



Council name	COTSWOLD DISTRICT COUNCIL
Name and date of Committee	AUDIT COMMITTEE – 26 th January 2023
Subject	TREASURY MANAGEMENT MID-YEAR REPORT 2022-23
Wards affected	N/A
Accountable member	Cllr Mike Evely, Cabinet Member for Finance Email: mike.evely@cotswold.gov.uk
Accountable officer	David Stanley, Deputy Chief Executive and Section 151 Officer Email: David.Stanley@cotswold.gov.uk
Summary/Purpose	To receive and discuss details of the Council's Treasury Management performance for the period 01 April to 30 September 2022.
Annexes	None
Recommendation	<i>That the Council's Treasury Management performance for the period 1 April 2022 to 30 September 2022 is considered and recommended to Council for approval.</i>
Corporate priorities	The Council's Treasury Management Strategy underpins all of the Council Priorities and is relevant to the Council principle of "Value for money – we will use the council's resources wisely, but will invest in the fabric and future of the district".
Key Decision	NO
Exempt	NO
Consultees/ Consultation	N/A



1. BACKGROUND

- 1.1** In February 2011 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code). The CIPFA Code requires the Council to approve reports on treasury management activities at the end of the first half of the financial year and at the end of the financial year.
- 1.2** This report covers the Treasury Management activity and performance of Cotswold District Council for the period 01 April to 30 September 2022.
- 1.3** The Council's Treasury Management Strategy for 2022/23 was approved at the Council meeting on 16 February 2022. The Council has 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 Treasury Management Strategy.
- 1.4** The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management 2021 ("the Code"), which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year. The Code also recommends that members be informed of Treasury Management activities at least twice a year. This report therefore ensures this authority is embracing best practice in accordance with CIPFA's recommendations.

2. TREASURY MANAGEMENT – INTRODUCTION

- 2.1** The purpose of the treasury management operation is to ensure that cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in counterparties or instruments commensurate with the Council's low risk approach, pursuing optimum performance while ensuring that security of the investment is considered ahead of investment return. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure.
- 2.2** 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 obligations. The management of longer-term cash may involve the arrangement of long and/or short-term loans (external borrowing) or may use longer term cash flow surpluses in lieu of external borrowing (internal borrowing).



- 2.3 The Council continued to engage the services of Arlingclose for independent treasury advice during the year 2022/23. Arlingclose provide specialist treasury support to 25% of UK local authorities. They provide a range of treasury management services including technical advice on investment management and long-term capital financing. They advise on investment trends, developments and opportunities consistent with the Council's Treasury Management Strategy.
- 2.4 The Council's treasury management advisors have provided commentary on the economic background that prevailed during the first half of 2021/22. This commentary is provided at Annex A.

3. TREASURY MANAGEMENT- SUMMARY POSITION - 1 APRIL 2022 to 30 SEPTEMBER 2022

- 3.1 On 31 March 2022, the Council had net investments of £32.923m 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 useable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table I below:

Table I: Balance Sheet Summary

	31/3/22 Actual £m
General Fund CFR	0
Less: External borrowing	0
Less: Usable reserves	(25.677)
Less: Working capital	2.326
Net Investments	(32.923)

- 3.1 The Council's current strategy is to maintain investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk. If interest rates were to rise by 1%, then investment income would average 3.08%, whilst borrowing costs (based on 20 year PWLB Loan) would be 4.48%. For every £1m borrowed the cost of carry would cost an additional £14,000 per annum.
- 3.2 The Council's strategy has been to diversify investments into pooled funds in order to reduce risk and increase returns. The treasury management position as at 31 March 2022 and the mid-year change is shown in Table 2 below.



