Cabinet
7 December 2022

Appendix 1

Derby City Council

Report sponsor: Simon Riley, Strategic Director of Corporate Resources
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Treasury Management Mid-Year Report 2022/23

Purpose

1.1 Council is required for good practice under the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the "CIPFA TM Code") to approve treasury management mid-year and outturn reports.

1.2 This mid-year report outlines the Treasury Management activity for the period 1st April 2022 to 30th September 2022 to note to Council, comprising:

- Summary of the Financial Markets to date in 2022/23;
- Forecast Outturn 2022/23 including Qtr.2 update;
- Borrowing Activity;
- Deposits; and
- Prudential Indicators.

1.3 **Summary**

The Treasury Management forecast outturn for 2022/23 is a balanced position as at 30th September 2022.

1.4 At the end of September 2022, total debt is £416.697m and total investments are £44.506m compared to £423.393m and £29.650 as at 31st March 2022.

1.5 Treasury Management advice to the Council up to 30th September 2022 has been provided by Arlingclose. Their services include economic and interest rate forecasting, advice on strategy, portfolio structure, debt restructuring, investment policy and credit ratings and technical assistance on treasury matters as and when required.

Recommendations

2.1 To note the forecast outturn position balanced position.

2.2 To note the position statement on Treasury Management Activity and compliance against the Prudential Indicators for the period 1st April 2022 to 30th September 2022.

2.3 To note and recommend the Treasury Management Mid-year Report to Full Council.

Reasons

3.1 In accordance with CIPFA Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code"), it is considered good Treasury Management practice for members to note the progress and monitor performance at least twice a year. This report covers the progress of this activity. In addition, the report is required to go to Cabinet in the first instance and then Council for approval.

Supporting information

Background

4.1 The Council's Treasury Management Strategy (TMS) for 2022/23 was approved by Full Council on 16th February 2022. The Council 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. The successful identification, monitoring and control of risk are therefore central to the Council's TMS.

4.2 The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy which involves a summary document approved by Full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy, complying with CIPFA's requirement, was approved by Full Council on 16th February 2022.

The Financial Markets to date in 2022/23

5.1 The ongoing impact on the UK from the war in Ukraine, together with higher inflation, higher interest rates, and a deteriorating economic outlook, will be major influences on the Authority's treasury management future plans.

5.2 After sustaining a low inflation rate during and post covid, the longer term impact on the economy has been affected. The Bank of England (BoE) increased Bank Rate by 0.75% to 3.0% in November 2022, the largest single rate hike since 1989 and the eighth successive rise since December 2021. The decision was voted for by a 7-2 majority of the Monetary Policy Committee (MPC).

5.3 The November quarterly Monetary Policy Report (MPR) forecast a prolonged but shallow recession in the UK with CPI inflation remaining elevated at over 10% in the near-term. While the projected peak of inflation is lower than in the August report, due in part to the government's support package for household energy costs, inflation is expected remain higher for longer over the forecast horizon and the economic outlook remains weak, with unemployment projected to start rising.

5.4 The information relating to the overall global position of the UK financial markets is provided by Arlingclose, our treasury advisors, who continue to update the Council with on-going market activity and interest rates.

Local Context

6.1 On 31st March 2022, the Authority had net borrowing of £311.076m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

Balance Sheet Summary	31/03/22 Actual £m
General Fund CFR	511.709
HRA CFR	210.857
Total CFR	**722.556**
Less: Other debt liabilities *	(80.571)
Borrowing CFR	**641.995**
Less: Usable reserves	(226.396)
Less: Working capital	(104.523)
Net borrowing Requirement	**311.076**

*Finance leases, PFI liabilities and transferred debt that form part of the Council's total debt

6.2 The Council's current strategy is to maintain borrowing and investments below their underlying levels, known as internal borrowing. This reduces risk by keeping interest costs low. This policy is consistent with the Council's Treasury Management Strategy.

6.3 The Treasury Management position at the 30th September 2022 and the change during the period is shown in Table 2 below.

