Report to the Audit & Governance Committee

Date of meeting: 28th November 2022

Epping Forest District Council

Portfolio:	**Finance, Qualis Client & Economic Development**	
Subject:	**Treasury Management Mid-Year Update 2022/23**	
Responsible Officer:	**Andrew Small**	**(01992 564278)**
Democratic Services:	**Laura Kirman**	**(01992 564243)**

Recommendations/Decisions Required:

(1) To note the Treasury Management Mid-Year Update 2022/23 ***(Appendix A)*** and pass comment for full Council.

Executive Summary:

The Council's Treasury Management Strategy (including Investment Strategy) for 2022/23 was considered at a meeting of the Audit and Governance Committee on 17th January 2022 and was subsequently agreed by full Council on 24th February 2022.

In accordance with CIPFA's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) and generally accepted good practice, the Treasury Management Mid-Year Update for 2022/23 (presented in ***Appendix A***) sets out the Council's actual Treasury Management activity for the first six months of 2022/23 (i.e., April to September 2022).

Appendix A begins by setting the external context for first half of 2022/23 by exploring the Economic Background, Financial Markets and Credit Ratings; this includes the volatility and spiralling inflation triggered – to a large extent – by the Russian invasion of Ukraine.

The Borrowing and Investment position for Epping Forest District Council as at 30th September 2022 shows the following:

- *Borrowing* – external borrowing marginally decreased by £0.7 million (from £269.0 million to £268.3 million) during the period April to September 2022; and

- *Investments* – there was a decrease in investments of £2.3 million (from £18.7 million to £16.4 million) during the same period.

The CIPFA Code also covers all the financial assets of the Council, as well as other non-financial assets which the Council holds, primarily for financial return. This report therefore also considers the Council's Commercial Property Portfolio, which delivered Net Income of £4.244 million during the first six months of 2022/23 and continues to be a key part of the Council's strategy to minimise Council Tax increases.

Appendix A concludes by considering compliance with the Council's adopted Treasury Management indicators. Compliance was achieved in all material respects, subject to one minor technical breach on debt maturities.

Reasons for Proposed Decision:

To enable the robust scrutiny the Council's Treasury Management performance in 2022/23 in compliance with CIPFA's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) and generally accepted good practice.

Legal and Governance Implications:

The Local Government Act 2003 created a framework for the financing of capital investments in local authorities which came into operation from April 2004. Alongside this, the Prudential Code was developed by CIPFA as a professional Code of Practice to support local authority decision making in capital investment and financing. Local authorities are required by regulation to have regard to the Prudential Code.

Safer, Cleaner and Greener (SCG) Implications:

None.

Background Papers:

Treasury Management Strategy (including Investment Strategy) 2022/23 (Audit and Governance Committee, 17th January 2022).

(MHCLG) Statutory Guidance on Local Government Investments (3rd Edition). Issued under section 15(1)(a) of the Local Government Act 2003 and effective for financial years commencing on or after 1st April 2018.

Risk Management:

There are a range of inherent financial risks associated with Treasury Management activity; not least the potential for loss of interest and/or deposits. The Council therefore engages the services of external Treasury Management advisors, Arlingclose Ltd.

Borrowing and Investment decisions are made in accordance with the Council's formally adopted Treasury Management Strategy (including Investment Strategy). The Strategy includes several Risk Management features, including – for example – the overriding priority that security of deposit takes precedence over return on investment.

Appendix A

Treasury Management Mid-Year Update 2022/23

Introduction

The Council has adopted CIPFA's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Council to approve Treasury Management semi-annual ("mid-year updates") and annual reports.

The Council's current Treasury Management Strategy (including Investment Strategy) was considered at a meeting of the Audit and Governance Committee on 17th January 2022 and was subsequently agreed by full Council on 24th 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 remains central to the Council's Treasury Management Strategy.

The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's updated Capital Strategy 2022/23 to 2026/27, complying with CIPFA's requirement, was also considered by the Audit and Governance Committee on 17th January 2022, and was also adopted subsequently by full Council on 24th February 2022.

External Context: April to September 2022

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

The economic backdrop during the first six months of the financial year continued to be characterised by high oil, gas and commodity prices, high inflation, no imminent end in sight to the Russia-Ukraine hostilities and its associated impact on the supply chain, and China's zero-Covid policy.

