Appendix A

HARLOW COUNCIL
TREASURY MANAGEMENT STRATEGY
MID-YEAR REVIEW 2022/23

Introduction

1. In December 2017 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Council to approve treasury management semi-annual and annual reports. This quarterly report provides an additional update.

2. The Council's treasury management strategy for 2022/23 was approved at a meeting on 27th January 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.

3. CIPFA published its revised Treasury Management Code of Practice ('TM Code') and Prudential Code for Capital Finance in December 2021. The key changes in the two codes are around permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments. The principles within the two Codes took immediate effect although local authorities could defer introducing the revised reporting requirements within the revised Codes until the 2023/24 financial year if they wish, which the Council has elected to do.

4. Treasury risk management at the Council is conducted within the framework of the TM Code. This Code now also includes extensive additional requirements for service and commercial investments, far beyond those in the 2017 version.

External Context

5. **Economic background:** 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.

6. 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.

7. 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.

8. 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.

9. The labour market remained tight through the period but there was some evidence of easing demand and falling supply. The unemployment rate 3m/year for April fell to 3.8% and declined further to 3.6% in July. Although now back below pre-pandemic levels, the recent decline was driven by an increase in inactivity rather than demand for labour. Pay growth in July was 5.5% for total pay (including bonuses) and 5.2% for regular pay. Once adjusted for inflation, however, growth in total pay was -2.6% and –2.8% for regular pay.

10. With disposable income squeezed and higher energy bills still to come, consumer confidence fell to a record low of –44 in August, down –41 in the previous month. Quarterly GDP fell -0.1% in the April-June quarter driven by a decline in services output, but slightly better than the 0.3% fall expected by the Bank of England.

11. The Bank of England increased the official Bank Rate to 2.25% over the period. From 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. August’s rise was voted by a majority of 8-1, with one MPC member preferring a more modest rise of 0.25%. the September vote was 5-4, with five votes for an 0.5% increase, three for an 0.75% increase and one for an 0.25% increase. 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.

12. 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. The swift rise in gilt yields left pension funds vulnerable, as it led to margin calls on their interest rate swaps and risked triggering large scale redemptions of assets across their portfolios to meet these demands. It became necessary for the Bank of England to intervene to preserve market stability through the purchase of long-dated gilts, albeit as a temporary measure, which has had the desired effect with 50-year gilt yields falling over 100bps in a single day.

13. 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.

14. After hitting 9.1% in June, annual US inflation eased in July and August to 8.5% and 8.3% respectively. The Federal Reserve continued its fight against inflation over the period with a 0.5% hike in May followed by three increases of 0.75% in June, July and September, taking policy rates to a range of 3% - 3.25%.

15. Eurozone CPI inflation reached 9.1% y/y in August, with energy prices the main contributor but also strong upward pressure from food prices. Inflation has increased steadily since April from 7.4%. In July the European Central Bank increased interest rates for the first time since 2011, pushing its deposit rate from –0.5% to 0% and its main refinancing rate from 0.0% to 0.5%. This was followed in September by further hikes of 0.75% to both policy rates, taking the deposit rate to 0.75% and refinancing rate to 1.25%.

16. **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.

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

18. Over the period the 5-year UK benchmark gilt yield rose from 1.41% to 4.40%, the 10-year gilt yield rose from 1.61% to 4.15%, the 20-year yield from 1.82% to 4.13% and the 50-year yield from 1.56% to 3.25%. The Sterling Overnight Rate (SONIA) averaged 1.22% over the period.

19. **Credit review:** In July Fitch revised the outlook on Standard Chartered from negative to stable as it expected profitability to improve thanks to the higher interest rate environment. Fitch also revised the outlook for Bank of Nova Scotia from negative to stable due to its robust business profile.

20. Also in July, Moody's revised the outlook on Bayerische Landesbank to positive and then in September S&P revised the GLA outlook to stable from negative as it expects the authority to remain resilient despite pressures from a weaker macroeconomic outlook coupled with higher inflation and interest rates.

21. 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.