Table 2: Treasury Management Summary

	31/3/2022 Actual £m	2022/23 Movement £m	30/9/2022 Balance £m	30/9/2022 Rate %
Short-term borrowing	0	0.500	0.500	2.21
Total borrowing	0	0.500	0.500	2.21
Long-term investments	12.557	(0.844)	11.713	4.30
Short-term investments	5.571	9.547	15.118	1.24
Cash and cash equivalents	14.795	(5.887)	8.908	0.99
Total investments	32.923	2.816	35.739	2.35

4. BORROWING ACTIVITY

- 4.1 Local authorities can borrow from the Public Works Loan Board (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 re-finance existing loans or externalise internal borrowing.
- 4.2 Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, re-financing debt and treasury management.
- 4.3 Competitive market alternatives are available for authorities with or without access to the PWLB. However, the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders.
- 4.4 CIPFA's Prudential Code on Capital Finance and the Treasury Management Code of Practice have been updated with a soft launch for 2022/23 and full implementation for 2023/24. The main changes to the Codes are shown below:
- 4.5 **Prudential Code** – The updated code includes the following as the focus of the substantive changes:
- Provisions in the code, which present the approach to borrowing in advance of need in order to profit from additional sums borrowed, have been strengthened. The relevant parts of the code have augmented to be clear that borrowing for debt-for-yield investment is not permissible under the Prudential Code. This recognises that commercial activity is part of regeneration but underlines that such transactions do



not include debt-for yield as the primary purpose of the investment or represent an unnecessary risk to public funds.

- Proportionality is included as an objective in the Prudential Code. Provisions have been added so that an authority incorporates an assessment of risk to levels of resources used for capital purposes.
- Capital strategies are required to report investments under the following headings: service, treasury management and commercial investments.

4.6 Treasury Management Code – The main changes to the Treasury Management code are as follows:

- Investment management practices and other recommendations relating to non-treasury investments are included within the Treasury Management Practices (TMPs) alongside existing TMPs.
- Introduction of the Liability Benchmark as a treasury management indicator for local government bodies.
- Environmental, Social and Governance (ESG) risks are incorporated into TMPI (Risk Management) rather than a separate TMP 13.
- The purpose and objective of each category of investments should be described within the Treasury Management Strategy

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

4.8 The Council's first Community Municipal Investment (CMI), named 'Cotswold Climate Investment' (CCI) which targeted a £500,000 fundraising closed on the 16 August 2022, fully funded by over 450 investors. As at 30 September 2022 the Council therefore held a £500k loan administered through Abundance Investments Limited for the purpose of Community Municipal Investments. The Cotswold Climate Investment will support a range of projects, including installing publicly available off-street electric vehicle charging points (EVCPs) around the District to encourage electric vehicle take-up, and improving the energy and carbon performance of the Council's Cirencester offices.

4.9 There are plans to borrow in the future to fund the Capital Programme. Any borrowing undertaken will be reported back to members of this Committee and will be subject to consideration by the Capital Programme Investment Board and approval by either Cabinet or Council as appropriate.



5. INVESTMENT PERFORMANCE AND PROJECTIONS

- 5.1 The Council invested funds, representing income received in advance of expenditure plus balances and reserves held. During the first-half of the year, the Council's investment balances ranged between £47m and £31m million due to timing differences between income and expenditure. The investment position is shown in table 3 below:

Table 3: Treasury Investment Position

	31.3.22 Balance £m	Net Movement £m	30.9.22 Balance £m	30.9.22 Return %
Bank of England DMADF	5.50	9.529	15.029	1.24
Money Market Funds/ Call Accounts	14.795	(5.887)	8.908	0.99
Real Estate Investment Trust (REIT)	1.036	0.011	1.047	2.80
Cash Plus Fund	1.072	0.005	1.077	0.51
Pooled Funds (1)	10.520	(0.843)	9.677	4.45
Total Investments	32.923	2.815	35.738	2.35

(1) See breakdown at Table 4 below.

- 5.2 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.
- 5.3 Due to the impact of the payment of the Government's Covid-19 grants to businesses on cash flow, the Council kept more cash available at very short notice than is normal. Liquid cash was diversified over several counterparties and Money Market Funds to manage both credit and liquidity risks.
- 5.4 The Investment income budget for 2022/23 is £0.510m, as approved in February 2022. As part of Treasury Management monitoring, a review of Investment income expectations for the year indicates income could exceed budget by £0.318m by year end (based on investment returns in the first half of the year). Increases in the Base Rate have fed-through to higher short term deposit and MMF interest rates. These have increased from 0.01% at the start of the year to over 1% by September with further increases continuing in line with the increases in Base Rate. There has been a small increase in Pooled Fund interest, further details are included in section 7 of this report.