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

UK inflation remained extremely high. Annual headline CPI hit 10.1% in July 2022, the highest rate for 40 years, before falling modestly to 9.9% in August 2022. The energy regulator, Ofgem, increased the energy price cap by 54% in April 2022, while a further increase in the cap from October 2022, which would have seen households with average energy consumption pay over £3,500 per annum, was dampened by the Government stepping in to provide around £150 billion of support to limit bills to £2,500 annually until 2024.

The Bank of England increased the Bank Rate to 2.25% over the period, with the Monetary Policy Committee noting that domestic inflationary pressures are expected to remain strong and so given ongoing strong rhetoric around tackling inflation, further Bank Rate rises should be expected.

On 23rd September 2022, the Government – following a change of leadership – announced a raft of measures in a 'mini budget', loosening fiscal policy with a view to boosting the UK's trend growth rate to 2.5%. With little detail on how Government borrowing would be returned to a sustainable path, financial markets reacted negatively with gilt yields rising dramatically, causing the Bank of England to intervene in order to preserve market stability.

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

Financial Markets: Uncertainty remained in control of financial market sentiment and bond yields remained volatile, continuing their general upward trend as concern over higher inflation and higher interest rates continued to dominate. Towards the end of September, volatility in financial markets was significantly exacerbated by the UK government's fiscal plans, leading to an acceleration in the rate of the rise in gilt yields and decline in the value of sterling.

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

Credit Review: Having completed a full review of its credit advice on unsecured deposits at UK and non-UK banks in May 2022, Arlingclose extended the maximum duration limit for five UK banks, four Canadian banks and four German banks to six months. The maximum duration for unsecured deposits with other UK and non-UK banks on the Arlingclose recommended list is one hundred days; these recommendations were unchanged at the end of the period.

There were no changes to the Arlingclose counterparty list or recommended durations during the period. Nevertheless, increased market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Council's counterparty list remain under constant review.

Local Context

On 31st March 2022, the Council had net borrowing of £250.3 million 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

	31/03/22 Actual £m
General Fund CFR	151.947
HRA CFR	157.552
Total CFR	**309.499**
Less: Other Debt liabilities	0
Borrowing CFR	**309.499**
Less: External borrowing	(268.956)
Internal borrowing:	**40.543**
Less: Usable reserves	(38.482)
Less: Working capital	(20.797)
Net Investments	**(18.736)**

The Treasury Management position as at 30th September 2022 and the change during the first six months of the financial year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31/03/22 Balance £m	Movement £m	30/09/22 Balance £m	30/09/22 Rate %
Long-term Borrowing	213.7	(0.7)	213.0	3.13%
Short-term Borrowing	55.3	0	55.3	1.97%
Total Borrowing	**269.0**	**(0.7)**	**268.3**	
Long-Term Investments	0	0	0	N/A
Short-term Investments	0	8.0	8.0	1.75%
Cash and Cash Equivalents	18.7	(10.3)	8.4	1.86%
Total Investments	**18.7**	**(2.3)**	**16.4**	
Net Borrowing	**250.3**	**1.6**	**251.9**	

The Council's cash flows during April to September 2022 continue to settle down following the general volatility experienced in the last two financial year. Thus:

- *Long-Term Borrowing* – no further long-term loans were taken out during the period April to September 2022, with the principal outstanding on PWLB maturity loans reducing in line with principal repayments on "Equal Instalments of Principal (EIP) loans

- *Short-Term Borrowing* – borrowing from other local authorities remained static at £55.3 million, with that source of borrowing still representing good value (although less so, following recent interest rate rises). Most of the borrowing was 'rolled over' on competitive rates with the agreement of lenders

- *Short-Term Investments* – the use of the recently opened "Debt Management Account Deposit Facility" (DMADF) has proved successful this year with the Council now securing better returns on short-term deposits (typically two to three weeks) than previously achieved on bank deposits

- *Cash and Cash Equivalents* – the use of the DMADF noted above is reducing the need for higher balances on Cash and Cash Equivalents (Bank and MMF deposits)

Borrowing Update

Local authorities can borrow from the PWLB provided they can confirm they are not planning to purchase 'investment assets primarily for yield' in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 Officer. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing.

