

APPENDIX A

SUMMARY OF TREASURY MANAGEMENT ACTIVITIES 2022-23 1 APRIL TO 30 SEPTEMBER 2022

1. External Debt and Investment Position

On 30 September 2022, the Council held £99.94 million of external long-term borrowing and £98.45 million of investments. The Council's external debt and investment position for 1 April to 30 September 2022 is shown below in Table 1; more detail is provided in section 3 - Borrowing Strategy and Outturn - and section 4 - Investment Strategy and Outturn:

Table 1: External debt and investment position 1 April 2022 to 30 September 2022

	Principal 01/04/2022 £m	Average Rate 01/04/2022 %	Principal 30/09/2022 £m	Average Rate 30/09/2022 %
External Long Term Borrowing:				
Public Works Loan Board	77.62	4.70	77.62	4.70
Lender's Option	19.25	4.65	19.25	4.65
Borrower's Option	2.68	0.00	3.07	0.00
Salix Loans				
Total External Borrowing	99.55		99.94	
Other Long Term Liabilities (LTL):				
Private Finance Initiative (PFI)*	14.77		14.33	
Other LTL	0.39		0.31	
Total Other Long Term Liabilities	15.16		14.64	
Total Gross External Debt	114.71		114.58	
Treasury Investments:				
Debt Management Office	30.20	0.54	29.00	1.14
Local Authorities	45.50	0.37	52.00	0.54
Banks	8.37	0.53	6.95	0.93
Money Market Fund***	0.00	0.00	10.50	1.16
Total Treasury Investments	84.07	0.43	98.45	0.88
Net Debt	30.64		16.13	

* (PFI) arrangement for the provision of a Secondary School in Maesteg 11.5 years remaining term

** these funds provide instant access

Where a Council finances capital expenditure by debt, it must put aside revenue resources to repay that debt in later years and this amount charged to revenue is called the Minimum Revenue Provision (MRP). The Local Authority (Capital Finance and Accounting) (Amendment) (Wales) Regulations 2008 requires the Council to produce and approve an annual Minimum Revenue Provision (MRP) Statement before the start of the financial year that details the methodology for the MRP charge and this is detailed in the Council's Capital Strategy. 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. The Council's current strategy is to delay the need to borrow externally by temporarily using cash it holds for other purposes such as earmarked reserves. This is known as internal borrowing. This strategy is prudent as investment returns are low and counterparty risk is relatively high. The CFR is forecast to increase from 2021-22 levels due to the amount of prudential borrowing in the capital programme in future years. The Loans CFR (which excludes PFI & Other Long Term Liabilities) is at the half year position estimated to be £171.35 million as shown in table 2 below.

The liability benchmark measures the Council's projected net debt requirement plus a short-term liquidity allowance in the form of minimum cash and investment balances. The purpose of the benchmark is to set the level of risk which the Council regards as its balanced or normal position. The forecast liability benchmark, or level of debt estimated for 31 March 2023 is £76.83 million, which is lower than the estimate within the TMS. The current level of long-term borrowing is £99.94 million. As the Council has available reserves it can use them to fund capital expenditure in the short term, which is a prudent approach to managing its cash resources. Table 2 below has been produced using estimates of capital spend and forecasts on usable reserves for the current financial year. The Loans CFR ignores cash balances and may be too high if the authority benefits from long term positive cash flows which this Council does benefit from. The benchmark assumes that cash and investment balances are kept to a minimum level of £10 million at to maintain sufficient liquidity but minimise credit risk.

Table 2: Liability benchmark

	2021-22 Actual	2022-23 Estimate TMS	2022-23 Projection
	£m	£m	£m
Loans Capital Financing Requirement	162.31	180.02	171.35
Less: Usable reserves	(141.69)	(76.29)	(104.52)
Plus: actual/minimum investments	10	10	10
Liability Benchmark	30.62	113.73	76.83

2. External Context

The ongoing conflict in Ukraine has continued to put pressure on global inflation and the economic outlook for UK and world growth remains weak. Towards the end of the period there was some uncertainty in the markets following the then Chancellor's fiscal plan. 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.

The Bank of England, Federal Reserve and the European Central Bank all increased 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 Consumer Price Index (CPI – which excludes housing costs) hit 10.1% in July, the highest rate for 40 years, before falling modestly to 9.9% in August and then returning to 10.1% in September. Retail Prices Index (RPI – including mortgage interest payments) registered 12.3% in both July and August increasing in September to 12.6%. 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, although it has since been announced it will end in April 2023.

