APPENDIX 4

Treasury Management Strategy Statement and Annual Investment Strategy Mid-year review report 2022/23

1 Background

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low-risk counterparties, providing adequate liquidity initially before considering optimising investment return.

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 operations. This management of longer-term cash may involve arranging long or short-term loans or using longer term cash flow surpluses and, on occasion, any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly, treasury management is defined as:

> "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2 Introduction

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (last revised in 2017) was adopted by this Council on 20 February 2012.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report covering activities during the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Executive, Resources and Contracts PDS Committee.

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first part of the 2022/23 financial year
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy
- The Council's capital expenditure (prudential indicators)
- A review of the Council's investment portfolio for 2022/23

- A review of the Council's borrowing strategy for 2022/23
- A review of any debt rescheduling undertaken during 2022/23
- A review of compliance with treasury and prudential limits for 2022/23

3 Key changes to the treasury and capital strategies

No amendments to the strategy are proposed at this time.

4 Economic update (provided by Link Asset Services)

- The second quarter of 2022/23 saw:
  - GDP revised upwards in Q1 2022/23 to +0.2% q/q from -0.1%, which means the UK economy has avoided recession for the time being
  - signs of economic activity losing momentum as production fell due to rising energy prices
  - CPI inflation ease to 9.9% y/y in August, having been 9.0% in April, but domestic price pressures showing little sign of abating in the near-term
  - the unemployment rate fall to a 48-year low of 3.6% due to a large shortfall in labour supply
  - bank rate rise by 100bps over the quarter, taking bank rate to 2.25% with further rises to come
  - gilt yields surge and sterling fall following the "fiscal event" of the new Prime Minister and Chancellor on 23 September.
- The UK economy grew by 0.2% q/q in Q1 2022/23, though revisions to historic data left it below pre-pandemic levels.
- There are signs of higher energy prices creating more persistent downward effects in economic activity. Both industrial production (-0.3% m/m) and construction output (-0.8% m/m) fell in July 2022 for a second month in a row. Although some of this was probably due to the heat wave at the time, manufacturing output fell in some of the most energy intensive sectors (e.g., chemicals), pointing to signs of higher energy prices weighing on production. With the drag on real activity from high inflation having grown in recent months, GDP is at risk of contracting through the autumn and winter months.
- The fall in the composite PMI from 49.6 in August to a 20-month low preliminary reading of 48.4 in September points to a fall in GDP of around 0.2% q/q in Q3 and consumer confidence is at a record low. Retail sales volumes fell by 1.6% m/m in August, which was the ninth fall in 10 months. That left sales volumes in August just 0.5% above their pre-Covid level and 3.3% below their level at the start of the year. There are also signs that households are spending their excess savings in response to high prices. Indeed, cash in households' bank accounts rose by £3.2bn in August, which was below the £3.9bn rise in July and much smaller than the 2019 average monthly rate of £4.6bn.
- The labour market remained exceptionally tight. Data for July and August provided further evidence that the weaker economy is leading to a cooling in labour demand. Labour Force Survey (LFS) employment rose by 40,000 in the three months to July (the smallest rise since February). But a renewed rise in inactivity of 154,000 over the same period meant that the unemployment rate fell from 3.8% in June to a new 48-year low of 3.6%. The single-month data showed that inactivity rose by 354,000 in July itself and there are now 904,000 more inactive people aged 16+ compared to before the pandemic in February 2020. The number of vacancies has started to level off from recent record highs but there

have been few signs of a slowing in the upward momentum on wage growth. Indeed, in July, the 3my/y rate of average earnings growth rose from 5.2% in June to 5.5%.