6. EXTERNALLY MANAGED POOLED FUNDS

6.1 Of the Council's investments, £11.5m are held in externally managed strategic pooled cash, bond, equity, multi-asset and property funds and a further £1m is invested in a Housing Real Estate Investment Trust where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds have generated a revenue return of £0.247m (4.30% annualised) in the first half of the financial year. As at 30 September 2022, there is a capital loss of £0.844m in the financial year due to external economic conditions. However, there has been a recovery since October owing to greater political stability and market confidence. A further recovery in capital value is expected over the remainder of the year but global economic uncertainty remains. Members are reminded that Pooled Funds are held for the longer-term and the capital value will fluctuate over each financial year.

6.2 Table 4 below shows the current valuations of the Pooled Funds portfolio, Cash Plus Fund and REIT at 30 September 2022, compared with the opening balances of 1 April 2022.

Table 4: Pooled Funds, Cash Plus Fund and REIT

FUND NAME	Initial Investment	1 April Fund Value	30th Sept Fund Value	Dividends in 2022/23 (as at 30 Sept)	Gain / (Loss) for 2022/23	Gain / (Loss) to Initial Principal	% Return Capital & Dividend 2022/23
	£	£	£	£	£	£	%
CCLA Property Fund	2,500,000	2,683,429	2,754,499	48,285	71,070	254,499	4.45%
Schroders Income Maximiser Fund (E)	1,000,000	847,022	694,555	39,544	(152,467)	(305,445)	(13.33)
CCLA Diversified Income Fund (M)	1,000,000	1,031,275	942,855	15,407	(88,420)	(57,145)	(7.08)
M&G UK Income Fund (E)	2,000,000	1,920,825	1,675,646	57,544	(245,179)	(324,354)	(9.77)
Investec Diversified Fund (M)	2,000,000	1,921,396	1,756,745	40,909	(164,651)	(243,255)	(6.44)
Columbia Threadneedle Bond Fund (B)	2,000,000	2,050,746	1,771,237	30,953	(279,509)	(228,763)	(12.12)
Federated Cash + Fund (C)	1,000,000	1,071,894	1,077,378	-	5,484	77,378	(0.51)
Fundamentum Housing REIT	1,000,000	1,030,000	1,040,000	14,000	10,000	40,000	(2.33)
Total	12,500,000	12,556,587	12,376,599	246,642	(843,673)	(787,085)	(4.75)

Key: E- Equity, M – Multi asset, B –Bond, C – Cash

6.3 Pooled funds capital value fell significantly in the period April to September, by 7.39%. This period has been a very difficult environment for bonds engendered by global central banks' determination to bring high and persistent inflation under control through increases in policy rates and strong rhetoric. The sell-off in gilts, other sovereign bonds and corporate bonds