The Bank of England's official Bank Rate was 0.75% at the start of the financial year. At the next two meetings of the Monetary Policy Commission it was decided to raise it each time by a further 0.25%, before following that with further increases of 0.50% in both August and September. This has increased the rate to 2.25%. The Committee noted 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.

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

3. Borrowing Strategy and Outturn for 1 April to 30 September 2022

At 30 September 2022, the Council held £99.94 million of long-term loans as part of its strategy for funding previous years' capital programmes. The TMS 2022-23 forecast that the Council would need to borrow £9.36 million in 2022-23. However, currently it is anticipated that the Council will not need to take out new borrowing during the year 2022-23, although this will be dependent on the progress of the Capital Programme expenditure and the use of available funding set aside for earmarked reserves during the remainder of the year.

More detail on forecast capital spend is provided in the Capital Strategy 2022-23 which was approved by Council on 23 February 2022 in conjunction with the Capital Annual Outturn 2021-22 and the Quarter 2 Capital Monitoring 2022-23 reported to Council on 19 October 2022.

The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans, should the Council's long-term plans change, is a secondary objective. Therefore the major objectives to be followed in 2022-23 are:

- to minimise the revenue costs of debt
- to manage the Council's debt maturity profile i.e. to leave no one future year with a high level of repayments that could cause problems in re-borrowing
- to effect funding in any one year at the cheapest cost commensurate with future risk
- to monitor and review the level of variable interest rate loans in order to take greater advantage of interest rate movement
- to reschedule debt if appropriate, in order to take advantage of potential savings as interest rates change
- to optimise the use of all capital resources including borrowing, both supported and unsupported, usable capital receipts, revenue contributions to capital and grants and contributions

The impact of the Covid-19 pandemic and ongoing conflict in Ukraine are still continuing to make a defined imprint on the economy, public finances in general, as well as on local government funding in particular. With uncertainty going forward, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. The ever-increasing uncertainty over future interest rates increases the risks associated with treasury activity. As a result, the Council will take a cautious approach to its treasury strategy. At present interest rates are rising rapidly and as there is uncertainty at the level at which rates will level out, it is likely to be more beneficial to either use internal resources or take out short term loans instead.

The Council's primary objective for the management of its debt is to ensure its long-term affordability. The majority of its loans have therefore been borrowed from the Public Works Loan Board (PWLB) at long term fixed rates of interest, but we will also investigate other sources of finance, such as Welsh Government and local authority loans and bank loans that may be available at more favourable rates. Following the increase in the numbers of local authorities taking out PWLB loans to buy commercial properties for yield, a UK government consultation by HM Treasury issued revised lending terms for PWLB borrowing by local authorities in November 2020. As a condition of accessing the PWLB, local authorities will be asked to confirm that there is no intention to buy investment assets primarily for yield in the current or next two

financial years. Local authorities' Section 151 Officers, or equivalent, will be required to confirm that capital expenditure plans are current and that the plans are within acceptable use of the PWLB. Whilst this in itself does not preclude the Council from investing in commercial activities, investing in assets for yield would preclude the Council from accessing PWLB borrowing. In December 2021, CIPFA published a new edition of the Prudential Code for Capital Finance in Local Authorities. A significant change to the Code is that, in order to comply with the Code, an authority must not borrow to invest primarily for financial return. It goes further to clarify that "*it is not prudent for local authorities to make any investment or spending that will increase the capital financing requirement, and so lead to new borrowing, unless directly and primarily related to the functions of the authority and where any financial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose*".

The Council has a number of energy schemes which are funded via Salix interest free loans. These loans are required to be repaid between 7 and 10 years. Excluding these loans the last time the Council took out long term borrowing was £5 million from the PWLB in March 2012. Should the need to borrow materialise as expected it is likely that we would look to borrow from the PWLB. For estimate purposes it has been assumed that this would be over 30 years. The Council may also take out short term loans (normally for up to one month) to cover unexpected cash flow shortages. Market conditions have meant that there has been no rescheduling of the Council's long term borrowing so far this year however, in conjunction with the Council's Treasury Management advisors Arlingclose Ltd, the loan portfolio will continue to be reviewed for any potential savings as a result of any loan rescheduling.