Acceptable use of PWLB borrowing includes Service Delivery, Housing, Regeneration, Preventative Action, Refinancing and Treasury Management.

The Council is not planning to purchase any investment assets primarily for yield within the next three years and so is able fully access the PWLB.

Borrowing Strategy

At 30th September 2022, the Council held £268.3. million in loans (a marginal decrease of £.7 million compared to the position as at 31st March 2022), as part of its strategy for funding the Capital Programme. Outstanding loans on 30th September 2022 are summarised in Table 3 below.

Table 3: Borrowing Position

	31/03/22 Balance £m	Net Movement £m	30/09/22 Balance £m	30/09/22 Weighted Average Rate %	30/09/22 Weighted Average Maturity (Years/Days)
Public Works Loan Board	215.0	(0.7)	214.3	3.13%	17.53 Years
Banks	0	0	0	N/A	N/A
Local authorities (long-term)	0	0	0	N/A	N/A
Local authorities (short-term)	54.0	0	54.0	1.97%	129 Days
Total Borrowing	**269.0**	**(0.7)**	**268.3**		

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

Over the April to September 2022 period, short-term PWLB rates rose dramatically, particular in late September after the Chancellor's 'mini-budget' included unfunded tax cuts and additional borrowing to fund consumer energy price subsidies. Exceptional volatility threatened financial stability, requiring Bank of England intervention in the gilt market.

Interest rates rose by over 2% during the period in both the long and short term. As an indication, the 5-year maturity certainty rate rose from 2.30% on 1st April 2022 to 5.09% on 30th September 2022; over the same period the 30-year maturity certainty rate rose from 2.63% to 4.68%.

Other Debt Activity

The Council did not raise any other capital finance in the first six months of 2022/23.

Treasury Investment Activity

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held, and money borrowed in advance of need. During the first six months of 2022/23, as is normal, the Council's investment balances varied due to timing differences between income and expenditure. The investment position is shown in Table 4 below.

Table 4: Treasury Investment Position

	31/03/22 Balance £m	Net Movement £m	30/09/22 Balance £m	30/09/22 Income Return %	30/09/22 Weighted Average Maturity Days
Banks & Building Societies (unsecured)	1.7	(1.3)	0.4	0.10%	Instant Access
Government (incl. local authorities)	0	8.0	8.0	1.75%	N/A
Money Market Funds	17.0	(9.0)	8.0	1.95%	Instant Access
Total Investments	**18.7**	**(2.3)**	**16.4**		

Both the CIPFA Code and Government guidance requires local authorities to invest 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.

The increases in Bank Rate over the period under review, and with the prospect of more increases to come, short-dated cash rates, which had ranged between 0.7% - 1.5% at the end of March 2022, rose by around 1.5% for overnight/7-day maturities and by nearly 3.5% for 9 to 12-month maturities during the period.

By the end of September 2022, the rates on "Debt Management Account Deposit Facility" (DMADF) deposits ranged between 1.85% and 3.5% per annum. The return on the Council's sterling Money Market Funds ranged between 0.9% to 1.1% in early April 2022, and between 1.8% and 2.05% at the end of September 2022.

Non-Treasury Investments

The definition of investments in CIPFA's Treasury Management Code 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 the Investment Guidance issued by Ministry of Housing, Communities and Local Government (MHCLG), in which the definition of investments is further broadened to also include all such assets held partially for financial return.

The Council also holds a significant commercial property portfolio on its Balance Sheet, which are summarised in Table 5 below.

Table 5: Commercial Property Investments

Category	31/03/22 Balance Sheet Value	Net Income 2022/23 (6 months April - September) *** Estimated	Net Income 2021/22 (6 months April - September) *** (50% Actual)
	£Ms	£Ms	£Ms
Shops*	99.367	2.819	2.663
Industrial Units	43.703	0.772	0.687
Other**	18.936	0.653	0.417
Total Value/Net Income	**162.006**	**4.244**	**3.768**

*Includes Public Houses and a Petrol Station

**Includes North Weald Airfield and Sports Facilities

The Council received total net income of £4.244 million from Commercial Property Investments in the first 6 months of 2022/23 (compared to £3.768 million for the corresponding period in 2021/22). Income streams at North Weald Airfield in particular have benefited due to the return of the Saturday Market following the disruption caused by the pandemic.