Table 2: Treasury Management Summary

TM Summary	31/03/22 Balance £m	Movement £m	30/09/22 Balance £m
Long-term borrowing	336.371	(0.523)	335.847
Short-term borrowing	6.556	(6.163)	0.393
Total borrowing	**342.927**	**(6.686)**	**336.241**
Long-term investments	-	-	-
Short-term investments	7.000	-	7.000
Cash and cash equivalents	24.851	12.655	37.506
Total investments	**31.851**	**12.655**	**44.506**
Net Borrowing	**311.076**	**(19.341)**	**291.735**

6.4 Net borrowing decreased significantly by £19.341m and is a result of a reduction to total borrowing and an increase of total investments between March 2022 and September 2022. As Table 2 shows, total borrowing decreased by £6.686m due to a repayment of a temporary loan of £6m required for day-to-day cash management as per our Treasury Management Strategy to borrow short term. Table 2 also illustrates that total investments have increased from £31.851m in March 2022 to £44.506m in September, and thus represents a movement of £12.655m. This is as a result of profiling/utilising of income from government grants and local taxes. Council tax and Business rates is in the main paid over the first ten months of the year resulting in a reduction of cash at the end of the financial year, which can be further impacted due to the timing of large invoices processed for capital schemes in the last financial quarter.

Forecast Outturn 2022/23

7.1 The Council budgets for the net cost of its Treasury Activities (Borrowing and Investments) through its Treasury Management Budget. As at 30th September, the budget is forecasting a balanced position. Any variance will be managed within the treasury management reserve set up to smooth the ebbs and flows of the capital programme, borrowing and funding requirements.

Treasury Borrowing Activity

8.1 At the 30th September 2022, the total external debt portfolio of the Council (including HRA debt and other long- term liabilities) was £416.697m. The analysis of external debt outstanding as at 30th September 2022 is shown in the Table 3 below:

Table 3: Treasury Borrowing Summary

External Borrowing	As at 31/03/22 £m	As at 30/09/22 £m
Fixed Rate PWLB	290.838	290.381
Fixed Rate Market	20	20
Other Local Authorities	31	25
SALIX Energy Efficiency	0.556	0.393
University of Derby	0.533	0.467
Other Long-term Liabilities:		
- Transferred Debt from other Local Authorities	0.277	0.277
- PFI Financing	78.814	78.814
- Finance Lease Liabilities	1.365	1.365
Total Gross External Debt	**423.383**	**416.697**

8.2 If the Council needs to borrow at any point, it will strike an appropriately low risk balance between short-term borrowing to reduce the risk of being tied into high interest rates over the longer term and achieving cost certainty over the period for which funds are required wherever possible.

Treasury Investment Activity

9.1 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the six-month period to 30th September 2022, the Council's daily investment balance ranged between £31.860m and £70.955m due to timing differences between income and expenditure. The investment position is shown in Table 4 below.

Table 4: Treasury Investment Summary

Counterparty	30/03/22 Balance £m	Net Movement £m	30/09/22 Balance £m
Banks & building societies (unsecured)	2.590	0.500	3.090
Local authorities	7.000	0.000	7.000
Money Market Funds	18.261	8.155	26.416
Debt Management Office	4.000	4.000	8.000
Total investments	**31.851**	**12.655**	**44.506**

9.2 The investment activity to the 30th September 2022 together with a comparison for the previous year is summarised in Table 5 below:

Table 5: Treasury Investment Activity

Treasury Investment Activity	**2021/22** Full year	**30/09/22 Up to Qtr.2**
Number of fixed-term deposits made	197	68
Number of instant access and money market accounts used	9	8
Number of deposits/withdrawals from money market funds/ call accounts	240	148
Value of deposits/ investments held	£31.850m	£44.506m
Average size of deposit/ investment portfolio	£67.365m	£51.975m
Average size of Lloyds Balance (operational)	£6.315m	£2.158m
Total interest earned on deposits/ investments (including Lloyds)	£0.042m	£0.275m
Average Return on deposits/ investment portfolio	**0.11%**	**0.53%**