The £19.25 million in table 1 above relates to Lender's Option Borrower's Option (LOBO) loans which have a maturity date of 2054, however these may be re-scheduled in advance of this maturity date. The LOBO rate and term may vary in the future depending upon the prevailing market rates, the lender exercising their option to increase rates at one of the bi-annual trigger points (the trigger dates being July and January) and therefore, the Council being given the option to accept the increase or to repay the loan without incurring a penalty. The lender didn't exercise their option on 22 July 2022 and the next trigger point is 22 January 2023. The lender is unlikely to exercise their option during low interest rate environments, however, an element of refinancing risk remains given the current economic climate and increasing interest rates. The Council would likely take the option to repay these loans at no cost if it has the opportunity to do so in the future. The current average interest rate for these LOBOs is 4.65% compared to the PWLB Loans average interest rate of 4.70%. The premiums payable to renegotiate the Council's Lender's Option Borrower's Option (LOBO) continues to be cost prohibitive at present.

The Treasury Management indicator shown in Table 3 below is for the Maturity Structure of Borrowing and is set for the forthcoming financial year to control the Council's exposure to refinancing risk with respect to the maturity of the Council's external borrowing and has been set to allow for the possible

restructuring of long-term debt where this is expected to lead to an overall saving or reduction in risk. It is the amount of projected borrowing maturing in each period as a percentage of total projected borrowing. The upper and lower limits on the maturity structure of borrowing set out in the TMS 2022-23 and the projections for 2022-23 are:

Table 3: Treasury Management Indicator Maturity Structure of Borrowing 2022-23

Refinancing rate risk indicator Maturity structure of borrowing	TMS 2022-23 Upper limit %	TMS 2022-23 Lower limit %	Projection 31-3-23 %
Under 12 months	50	-	19.87
12 months and within 24 months	25	-	-
24 months and within 5 years	25	-	12.47
5 years and within 10 years	40	-	13.45
10 years and within 20 years	50	-	16.64
20 years and above	60	25	37.57

The 19.87% shown in Table 3 above relates to the £19.25 million LOBO loans which may be re-scheduled in advance of their maturity date of 2054, as detailed in the paragraph above. The CIPFA Code requires the maturity of LOBO loans to be shown as the earliest date on which the lender can require payment, i.e. the option/call dates in 2022-23, so the maturity date is actually uncertain but is shown in the “Under 12 months” category as per the Code.

4. Investment Strategy and Position 1 April to 30 September 2022

Both the CIPFA Code and the WG Guidance require the Council to invest its funds prudently and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council’s objective when investing money is to strike an appropriate balance between risk and return, balancing the risk of incurring losses from defaults against receiving unsuitably low investment income.

The major objectives during 2022-23 are to:

- Maintain capital **security**
- Maintain **liquidity** so funds are available when expenditure is needed
- Achieve a **yield** on investments commensurate with the proper levels of security and liquidity

The Annual Investment Strategy incorporated in the Council’s TMS 2022-23 includes the credit ratings defined for each category of investments and the liquidity of investments. The Council’s investments have historically been placed in mainly short-term bank and building society unsecured deposits and

local and central government. However, investments may be made with any public or private sector organisations that meet the minimum credit criteria and investment limits specified in the Investment Strategy. The majority of the Council's surplus cash is currently invested with other Local Authorities, Central Government (DMO) and in Money Market Funds, but the Council will continue to look at investment options in line with the limits detailed in the Investment Strategy. Arlingclose Ltd constantly stress tests the financial institutions on its recommended counterparty list and as a result, removing or in some cases adding back some previously removed on its recommended list for unsecured deposits and revising the credit rating, outlook and recommended deposit period for a number of others. The Council takes into account updated advice from its advisors before making any investment decisions.

The Council holds surplus funds representing income received in advance of expenditure, plus balances and reserves, and, as shown in Table 1 above, the balance on investments at 30 September 2022 was £98.45 million. Table 4 below details these investments by counterparty type. The average investment rate in the period 1 April to 30 September 2022 was 0.88%.

