices resulting in potential housing schemes now being seen as unviable.

- October growth figures came in at the upside of market expectations, with a 0.5% monthly growth in October, leaving in down 0.3% over the past three months.

- At sector level, services growth was stronger than expected, although it failed to recoup losses seen in September, where activity was hit by the Queen's State Funeral.

- November & December MPCs saw bank rate continue to increase, by 75bps and 50bps respectively, to its current level of 3.50%. The majority of MPC members indicated that further rate hikes will likely be necessary, with rates expected to peak at 4.50% following anticipated increases in the February, March and May MPC meetings.

- Looking ahead, the Bank of England has projected that growth would remain negative to the tune of 1.5% in 2023 and a further 1% in 2024, which would cause unemployment to rise to 6.5% by the end of 2025. On the inflation front, the November inflation figures came in marginally weaker than markets had expected, although it will take a few more releases to confirm that the peak position was October.

Interest Rate Forecasts

2.2 The current interest rate forecasts (as at 3rd January 2023) of Link Group are as follows:

Date	*Bank rate*	*5-year PWLB**	*10-year PWLB**	*25-year PWLB**	*50-year PWLB**
	%	%	%	%	%
Current rates	3.50%	4.28%	4.39%	4.66%	4.29%
March 2023	4.25%	4.20%	4.40%	4.60%	4.30%
June 2023	4.50%	4.20%	4.40%	4.60%	4.30%
Sept 2023	4.50%	4.10%	4.30%	4.50%	4.20%
Dec 2023	4.50%	4.00%	4.10%	4.40%	4.10%
March 2024	4.00%	3.90%	4.00%	4.20%	3.90%
June 2024	3.75%	3.80%	3.90%	4.10%	3.80%
Sept 2024	3.50%	3.60%	3.80%	4.00%	3.70%
Dec 2024	3.25%	3.50%	3.60%	3.90%	3.60%

* Net of certainty rate 0.2% discount

2.3 The previous months have seen the Bank of England continue to take sustained action via increases to the bank base rate in their effort to combat inflationary pressures. As such base rate set by the Monetary Policy Committee (MPC) is currently sitting at 3.50%. As shown in the forecast table above, significant further increases in bank rate are anticipated over the coming months, with base rate currently expected to be around 4.25% at the time of Q4 reporting in March 2023. This position remains highly fluid given the current economic situation and will be updated and reviewed in future Treasury reports.

Annual Investment Strategy

2.4 The Annual Investment Strategy outlines the Council's investment priorities which are consistent with those recommended by DCLG and CIPFA:

- Security of Capital; and
- Liquidity of its investments

2.5 The Investment of cash balances of the Council are managed as part of the investment pool operated by North Yorkshire County Council (NYCC). In order to facilitate this pooling, The Councils Annual Investment strategy and Lending List has been aligned to that of NYCC.

2.6 NYCC continues to invest in only highly credit rated institutions using the Link suggested creditworthiness matrices which take information from all the credit ratings agencies. Officers can confirm that the Council has not breached its approved investment limits during the year.

2.7 The Council's investment activity in the NYCC investment pool up to 31st December 2022 was as follows:

- Balance invested at 31 December 2022 — £88.32m
- Average Daily Balance Q3 2022/23 — £87.78m
- Average Interest Rate Achieved Q3 2022/23 — 2.79%
- Total Interest Budgeted for 2022/23 — £152.5k
- Total Forecast Interest for 2022/23 — £1,853.7k

2.8 The average return to the end of December 2022/23 of 2.79% compares with the average benchmark returns as follows:

- 1 month 3.18%
- 3 months 2.74%
- 6 months 2.15%
- 12 months 1.40%

Commentary on Investment Returns

2.9 As indicated above in paragraph 2.7, the total interest returns for 22/23 is currently forecast to amount to approximately £1,853.7k for the year, a figure that compares positively to the budgeted figure of £152.5k.

2.10 There are two primary reasons for this over-performance against budget. First, that average cash balances held and invested by the council have remained higher than anticipated over the course of the previous year. Second, that Average interest rates currently achieved on council investments are significantly higher than was previously anticipated.

2.11 The table below summarises current assumptions, vs the assumptions used at the time the budget was set in these two areas.

	Budget	Current Position
Average Cash balance (Full year)	£61,000k	£84,936k
Average Interest rate (Full year)	0.25%	2.18%
Annual Forecast Interest	£152.5k	£1,853.7k

2.12 Cash Balances held and invested by the council were expected to decrease significantly, as expenditure accelerated on the Council's Capital and P4G programmes. Slippage in these programmes between financial years however has meant that balances have continued to remain high, with the invested balance as at 31.12.2022 sitting at £88.32m. Significant expenditure in these programmes is now anticipated to be incurred in the second half of the current financial year, with an anticipated additional £8.2m (Capital) and £3.2m (P4G) of expenditure between now and 31.03.2023. This additional expenditure is anticipated to facilitate the decrease in cash balances that was previously anticipated to have occurred prior to the 22/23 financial year.