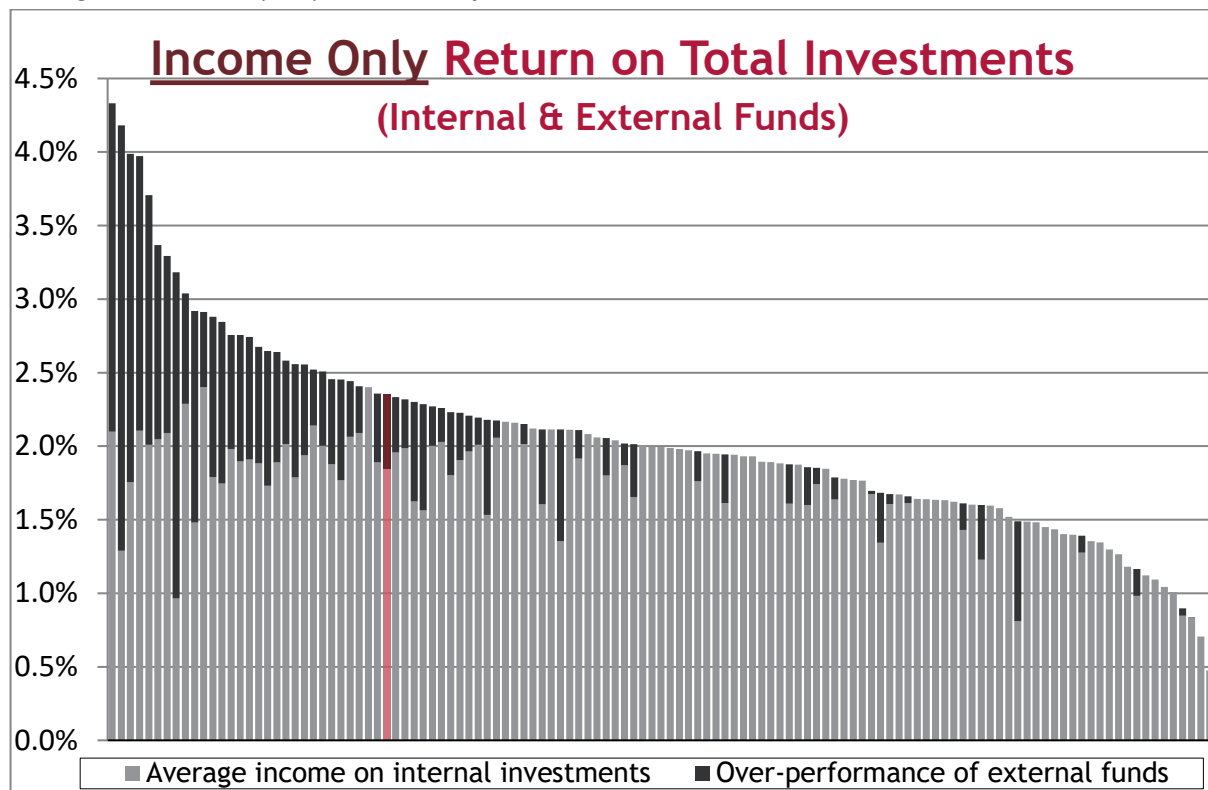


with a rise in gilt/bond yields (i.e. a fall in price) was reflected in the Authority's bond and multi-asset income funds. The increase in policy rates in the UK, US and Eurozone and the prospect of low to no growth and a recessionary period ahead was also a challenging period for equities, the FTSE All Share index falling from 4,187 on 31 March to 3,763 on 30 September. The fall in equity valuations is reflected in the equity and multi-asset income funds.

- 6.4 Significant financial market volatility and uncertainty remain due to stagflation fears, little sight of the war in Ukraine ending soon and ongoing supply chain issues, a lingering problem over the past 30 months, yet to be fully resolved.
- 6.5 The change in the Authority's funds' capital values and income earned over the first half of the financial year is shown in Table 4.
- 6.6 Because the Council's externally managed funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rates.
- 6.7 Table 5 below shows that as at 30 September 2022, Cotswold District Council (red bar) achieved the 31st highest average rate on investments from the 121 local authorities that Arlingclose support.



Table 5 Cotswold' District Council investment returns v Arlingclose clients (121) as at 30 September 2022.



7. ARLINGCLOSE'S ECONOMIC OUTLOOK FOR THE REMAINDER OF 2022/23

7.1

	Current	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Official Bank Rate													
Upside Risk	-	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25	1.25
Arlingclose Central Case	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	3.50	3.25	3.25	3.25	3.25
Downside Risk	-	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00

7.2 The influence of the mini-budget on rates and yields continues to wane following the reversal of many of the mini-budget announcements and a more fiscally responsible approach shown by UK government.

7.3 Volatility in global markets continues, however, as investors seek the extent to which central banks are willing to tighten policy, as evidence of recessionary conditions builds. Investors have been more willing to price in the downturn in growth, easing financial conditions, to the displeasure of policymakers. This raises the risk that central banks will incur a policy error by tightening too much.