22. Arlingclose continued to monitor and assess credit default swap levels for signs of credit stress but made no changes to the counterparty list or recommended durations. 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 recommended by Arlingclose remains under constant review.

Local Context

23. On 31st March 2022, the Council had net borrowing of £175.1m 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

	31.3.22 Actual £m
General Fund CFR	72.9
HRA CFR	196.3
Total CFR	**269.1**
Less: *Other debt liabilities	1.5
Loans CFR	**267.6**
External borrowing	211.8

Internal borrowing	**55.8**
Less: Usable reserves	76.8
Less: Working capital	11.8
Investments	**36.7**

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

24. The treasury management position on 30th September 2022 and the change over the six months is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.22 Balance £m	Movement £m	30.9.22 Balance £m	30.9.22 Rate
Long-term borrowing Short-term borrowing	(211.8) -	- -	(211.8) -	(3.3%) -
Total borrowing	**(211.8)**	**-**	**(211.8)**	**(3.3%)**
Long-term investments Cash and cash equivalents	4.2 32.5	0.1 (7.5)	4.3 25.0	7.7%* 1.8%
Total investments	**36.7**	**(7.4)**	**29.3**	**3.1%**
Net borrowing	**(175.1)**	**(7.4)**	**(182.5)**	

* The return for long term investments includes total return for the Council's investment in a property fund which was unusually high due to increasing property prices. These returns would not be expected to occur in the long term. Income returns were 2.0% which is a more accurate view as to long term returns.

Borrowing

25. CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the Council.

26. The Council currently holds £1.4m in commercial investments that Harlow have owned for historical reasons, these were purchased prior to the change in the CIPFA Prudential Code. Before undertaking further additional borrowing the Council will review the options for exiting these investments. This review will include an option to sell them, although sale is not mandatory particularly if the market conditions are not desirable.

27. The Council is not planning to undertake any new borrowing to invest primarily for commercial return and so is otherwise unaffected by the changes to the Prudential Code.

Borrowing Strategy and Activity

28. As outlined in the treasury strategy, the Council's 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.

29. Over the April-September period short term and 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. Over a twenty-four-hour period some PWLB rates increased to 6%, before the intervention had the desired effect, bringing rates back down by over 1% for certain maturities. A truly wild and unprecedented period in fixed income markets, with a direct impact on PWLB rates.

30. 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 to 5.09% on 30th September; over the same period the 30-year maturity certainty rate rose from 2.63% to 4.68%.

31. At 30th September the Council held £211.8m of loans from the PWLB, the same figure held as at 31st March 2022. These had a weighted average interest rate of 3.3% and a weighted average maturity of 11.7 years. The loans individually have maturities of between 4 and 26 years, the Council held no short term loans during this period.

32. In the near future the Council plans to undertake any new borrowing required on a short term, variable rate basis to avoid locking in the current high interest rate for an extended period. If interest rates fall as is expected in the next 18-24 months' the Council will look to gain more certainty over future interest rates by borrowing on a longer term basis.

Other Debt Activity

33. Although not classed as borrowing, the Council also owned vehicles that were funded via a finance lease as at 30th September. The outstanding liability for these vehicles calculated at the most recent year end figure of 31st March 2022 was £1.5m.

Treasury Investment Activity

34. CIPFA's revised TM Code defines treasury management investments as those which arise from the Council's cash flows or treasury risk management activity that ultimately represents balances which need to be invested until the cash is required for use in the course of business.

35. The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the half year, the Council's investment balances ranged between £23.1 and £45.7 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.22 Balance £m	**Net Movement £m**	**30.9.22 Balance £m**	**30.9.22 Income Return**	**30.9.22 Weighted Average Maturity days**
Banks & building societies (unsecured)	2.0	(0.3)	1.7	2.0%	1
Government (incl. local authorities)	10.5	(1.1)	9.4	N/A	N/A
Money Market Funds	20.0	(6.0)	14.0	1.8%	1
Cash Plus Fund	2.0	-	2.0	0.0%	N/A*
Property Fund	2.2	0.1	2.3	3.8%	N/A*
Total investments	**36.7**	**(7.3)**	**29.4**	**1.9%**	

* The Council's cash plus and property funds do not have a set period to maturity. Cash can be redeemed on request after a notice period is given. They are considered a long term investments as there is price risk associated with needing to make a withdrawal at short notice.