9.3 The average size of Lloyds' Bank operational limit has significantly decreased due to the new investment limit as prescribed under the TMS for 2022/23. The limit was set to £7m in 2021/22 for both the Council's and Derby Homes Bank accounts combined. The TMS for 2022/23 now excludes the requirement to report Derby Homes bank accounts with the Councils. A limit of £4m was set for the Council for this financial year 2022/23. This is because of changes to the Council's and Derby Homes' respective banking requirements as mandated by Lloyds' Bank and upon subsequent advice from our external treasury advisors, Arlingclose.

9.4 The total interest earned on deposits/investment up to Qtr.2 shows a large increase compared to last year due to economic conditions which have increased interest rates globally.

9.5 Both the CIPFA Code and Government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

9.6 The credit risk and return metrics for the Council's investments extracted from Arlingclose's quarterly investment benchmarking is shown in Table 6.

Table 6: Investment Benchmarking

Investment Benchmarking	Credit Score*	Credit Rating	Bail-in Exposure	WAM** (days)	Rate of Return
31/03/2022	4.58	A+	65%	72	0.52%
30/09/2022	4.55	A+	66%	25	1.27%
Similar LAs	4.32	AA-	53%	50	2.27%
All LAs	4.29	AA-	55%	18	1.47%

*The lower the credit score the lower risk
** Weighted Average Maturity

9.7 The benchmarking shows that the Council's Weighted Average Maturity (WAM) for investments moved from 72 days to 25 days a reduction of 47 days between 31stMarch 2022 and 30th September 2022. Consistent with the spirit of CIPFA's TM Code, our low WAM demonstrates that the Council placed security, liquidity and low risk above yield when deciding investment outcomes throughout and towards the end of the global pandemic. This approach enabled the Council to sustain an appropriate level of working capital in order to deliver public services with little or no disruption during these unprecedented times. It also allowed us to adhere to the Council's strategy of using internal resources to offset the need to borrow and therefore maintain our under-borrowed position.

However, our low-risk appetite is reflected in the rate of return generated from our investments and our strategy to remain liquid through internal resources. The rate of return earned by similar Local Authorities is higher compared to Derby City Council this could be due to a higher risk-appetite and a different borrowing strategy.

9.8 **Liability benchmark**

To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest level of borrowing the Council would be required to have to enable cash and investment balances to be kept to a minimum level of £20m during 2020/21 and £15m 2021/22 onwards to maintain sufficient liquidity but minimise credit risk.

Table 7: Liability Benchmark

Liability Benchmark	31/03/22 Actual £m	31/03/23 Forecast £m	31/03/24 Forecast £m	31/03/25 Forecast £m	31/03/26 Forecast £m	31/03/27 Forecast £m
Loans CFR	641.9	687.9	726.7	810.1	801.9	850.6
External borrowing	-342.9	-328.4	-324.6	-314.2	-314.1	-310.2
Internal (over) borrowing	299.0	359.5	402.1	495.9	487.8	540.4
Balance sheet resources	-327.6	-278.9	-274.5	-274.7	-269.5	-261.1
Investments (new borrowing)	28.6	-80.6	-127.6	-221.2	-218.3	-279.3
Treasury Investments	28.6	15.0	15.0	15.0	15.0	15.0
New borrowing	0.0	95.6	142.6	236.2	233.3	294.3
Net loans requirement	312.8	409	452.2	535.4	532.4	589.5
Liquidity allowance	15	15	15	15	15	15
Liability Benchmark	**327.8**	**424.0**	**467.2**	**550.4**	**547.4**	**604.5**

9.9 The benchmark assumes the following from 2022/23 to 2024/25:

- Capital Expenditure funded by borrowing of £211.2m as reported to Cabinet on 16th November in the Qtr.2 Financial Monitoring Report, a forecast is also included for rolling programme for future years only
- Minimum Revenue Provision on new capital expenditure based on the Council's MRP policy
- Decrease in internal resources of £66.5m
- Existing loans of £32.7m being repaid.