- 7.4** The UK economy is already experiencing recessionary conditions and recent GDP and PMI data suggests the economy entered a technical recession in Q3 2022. The resilience shown by the economy has been surprising, despite the downturn in business activity and household spending. Lower demand should bear down on business pricing power – recent data suggests the UK has passed peak inflation.
- 7.5** The lagged effect of the sharp tightening of monetary policy, and the lingering effects of the mini-budget on the housing market, widespread strike action, alongside high inflation, will continue to put pressure on household disposable income and wealth. The short- to medium-term outlook for the UK economy remains bleak.
- 7.6** Demand for labour appears to be ebbing, but not quickly enough in the official data for most MPC policymakers. The labour market remains the bright spot in the economy and persisting employment strength may support activity, although there is a feeling of borrowed time. The MPC focus is on nominal wage growth, despite the huge real term pay cuts being experienced by the vast majority. Bank Rate will remain relatively high(er) until both inflation and wage growth declines.
- 7.7** The MPC raised Bank Rate by 50bps to 3.5% in December as expected, with signs that some members believe that 3% is restrictive enough. However, a majority of members think further increases in Bank Rate might be required. Arlingclose continues to expect Bank Rate to peak at 4.25%, with further 25bps rises February, March and May 2023.
- 7.8** The MPC will cut rates in the medium term to stimulate a stuttering UK economy, but will be reluctant to do so until wage growth eases. We see rate cuts in the first half of 2024. Arlingclose expects gilt yields to remain broadly steady over the medium term, although with continued volatility across shorter time periods.
- 7.9** Gilt yields face pressures to both sides from hawkish US/EZ central bank policy on one hand to the weak global economic outlook on the other. BoE bond sales and high government borrowing will provide further underlying support for yields.

8. COMPLIANCE

- 8.1** The Chief Finance Officer reports that all treasury management activities undertaken during the quarter complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy.

9. LEGAL IMPLICATIONS

- 9.1** There are no legal implications arising from this report.

10. RISK ASSESSMENT



10.1 This report discusses the impact of economic risk on the value and returns associated with the Council's investment portfolio together with the risk of low interest rates on the Council's revenue budget.

11. CLIMATE CHANGE IMPLICATIONS

11.1 None directly arising from this report.

12. BACKGROUND PAPERS

12.1 None

(END)



1. ECONOMIC BACKGROUND

- 1.1 The ongoing conflict in Ukraine has continued to put pressure on global inflation and the economic outlook for UK and world growth remains weak. The UK political situation towards the end of the period following the 'fiscal event' increased uncertainty further.
- 1.2 The economic backdrop during the April to September period continued to be characterised by high oil, gas and commodity prices, ongoing high inflation and its impact on consumers' cost of living, no imminent end in sight to the Russia-Ukraine hostilities and its associated impact on the supply chain, and China's zero-Covid policy.
- 1.3 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.
- 1.4 UK inflation remained extremely high. Annual headline CPI hit 10.1% in July, the highest rate for 40 years, before falling modestly to 9.9% in August. RPI registered 12.3% in both July and August. The energy regulator, Ofgem, increased the energy price cap by 54% in April, while a further increase in the cap from October, which would have seen households with average energy consumption pay over £3,500 per annum, was dampened by the UK government stepping in to provide around £150 billion of support to limit bills to £2,500 annually until 2024.
- 1.5 The Bank of England increased the official Bank Rate to 2.25% over the period. From a rate of 0.75% in March, the Monetary Policy Committee (MPC) pushed through rises of 0.25% in each of the following two MPC meetings, before hiking by 0.50% in August and again in September.
- 1.6 On 23rd September the UK 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. Gilt yields rose dramatically by between 0.7% - 1% for all maturities with the rise most pronounced for shorter dated gilts.

2. FINANCIAL MARKETS

- 2.1 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.

ANNEX A



COTSWOLD
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- 2.2 Due to pressure on pension funds, the Bank of England announced a direct intervention in the gilt market to increase liquidity and reduce yields.
- 2.3 Over the period Fitch and Moody's upwardly revised to stable the outlook on a number of UK banks and building societies on the Council's counterparty list, recognising their improved capital positions compared to last year and better economic growth prospects in the UK.
- 2.4 Having completed its full review of its credit advice on unsecured deposits at UK and non-UK banks, in May 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 Arlingclose's recommended list is 100 days. These recommendations were unchanged at the end of the period.