Table 4: Investments Profile 1 April to 30 September 2022

Investment Counterparty Category	Balance 01 April 2022 (A) £m	Investments raised (B) £m	Investments Repaid (C) £m	Balance 30 September 2022 (A+B-C) £m	Investment income received** Apr-Sep 2022 £'000	Average original duration of the Investment Days	Weighted average investment balance Apr-Sep 2022 £m	Weighted average interest rate Apr-Sep 22 %
Government DMO	30.20	217.90	219.10	29.00	146.08	26	32.62	1.14
Local Authorities	45.50	31.00	24.50	52.00	53.05	298	45.22	0.54
Banks (Fixed Maturity)	3.00	12.00	12.00	3.00	13.32	49	3.00	1.34
Banks Instant Access/Notice Period Account	5.38	47.85	49.28	3.95	13.77	-	7.38	0.76
Building Societies				-		-		
Money Market Fund (Instant Access)		38.00	27.50	10.50	108.40	-	21.80	1.17
Total/Average	84.08	346.75	332.38	98.45	334.62	93	110.02	0.88

* actual income received in year excluding accruals

The Treasury Management indicator shown below in Table 5 is for Principal Sums Invested for periods longer than a year. Where the Council invests, or plans to invest, for periods longer than a year, an upper limit is set for each

forward financial year period for the maturing of such investments. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of long-term investments. The limit on the long-term principal sum invested to final maturities beyond the period end are set out in the TMS 2022-23.

Table 5: Treasury Management Indicator Principal Sums Invested for periods longer than a year

Price risk indicator	TMS 2022-23 £m	Projection 31-3-23 £m
Limit on principal invested beyond financial year end	15	5

All investments longer than 365 days (non-specified) will be made with a cautious approach to cash flow requirements and advice from Arlingclose Ltd will be sought as necessary.

There is only 1 long-term investment (original duration of 12 months or more) outstanding at 30 September 2022. This is with Medway Council and is repayable on 25 July 2024. All other investments at 30 September 2022 were short term deposits including Government Debt Management Office (DMO), Money Market Funds, Local Authorities, instant access and notice accounts. Table 6 below details these investments by counterparty type based on the remaining maturity period at 30 September 2022:

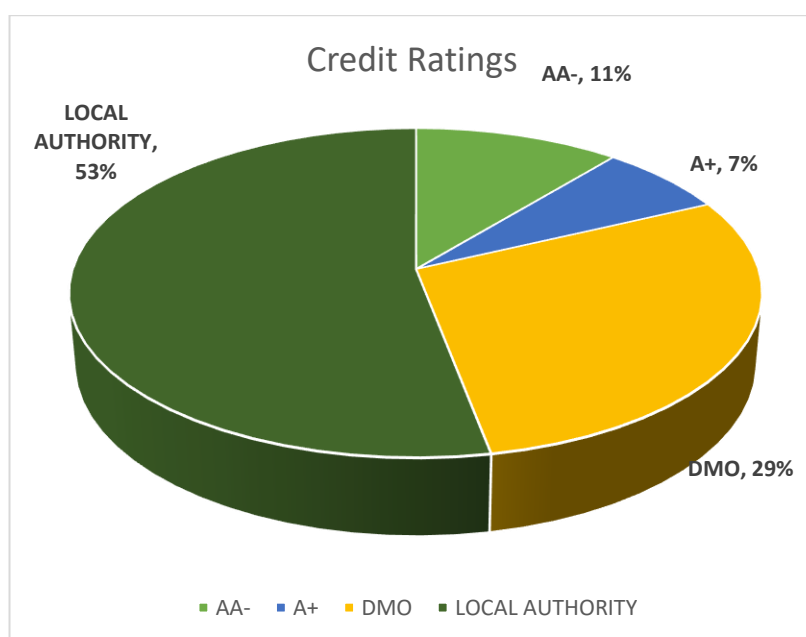
Table 6: Investments Outstanding Maturity Profile 30 September 2022

Counterparty Category	Instant Access £m	Deposits Maturing Within 1 Month £m	Deposits Maturing Within 2-3 Months £m	Deposits Maturing Within 4-12 Months £m	Deposits Maturing Over 12 Months £m	Total £m
Government DMO	0.00	0.00	29.00	0.00	0.00	29.00
Local Authorities	0.00	0.00	0.00	47.00	5.00	52.00
Banks	0.95	0.00	3.00	3.00	0.00	6.95
Money Market Fund	10.50	0.00	0.00	0.00	0.00	10.50
Total	11.45	0.00	32.00	50.00	5.00	98.45

Investment decisions are made by reference to the lowest published long-term credit rating from a selection of external rating agencies to ensure that this lies within the Council's agreed minimum credit rating. 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 into account. **Appendix B** shows the equivalence table for credit ratings for three of the main rating agencies: Fitch,

Moody's, and Standard & Poor's, and explains the different investment grades. The Council defines high credit quality as organisations and securities having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher.