2.13 The average interest rate achieved on council investments has also increased significantly faster than was previously anticipated. The rate used in determining the Council's investment returns is based upon the expected movement in Bank of England base rate over the course of the year, as advised by the Council's Treasury Advisors, Link Group. At the time the budget was set, the base rate stood at 0.10%, with Link Group not expecting any increase in rate until the 24/25 financial year, whereupon the rate was expected to rise to 0.25%. The wider global economic situation, however, has led the Bank of England Monetary Policy Committee to increase base rates at an unprecedented rate, in an attempt to combat Inflationary pressures. Whilst this has had a positive impact on the council's investment returns, there will nonetheless be corresponding pressures in other areas of council expenditure, such as expenditure on energy and fuel.

Borrowing

2.14 It is a statutory duty for the Council to determine and keep under review its "Affordable Borrowing Limits". The Council's approved Prudential Indicators (affordable limits) were outlined in the Treasury Management Strategy Statement (TMSS). A list of the limits is shown at Appendix A. Officers can confirm that the Prudential Indicators were not breached during the year.

2.15 The TMSS indicated that there was no requirement to take long-term borrowing during 2022/23 to support the budgeted capital programme. Currently there are no plans to undertake further long-term borrowing in the coming financial year.

2.16 The Council approved an Authorised Borrowing Limit of £78m (£77m debt and £1m Leases) and an Operational Borrowing Limit of £73m (£72m debt and £1m Leases) for 2022/23 on the 24 February 2022 within the Council's Treasury Strategy.

2.17 As at 31st December 2022 Long-term borrowing totalled £52.833m, (£1.6m relating to the General Fund; £51.233m relating to the HRA). This figure is forecast to remain unchanged throughout the year, with the next scheduled loan repayment scheduled for March 2035.

2.18 The Treasury strategy, in relation to capital financing, is to continue the voluntary set aside of Minimum Revenue Provision (MRP) payments from the HRA in relation to self-financing debt, to allow for repayment of the outstanding debt. Following an updating of the HRA business plan in 2021/22, the voluntary set aside of HRA MRP payments has been reprofiled over the life of the existing debt, a change from the original 30 year profiling period. As a result of this update, £1.21m of HRA Voluntary MRP is currently forecast to be incurred in 2022/23.

2.19 As at 31st December 2022, the Council was in an under-borrowed position of £1.5m, unchanged from the position reported at Q1 & Q2. This means that capital borrowing (external debt) is currently and temporarily lower than the Council's underlying need to borrow. This under-borrowed position has been driven by the council's utilisation of internal borrowing, a Treasury Management practice whereby a Council can defer the need to borrow funds externally, thus attracting additional interest expenses, by utilising its existing cash balances to finance its capital programme. At year end, following the voluntary set aside of the MRP payments, the council is forecast to be in an over-borrowed position of £772k. This is in line with expectations set out in the approved Treasury Management Strategy and in line with the figures reported at Q1 and Q2.

Capital Strategy

2.20 The Capital Strategy was included as part of the Council's Annual Treasury Management and Investment Strategy 2022/23, approved in February 2022. The Capital Strategy sets out how capital expenditure, capital financing and treasury management contribute to the provision of Corporate and service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability. It sets out the long-term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.

2.21 Alternative non-treasury investments are considered as part of the Capital Strategy. Given the technical nature of potential alternative investments and strong linkages to the Council's Treasury Management function, appropriate governance and decision-making arrangements are needed to ensure robust due diligence in order to make recommendations for implementation. As a result, all investments are subject to consideration and where necessary recommendations of the Executive.

2.22 Aside from the existing loans to Selby & District Housing Trust to support the Housing Delivery Programme, no further options for alternative investments are currently being pursued.

Housing Delivery Programme Loans

2.23 The Housing Delivery Programme has delivered a number of successful schemes so far, in partnership with Selby & District Housing Trust. No further schemes are planned, though the existing loans to fund provision of affordable homes in the District have continued over the course of Q3 2022/23. Discussions are currently ongoing with the Trust around the potential to repay the loans detailed below, and purchase the properties owned by the Trust.

Scheme	Loan Rate %	Principal Outstanding as at 31 December 2022 £	Interest at Dec 22/23 £	Interest Full year £
Kirgate, Tadcaster	4.56%	178,293	6,386	8,514
St Joseph's St	4.20%	193,573	6,249	8,331
Jubliee Close, Riccall	3.55%	514,240	13,808	18,410
Ulleskelf	4.87%	1,017,691	37,253	49,670
Ousegate	3.65%	825,158	22,872	30,496
Total Principal / Average Rate	**4.19%**	**2,728,955**	**86,567**	**115,423**

Commercial Property Investments

2.24 The Council currently possesses one Commercial Property, the former NatWest Bank located in Tadcaster. As part of the Council's wider P4G programme a decision has been made to declare the property as surplus to council requirements and formally dispose of the property.