Non-Treasury Investments

10.1 The definition of investments in the revised "CIPFA TM Code" now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return. The Council's Non-Treasury Investments are shown in Table 8:

Table 8: Non-Treasury Investments as at 30th September 2022

Type of investment	Investment value £m	Return £m	Rate of Return %
Directly owned investment property*	5.240	0.111	2.12%
Loans to local businesses	1.047	0.016	1.52%
Loans to subsidiaries (Derby Homes)**	2.797	0.151	5.38%

* Investment value and return taken from the 2021/22 statement of accounts as an indication of 2022/23.
** This is the full year position as an annual interest is charged.

Compliance Report

11.1 A number of Treasury Management Prudential Indicators are prescribed under the Council's Treasury Management Strategy 2022/23 which was approved by Full Council Cabinet on 16th February 2022, and within CIPFA's Prudential Code for Capital Finance in Local Authorities. With the exception for one indicator, all Treasury Management activities have been satisfied as at the 30th September 2022.
Compliance with specific investment limits is demonstrated in Table 9 below.

Table 9: Investment Limits

Investment Limits	2022/23 Maximum to date	30/09/22 Actual	2022/23 Limit	Complied
The Councils Banking Provider – Lloyds	£8.6m	£2.2m	£4m	✗
Any single organisation, except the UK Central Government (excluding the operational bank)	£7m	£7m	£7m	✓
Any group of pooled funds under the same management	£19.5	£4m	£20m	✓
Money Market Funds (MMF)	£7m	£5m	£7m	✓

The limit of £4m total cash invested with Lloyds, our banking provider, has not been met on one occasion during Qtr.2.

Event 1:

At the end of Qtr.2, we breached the minimum limit for funds to be held with our bank, Lloyds (we held more money in there than prescribed in our TM strategy) this represented minimal risk. The breach was due to human error and occurred due to timing differences when running reports from our banking system, procedures have been reviewed and put in place to minimise this risk in the future'.

11.2 Compliance with the authorised limit and operational boundary for external debt is demonstrated in Table 10 below.

Table 10: Debt Limits

Debt Limits	2022/23 Maximum £m	30/09/22 Actual £m	2022/23 Operational Boundary £m*	2022/23 Authorised Limit £m*	Complied
Borrowing	411.7	329.0	632.7	759.2	✓
PFI & finance leases	80.5	76.3	76.2	91.4	✓
Total debt	**492.2**	**405.3**	**708.9**	**850.6**	✓

Since the operational boundary is a management tool for in-year monitoring, it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

Treasury Management Indicators

12.1 The Council measures and manages its exposures to treasury management risks using the following indicators.

12.2 **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

12.3 Local Authorities are unrated, therefore fixed term deposits with Local Authorities must be assigned a score. The score assigned is AAA=1, this means the investments are of the highest credit quality. This is due to Local Authorities not being subject to bail-in and having an insignificant risk of insolvency linked to its covenant strength.

12.4 Table 11 shows the target for the portfolio average credit score and the actual to 30th September 2022/23:

Table 11: Security Indicator - Portfolio average credit score

Security Indicator	Target	Actual
Portfolio average credit score	3	1.02

12.5 The actual credit score is below the target showing the exposure to credit risk for the year to date has been lower than the target set, due to higher credit quality investment being used over lower credit quality investment. This is as a result of using fixed term deposits with Local Authorities and the DMO and high credit quality Money Market Funds (MMF's).

12.6 **Interest rate exposure indicator:** The other locally-set prudential indicator relates to interest rate exposure which allows the Council to manage the extent to which it is exposed to changes in interest rates. It shows the split of borrowing and investments between fixed and variable rates, and the maturity profile of long-term loans. Fixed investments and borrowings are those where the rate of interest is fixed for the whole financial year or from the transaction date if later. Instruments that mature during the following financial year are classed as variable rate.