36. 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.

37. 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, rose by around 1.5% for overnight/7-day maturities and by nearly 3.5% for 9-12 month maturities.

38. By end September, the rates on DMADF deposits ranged between 1.85% and

3.5%. The return on the Council's sterling Low Volatility Net Asset Value (LVNAV) Money Market Funds ranged between 0.46% - 0.58% in early April and between 1.74% and 1.86% at the end of September.

39. Given the low returns from short-term cash investments, the Council has maintained its diversification in higher yielding asset classes as shown in table 4 above with £4.3m investment with a cash plus and property fund.

40. The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below.

Table 5: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	**Credit Rating**	**Bail-in Exposure**	**Weighted Average Maturity (days)**	**Rate of Return**
31.03.2022 30.09.2022	4.28 5.07	AA- A+	68% 100%	1 1	0.52% 1.8%
Similar LAs **All Las** **(as at 31.03.2022)**	**4.34** **4.29**	**AA-** **AA-**	**57%** **55%**	**13** **13**	**1.7%** **1.7%**

41. **Externally Managed Pooled Funds:** £4.3m of the Council's investments are invested in an externally managed pooled funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. The funds generated an average total return of 7.7%, comprising a 2.0% income return which is used to support services in year, and 5.7% capital growth.

42. Because the fund has no defined maturity date, but is available for withdrawal after a notice period, its performance and continued suitability in meeting the Council's medium to long-term investment objectives is 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.

Non-Treasury Investments

43. The definition of investments in CIPFA's revised 2021 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. Investments that do not meet the definition of treasury management

investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).

44. Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) also includes within the definition of investments all such assets held partially or wholly for financial return.

45. The Council also held £1.8m of investments made for services purposes. This included £1.3 m of loans made to wholly owned subsidiaries HTS (Property and Environment) Ltd, HTS (Housing and Property) Ltd and Harlow Property Ltd as at 30th September 2022. The also include an equity investment of £0.45m as at 30th March 2022 in HTS (Housing & Property) Ltd.

46. The Council held £1.4m of investments made for commercial purposes as at 30th September 2022. These consisted of four historically owned properties. These generated a small income of £45k in the first half of the 2022/23 financial year.

Planned Acquisition of the Harvey Centre

47. The Council plans to purchase Harvey Centre in November 2022. The Harvey Centre is a shopping centre situated in the centre of Harlow. The purchase cost is expected to be funded by prudential borrowing. A cabinet meeting will take place on the 17th November 2022 to formerly approve the purchase. If the purchase is not approved by cabinet the sale will not take place or will be delayed.

48. Due to currently high interest rates the Council plans to initially borrow on a short term, variable rate basis. Interest rates are expected to fall within the next 18-24 months when the Council would look to fix interest rates for a longer period by long term borrowing.

49. The investment will be a non-treasury investment made for service reasons. The Council are intending to purchase the shopping centre to assist with their wider regeneration plans for Harlow Town Centre. The Council have already adopted the Harlow Local Development Plan (HLDP) and Harlow Town Centre Area Action Plan (HTCAAP) which aim to shape growth and development in the area until 2033. The plans cover diverse issues including commercial spaces, transport, connectivity, residential accommodation and other improvements. The Harvey Centre lies at the heart of the area that these plans cover and realisation of full regeneration goals would be difficult without Council ownership of the Centre. It is felt that a private sector investor would not invest in improving the Centre and wider area in the same way.

50. The Council expects that the purchase of the Shopping Centre will involve cash outlays in the initial years but will in future generate a revenue return. Financial return is not the primarily aim of the purchase however: the primary aim is regeneration and improvement of the town centre. The Council is therefore satisfied that it is not breaching the requirements of the PWLB and CIPFA Prudential and Treasury Management Codes by undertaking this purchase.