Property Funds

2.25 The forecast position on Property Funds at 31 December 2022 is as follows:

In Year Performance

Fund	Bfwd Investment £k	Valuation as at 31-Dec-22 £k	In Year Performance Q3 22/23			
			Capital Gain / (Loss)		Revenue Return	
			£k	%	£k	%
Blackrock	2,823.44	2,335.62	(487.8)	(17.28)	53.2	2.62
Threadneedle	2,636.30	2,209.49	(426.8)	(16.19)	74.2	3.87
Total	**5,459.73**	**4,545.11**	**(914.6)**	**(16.75)**	**127.4**	**3.22**

Total Fund Performance

Fund	Original Investment £k	Valuation as at 31-Dec-22 £k	Total Performance			
			Capital Gain / (Loss)		Revenue Return	
			£k	%	£k	%
Blackrock	2,502.50	2,335.62	(166.9)	(6.67)	321.8	3.09
Threadneedle	2,439.24	2,209.49	(229.7)	(9.42)	429.9	4.30
Total	**4,941.73**	**4,545.11**	**(396.6)**	**(8.03)**	**751.7**	**3.69**

2.26 Investments held in Property Funds are classified as Non-Specified Investments and are, consequently, long term in nature. Valuations can, therefore, fall and rise over the period they are held. Any gains or losses in the capital value of investments are held in an unusable reserve on the balance sheet and do not impact on the General Fund until units in the funds are sold.

2.27 Following the peak in value that the funds experienced at the beginning of the current financial year, the Capital Values of both funds have continued to experience the reduction in value that was reported in Quarter 2. At the end of December 2022/23, the funds have demonstrated a combined capital loss of £914.6k so far for the year, and a loss of £396.6k against initial purchase price. This loss has been incurred as a result of the current strain on commercial property markets, driven by the increasing cost of borrowing that has been seen as the year progressed. This strain has resulted in the recent decrease in the value of the funds to their current levels, which, combined with the reported value of the funds at the beginning of the year being the highest since the Council took ownership of the funds, has resulted the loss figure reported. Both funds continue to generate a positive revenue return however, amounting to £127.4k over the course of the year by the end of December 2022.

3. Alternative Options Considered

3.1 The Council has access to a range of investments through the pooled arrangements in place through North Yorkshire County Council.

4. Implications

4.1 Legal Implications

There are no legal implications as a direct result of this report.

4.2 Financial Implications

The financial implications are set out in the report.

4.3 Policy and Risk Implications

4.3.1 Management of the Council's treasury activities are in accordance with approved policies. Treasury management in Local Government is governed by the CIPFA "Code of Practice on Treasury Management in the Public Services" which aims to ensure the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks. This Council has adopted the Code and complies with its requirements.

4.4 Corporate Plan Implications

4.4.1 There are no direct Corporate Plan implications as a result of this report.

4.5 Resource Implications

4.5.1 The resources necessary to manage the Council's Treasury activities are contained within the collaboration agreement with NYCC.

4.6 Other Implications

4.6.1 There are no other implications as a direct result of this report.

4.7 Equalities Impact Assessment

4.7.1 There are no equalities impacts as a direct result of this report.

5. Conclusion

5.1 Overall the Council's investments have continued to generate strong revenue returns over the course of the quarter. This has been driven by the sustained increases in the bank base rate which will translate into continued increasing investment returns into the New Year, as older investments at lower value are replaced with those at higher rates.

5.2 After the sustained period of Capital growth that has been reported since the midst of the Covid-19 Pandemic, the Council's Property Fund investments have since reported a second consecutive quarter of decreasing Capital Value. Both funds continue to generate positive revenue returns for the Council, however. These investments are intended to be longer term in nature and as such their strong capital growth will not impact on the General Fund until units in the funds are sold, with any change in value (up or down) until that point held on the Balance Sheet in an unusable reserve.

5.3 The Council's debt position is in line with expectations set out in the Strategy. Opportunities to ensure the optimisation of the Council's Debt Portfolio will remain under review, however at present no changes are expected, either via the early resettlement of existing debt or the raising of further borrowing.

5.4 The Council operated within approved Strategy Indicators over the course of the quarter, with no breaches on authorised limits. The Prudential Indicators are reviewed annually as part of the Treasury Strategy to ensure approved boundaries remain appropriate; activities during Q3 2022/23 have not highlighted any concerns.

6. Background Documents

None.

7. Appendices

Appendix A – Prudential Indicators as at 31 December 2022

Contact Officer:
Chris Chapman, Accountant – External Clients, NYCC
cchapman@selby.gov.uk

Karen Iveson, Chief Finance Officer
kiveson@selby.gov.uk