The Committee should note that the numbers reflect the accrued position currently in the Council's books, which does not take account of the collectability of income. So far, there have been no write-offs due to the effects of Covid-19, with the Council's portfolio appearing to have weathered the pandemic generally very well. However, an increase in write-offs cannot be ruled out in the future given the current economic climate.

Compliance

The Strategic Director and Section 151 Officer reports that all Treasury Management activities undertaken during the first six months of the year complied fully with the CIPFA Code of Practice. Compliance with the approved Treasury Management Strategy was as follows:

- *Investment Limits* – full compliance achieved
- *Security* – full compliance achieved
- *Liquidity* – full compliance achieved
- *Interest Rate Exposure* – full compliance achieved
- *Maturity Structure* – compliance with the adopted maturity structure limits was achieved in all material respects. There is however now a small technical breach with the debt maturities in the range 15 to 20 years; at present, 58% of outstanding debt falls within that age bracket due to a 30-year PWLB Loan of £33.656 million taken out on 28th March 2012 'moving down' from the range 20 to 25 years due to the passage of time. There is currently no justification to changing the current debt portfolio in the light of that statistic. However, this is something that will be considered, and reported to the Committee (with advice taken from Arlingclose) in preparing the Strategy for 2023/24; and
- *Long-Term Investments* – full compliance achieved.

Table 8: Investment Limits

Sector	Time Limit	Counterparty Limit	Sector limit	30/09/22 Actual	Complied? (Yes/No)
The UK Government	50 years	Unlimited	N/A	£8.0 million	Yes
Local authorities & other government entities	25 years	£10.0 million	Unlimited	£0	Yes
Banks (unsecured)*	13 months	£4.0 million	£20.0 million	£0.4 million	Yes
Building Societies* (unsecured)	13 months	£2.0 million	£2.0 million	£0	Yes
Registered Providers* (unsecured)	5 years	£3.0 million	£3.0 million	£0	Yes
Money Market Funds*	N/A	£10.0 million	Maximum of 3 Funds (£10m each)	£8.0 million	Yes

** Minimum Credit Rating*

Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken account of.

Treasury Management Indicators

The Council measures and manages its exposures to Treasury Management risks using the following indicators.

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average 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.

	30/09/22 Actual	**2022/23 Target**	**Complied?**
Portfolio average credit rating	AA	A-	Yes

Liquidity: The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

	30/09/22 Actual	**2022/23 Target**	**Complied?**
Total cash available within 3 months	£11.0 million	£3.0 million	Yes

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

Interest rate risk indicator	**30/09/22 Actual**	**2022/23 Limit**	**Complied?**
Upper limit on one-year revenue impact of a 1% rise in interest rates (Borrowing)	£0	£1.0 million	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates (Investments)	£0.1 million	£0.5 million	Yes

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates. The Council no longer has any Variable Rate Exposure on Borrowing.

Maturity Structure of Borrowing: This indicator is set to control exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	30/09/22 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	21%	50%	0%	Yes
12 months and within 24 months	1%	50%	0%	Yes
24 months and within 5 years	2%	50%	0%	Yes
5 years and within 10 years	14%	50%	0%	Yes
10 years and within 15 years	2%	50%	0%	Yes
15 years and within 20 years	**58%**	**50%**	**0%**	**No**
20 years and within 25 years	1%	50%	0%	Yes
25 years and above	2%	50%	0%	Yes

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.

Principal Sums Invested for Periods Longer than a year: 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:

	2022/23 (April – Sept)
Actual principal invested beyond year end	£0
Limit on principal invested beyond year end	£15.0 million
Complied?	Yes

Other

IFRS 16: The implementation of the new IFRS 16 Leases accounting standard was due to come into for force for local authorities from 1st April 2022. Following a consultation, CIFPA/LASAAC announced an optional two-year delay to the implementation of this standard; the decision which was confirmed by the Financial Reporting Advisory Board (FRAB) in early April 2022. Authorities can now choose to adopt the new standard on 1st April 2022, 1st April 2023, or 1st April 2024. IFRS16 is unlikely to have a material impact on Epping Forest District Council; on that basis, the intended local adoption of the new standard is on 1st April 2024.