- CPI inflation eased from 10.1% in July to 9.9% in August, though inflation has not peaked yet. The easing in August was mainly due to a decline in fuel prices reducing fuel inflation from 43.7% to 32.1%. And with the oil price now just below $90pb, we would expect to see fuel prices fall further in the coming months.
- However, utility price inflation is expected to add 0.7% to CPI inflation in October when the Ofgem unit price cap increases to, typically, £2,500 per household (prior to any benefit payments). But, as the government has frozen utility prices at that level for two years, energy price inflation will fall sharply after October and have a big downward influence on CPI inflation.
- Nonetheless, the rise in services CPI inflation from 5.7% y/y in July to a 30-year high of 5.9% y/y in August suggests that domestic price pressures are showing little sign of abating. A lot of that is being driven by the tight labour market and strong wage growth. CPI inflation is expected to peak close to 10.4% in November and, with the supply of workers set to remain unusually low, the tight labour market will keep underlying inflationary pressures strong until early next year.
- During H1 2022, there has been a change of both Prime Minister and Chancellor. The new team (Liz Truss and Kwasi Kwarteng) have made a step change in government policy. The government's huge fiscal loosening from its proposed significant tax cuts will add to existing domestic inflationary pressures and will potentially leave a legacy of higher interest rates and public debt. Whilst the government's utility price freeze, which could cost up to £150bn (5.7% of GDP) over 2 years, will reduce peak inflation from 14.5% in January next year to 10.4% in November this year, the long list of tax measures announced at the "fiscal event" adds up to a loosening in fiscal policy relative to the previous government's plans of £44.8bn (1.8% of GDP) by 2026/27. These included the reversal of April's national insurance tax on 6 November, the cut in the basic rate of income tax from 20p to 19p in April 2023, the cancellation of next April's corporation tax rise, the cut to stamp duty and the removal of the 45p tax rate, although the 45p tax rate cut announcement has already been reversed.
- Fears that the government has no fiscal anchor on the back of these announcements has meant that the pound has weakened again, adding further upward pressure to interest rates. Whilst the pound fell to a record low of $1.035 on the Monday following the government's "fiscal event", it has since recovered to around $1.12. That is due to hopes that the Bank of England will deliver a very big rise in interest rates at the policy meeting on 3rd November and the government will lay out a credible medium-term plan in the near term. This was originally expected as part of the fiscal statement on 23 November but has subsequently been moved forward to an expected release date in October. Nevertheless, with concerns over a global recession growing, there are downside risks to the pound.
- The MPC has now increased interest rates seven times in as many meetings in 2022 and has raised rates to their highest level since the global financial crisis. Even so, coming after the Fed and ECB raised rates by 75 basis points (bps) in their most recent meetings, the Bank of England's latest 50 basis points hike looks relatively dovish. However, the UK's status as a large importer of commodities, which have jumped in price, means that households in the UK are now facing a much larger squeeze on their real incomes.
- Since the fiscal event on 23 September, we now expect the Monetary Policy Committee (MPC) to increase interest rates further and faster, from 2.25% currently to a peak of 5.00% in February 2023. The combination of the government's fiscal loosening, the tight labour market and sticky inflation expectations means we expect the MPC to raise interest rates by 100bps at the policy meetings in November (to 3.25%) and 75 basis points in December (to 4%) followed by further 50 basis point hikes in February and March (to

5.00%).Market expectations for what the MPC will do are volatile. If Bank Rate climbs to these levels the housing market looks very vulnerable, which is one reason why the peak in our forecast is lower than the peak of 5.50% - 5.75% priced into the financial markets at present.

- Throughout 2022/23, gilt yields have been on an upward trend. They were initially caught up in the global surge in bond yields triggered by the surprisingly strong rise in CPI inflation in the US in May. The rises in two-year gilt yields (to a peak of 2.37% on 21st June) and 10-year yields (to a peak of 2.62%) took them to their highest level since 2008 and 2014 respectively. However, the upward trend was exceptionally sharply at the end of September as investors demanded a higher risk premium and expected faster and higher interest rate rises to offset the government's extraordinary fiscal stimulus plans. The 30-year gilt yield rose from 3.60% to 5.10% following the "fiscal event", which threatened financial stability by forcing pension funds to sell assets into a falling market to meet cash collateral requirements. In response, the Bank did two things. First, it postponed its plans to start selling some of its quantitative easing (QE) gilt holdings until 31st October. Second, it committed to buy up to £65bn of long-term gilts to "restore orderly market conditions" until 14 October. In other words, the Bank is restarting QE, although for financial stability reasons rather than monetary policy reasons.
- Since the Bank's announcement on 28 September, the 30-year gilt yield has fallen back from 5.10% to 3.83%. The 2-year gilt yield dropped from 4.70% to 4.30% and the 10-year yield fell back from 4.55% to 4.09%.
- There is a possibility that the Bank continues with QE at the long-end beyond 14 October or it decides to delay quantitative tightening beyond 31 October, even as it raises interest rates. So far at least, investors seem to have taken the Bank at its word that this is not a change in the direction of monetary policy nor a step towards monetary financing of the government's deficit. But instead, that it is a temporary intervention with financial stability in mind.
- After a shaky start to the year, the S&P 500 and FTSE 100 climbed in the first half of Q2 2022/23 before falling to their lowest levels since November 2020 and July 2021 respectively. The S&P 500 is 7.2% below its level at the start of the quarter, whilst the FTSE 100 is 5.2% below it as the fall in the pound has boosted the value of overseas earnings in the index. The decline has, in part, been driven by the rise in global real yields and the resulting downward pressure on equity valuations as well as concerns over economic growth leading to a deterioration in investor risk appetite.