The pie chart below summarises Table 6 by credit ratings and shows the £98.45 million investments at 30 September 2022 by percentage. Most Local Authorities do not have credit ratings and the £10.5 million invested with AA-rated MMF's were on an approved counterparty by Arlingclose Ltd, whilst the remainder of the investments all had a credit rating of A or above.



5. Interest Rate Exposures – Borrowing and Investments

The Council is exposed to interest rate movements on its borrowings and investments. Movements in interest rates have a complex impact on the Council depending on how variable and fixed interest rates move across differing financial instrument periods. Short term and variable rate loans expose the Council to the risk of short-term interest rate rises and are therefore subject to the Treasury Management indicator in Table 7 below to manage Interest Rate Exposures.

Table 7: Treasury Management Indicator Interest Rate Exposures

Interest rate risk indicator	Indicator £'000	As at 30.9.22 £'000
One year revenue impact of a 1% rise in interest rates	(537)	(786)
One year revenue impact of a 1% fall in interest rates	726	978

This has been set as an **indicator** (not a limit) to measure the net impact over one year on the revenue account of both a 1% rise and a 1% fall in all interest rates for borrowing net of treasury investments. This is calculated at a point in time on the assumption that maturing loans and investments will be replaced at rates 1% higher or lower than they would otherwise have been on their maturity dates and that the treasury investment and borrowing portfolios remain unchanged over the coming year. Interest rates can move by more than 1% over the course of a year and since April 2022 interest rates have increased by 1.5% with further increases anticipated. The council has benefitted from additional investment income as rates have risen.

The figures for the 1% fall in interest rates indicator are not the same figures as the 1% rise in interest rates (but reversed) as the borrowing relates to variable LOBO loans where it is assumed that the lender would not exercise their option if there was a fall in interest rates. All other borrowing does not have a rate reset in the next year and is with the PWLB at fixed rates

Table 8: Interest Expenditure & Receipts

A comparison of interest expenditure against income for the period 1 April to 30 September is shown below:

	2021-22 £'000	2022-23 £'000
Interest expenditure payable on long term borrowing*	2,273	2,273
Interest income received in period	(69)	(335)
Net interest cost	2,204	1,938

* Estimated as at 30 September 2022. Actual payments may occur after this date.

APPENDIX B

Credit Rating Equivalence Table

	Description	Fitch		Moody's		Standard & Poor's	
		Long	Short	Long	Short	Long	Short
INVESTMENT GRADE	Extremely strong	AAA		Aaa		AAA	
	Very strong	AA+	F1+	Aa1	P-1	AA+	A-1+
		AA		Aa2		AA	
		AA-		Aa3		AA-	
	Strong	A+	F1	A1	P-2	A+	A-1
		A		A2		A	
		A-		A3		A-	
	Adequate	BBB+	F2	Baa1	P-3	BBB+	A-2
		BBB		Baa2		BBB	
		BBB-		Baa3		BBB-	
SPECULATIVE GRADE	Speculative	BB+	B	Ba1	Not Prime (NP)	BB+	B
		BB		Ba2		BB	
		BB-		Ba3		BB-	
	Very speculative	B+	C	B1	Not Prime (NP)	B+	C
		B		B2		B	
		B-		B3		B-	
	Vulnerable	CCC+	C	Caa1	Not Prime (NP)	CCC+	C
		CCC		Caa2		CCC	
		CCC-		Caa3		CCC-	
		CC		Ca		CC	
	C				C		
Defaulting	D	D	C		D	D	

Standard & Poor's (S&P), Moody's and Fitch are the three most significant rating agencies in the world. These agencies rate the creditworthiness of countries and private enterprises.

"AAA" or "Aaa" is the highest rating across all three rating agencies and indicates the highest level of creditworthiness. A "D" rating ("C" rating from Moody's) indicates poor creditworthiness of a company or government. A difference is made between short-term and long-term ratings.