Treasury Performance

51. The Council measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 6 below.

		Interest Payable	**Interest Receivable**
General Fund	**Actual £**	126,069	(203,800)
	Budget £	335,620	(37,500)
	Over / (Under) £	(209,551)	166,300
	% Over / (Under)	(62.4%)	443.5%
HRA	**Actual £**	3,369,904	(39,693)
	Budget £	3,522,011	(39,693)
	Over / (Under) £	(152,107)	0
	% Over / (Under)	(4.3%)	0%

Compliance

52. The Chief Finance Officer reports that all treasury management activities undertaken during the quarter complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 7 below.

53. Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 7 below.

Table 7: Debt Limits

	H1 Maximum £m	**30.9.22 Actual £m**	**2022/23 Operational Boundary £m**	**2022/23 Authorised Limit £m**	**Complied ?**
Borrowing	211.8	211.8			
PFI and Finance Leases	1.5	1.4			

Total debt	213.3	213.2	305.5	315.5	Yes

54. 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.

Table 8: Investment Limits

	H1 Maximum £m	30.9.22 Actual £m	2022/23 Limit £m	Complied?
Any single organisation**, except the UK Government		1.7	2.0 each	Yes
UK central government	20.7	9.4	Unlimited	Yes
Any group of organisations under the same ownership		2.0	2.0 per group	Yes
Any group of pooled funds under the same management	4.2	4.2	5.0 per manager	Yes
Negotiable instruments held in a broker's nominee account		-	5.0 per broker	Yes
Foreign countries		-	2.0 per country	Yes
Registered providers and registered social landlords		-	5.0 in total	Yes
Unsecured investments with building societies		-	2.0 in total	Yes
Loans to unrated corporates	1.4	1.4	2.0 in total	Yes
Money Market Funds	20.0	14.0	20.0 in total	Yes
Real Estate Investment Trusts			5.0 in total	Yes
FIBCA (Barclays Call Account)	4.0	1.7	4 in total	Yes

* Loans made to subsidiary companies?

** 'Single organisation' in this context does not mean a single money market fund or other pooled fund as these are inherently diversified and spread investments across a number of organisations.

Treasury Management Indicators

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

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

	30.9.22 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	0%	25%	0%	Yes
12 months and within 24 months	0%	50%	0%	Yes
24 months and within 5 years	20%	100%	0%	Yes
5 years and within 10 years	20%	100%	0%	Yes
10 years and above	60%	100%	0%	Yes

57. Time periods start on the first day of each financial year.

58. **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	2023/24	2024/25
Actual principal invested beyond year end	£4.3m	£4.3m	£4.3m
Limit on principal invested beyond year end	£5m	£5m	£5m
Complied?	Yes	Yes	Yes

59. The £4.3m consists of the Council's investment in a cash plus fund and a property fund. Although the funds can be accessed within a year, volatility means that they should be considered as a long term investment. £4.3m is the actual amount invested at 30th September 2022, it is assumed that this will not change for the sake of the indicator above.

Future Changes to Reporting Requirements

60. From 1st April 2023 the Council will need to report on treasury management under the new requirements of the 2021 Prudential and TM Codes. This will include a requirement to report on treasury management including prudential indicators on a quarterly rather than semi-annual basis. There is a new prudential indicator on the net income from commercial and service investments as a proportion to net revenue stream. The liability benchmark will also need to be reported on quarterly.

Arlingclose's Economic Outlook for the remainder of 2022/23 (based on 7th November 2022 interest rate forecast)

	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

61. Arlingclose expects Bank Rate to rise further during 2022/23 to reach 4.0% by

the end of the year, reaching 4.25% by September 2023. With the new Prime Minister Rishi Sunak reversing most of the planned changes under Liz Truss' 'mini budget' inflation is less of a concern than it was with correspondingly less pressure on interest rates to rise.

62. Inflation driven by high commodity prices and a tight labour market does however continue to be a concern. Action by the MPC to raise interest rates will slow the economy, necessitating cuts in Bank Rate in 2024. Over the longer term, gilt yields are forecast to remain broadly flat over the forecast period.