The split in respect of borrowing and investments as at 30th September 2022, and the comparative figures for the previous year, are shown in Table 12 below:

Table 12: Interest Rate Exposure

This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest is shown below:

Interest rate risk indicator	30/9/21 Actual	2022/23 Limit	Complied
Upper limit on one-year revenue impact of a 1% rise in interest rates	£0.064m	£0.450m	✓
Upper limit on one-year revenue impact of a 1% fall in interest rates	£0.080m	£0.880m	✓

12.7 The actual position of risk forecasts the potential impact from Qtr.*3 to the end of the financial year.

12.8 **Maturity Structure of Borrowing:** This indicator is set to control the Council's exposure to refinancing risk. The indicator is calculated as the amount of projected borrowing that is maturing in each period expressed as a percentage of total projected borrowing. For each maturity period, an upper and lower limit is set.

The actual maturity structure of borrowing as at 30th September 2022 has been compared to the loan maturity limit profile that was approved in the Treasury Management Strategy 2022/23. Table 13 below shows that this indicator has been met as follows:

Table 13: Maturity Structure of Borrowing

Number of Years to Maturity	Upper limit per 2022/23 Strategy	Actual position for 31/09/22
	%	%
Up to 1 year	10	3.1%
Up to 2 years	20	6.2%
Up to 5 years	30	7.6%
Up to 10 years	50	22.3%
Up to 20 years	70	31.9%
Up to 30 years	80	56.4%
Up to 40 years	95	99.7%

* The majority of loans mature within 40 years, therefore the 95% upper limit for up to 40 years will need to be reviewed in the next TMS. One loan matures outside of this range which represents the 0.3% difference to reach 100%.

12.9 **Principal Sums Invested for Periods Longer than 365 days**: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

Table 14: Principal Sums Invested for Periods Longer than 365 days

Principal sums invested longer than 354 days	2022/23 £m
Actual principal invested for longer than 364 days	0
Limit on principal invested for longer than 364 days	20
Complied?	✓

Economic Outlook for the remainder of 2022/23

13.1 The world economy is paying a high price for Russia's war against Ukraine. With the impacts of the COVID-19 pandemic still lingering, the war is dragging down growth and putting additional upward pressure on prices, above all for food and energy.

13.2 Multiple interest rate rises are still expected over the forecast horizon despite looming recession. Arlingclose expects Bank Rate to rise to 4.25% by June 2023 under its central case. The table below highlights potential increase/decrease to the bank rate depending on if inflation reduces or stays high.

Table 15: Arlingclose forecast interest rate for the remainder of 2022/23

	Current	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
Official Bank Rate													
Upside risk	0.00	0.25	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25
Arlingclose Central Case	3.00	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	3.50	3.50	3.50	3.50
Downside risk	0.00	0.25	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00

13.3 The UK economy is already experiencing recessionary conditions, with business activity and household spending falling. Tighter monetary and fiscal policy, alongside high inflation will bear down on household disposable income. The short- to medium-term outlook for the UK economy is bleak, with the Bank of England projecting a protracted recession.

Public/stakeholder engagement

14.1 None arising directly from this report.

Other options

15.1 None arising directly from this report.

Financial and value for money issues

16.1 As described in report.

Legal implications

17.1 None arising directly from this report.

Climate Implications

18.1 None arising directly from this report.

Socio-Economic Implications

19.1 None arising directly from this report.

Other significant implications

20.1 None arising directly from this report.

This report has been approved by the following people:

Role	Name	Date of sign-off
Legal	Olu Idowu, Head of Legal Services	15yth November 2022
Finance	Toni Nash, Head of Finance	15th November 2022
Service Director(s)	Alison Parkin, Director of Financial Services	
Report sponsor	Simon Riley, Strategic Director of Corporate Resources & S151 Officer	15th November 2022
Other(s)	Liz Moore, Head of HR	15th November 2022
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List of appendices:		