5 Treasury Management Strategy Statement and Annual Investment Strategy update

The Treasury Management Strategy Statement (TMSS) for 2022/23 was approved by this Council on 28 February 2022. No revisions were proposed in the annual report 2022/23 reported to Council on 25 July 2022 or in the mid-year review report.

6 Investment portfolio

In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As shown by forecasts in section 3, it is a very volatile investment market, though recent successive increases in the Bank of England base rate have fed through into significantly improved lending rates with counterparties. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short-term strategy.

Details of the Council's investment activity during the first six months of 2022/23 are provided in the covering report and lists of current investments are provided in Appendices 2 (in maturity date order) and 3 (by counterparty). The Council held £390.6m of investments as at 30 September 2022 (£427.6m as at 30 September 2021).

The Director of Finance confirms that the approved limits within the annual investment strategy were not breached during the first six months of 2022/23.

The Council's budget for interest on investments in 2022/23 is £2.841m and the current projection is that the outturn will be £5.841m - £3.000m over budget.

Investment counterparty criteria

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

7 Borrowing

The Council's estimated capital financing requirement (CFR) for 2022/23 is £29.8m.The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The Council does not currently borrow to finance its capital expenditure and has, in recent years, only had to borrow short-term (for cashflow purposes) on very few occasions.

No borrowing is currently anticipated during this financial year, but it is possible that some may be required in future years.

Prudential and treasury indicators – mid-year review 2022/23

The old capital control system was replaced in April 2004 by a prudential system based largely on self-regulation by local authorities themselves. At the heart of the system is The Prudential Code for Capital Finance in Local Authorities, developed by CIPFA. The Code requires the Council to set a number of prudential indicators designed to monitor and control capital expenditure, financing and borrowing. The indicators for 2022/23 were approved by Council in February 2022 and this annex sets out the actual performance against those indicators in the first six months, updating them where necessary. Prudential and treasury indicators are relevant for the purposes of setting an integrated treasury management strategy.

The Council is required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This original 2001 Code was adopted by the full Council in February 2002 and the revised 2011 Code was initially adopted by full Council in February 2012.

Prudential indicators for capital expenditure

This table shows the revised estimates for capital expenditure and the changes since the capital programme for 2022/23 was agreed in February 2022. The increase in the latest estimate for 2022/23 is mainly brought forward underspend from the prior year, additional funding for Basic Need in schools (CEF line) and, more generally, the result of new schemes added to the programme, as highlighted in previous reports to the Executive and to PDS committees.

Capital expenditure by portfolio	**2022/23 original estimate £m**	**2022/23 revised estimate £m**
Children, Education and Families	9.0	23.2
Adult Care and Health	0.7	0.3
Environment and Community Services	6.9	12.5
Renewal, Recreation and Housing	24.7	48.5
Executive, Resources and Contracts	23.2	40.6
Estimated slippage/new schemes	-6.5	-49.7
Total	**58.0**	**75.5**

Changes to the financing of the capital programme

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure.

Capital expenditure	**2022/23 original estimate £m**	**2022/23 revised estimate £m**
Supported	58.0	75.5
Unsupported	-	-
Total spend	**58.0**	**75.5**
Financed by:		
Capital receipts	21.6	18.7
Capital grants/contributions	17.8	28.7
General Fund	-	-
Internal borrowing	16.4	14.0
Revenue contributions	2.4	14.2
Total financing	**58.0**	**75.5**
Borrowing need	**-**	**-**

Changes to the prudential indicators for the CFR, external debt and operational boundary

It is a statutory duty for the Council to determine and keep under review the "affordable borrowing limits", which comprise external/internal borrowing and other long-term liabilities, mainly finance leases. The Council's approved treasury and capital prudential indicators (affordability limits) are outlined in the approved TMSS. The table below shows the expected "worst case" debt position over the period. This is termed the operational boundary. Bromley has an operational "borrowing" limit ("operational boundary") of £30m.

The authorised limit, which represents the limit beyond which borrowing is prohibited, is another of the prudential indicators and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003 and, for Bromley, this figure has been set at £60m.

The table also shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. The Council's capital financing requirement (CFR) as at 1 April 2022 was £25.7m. If the CFR is positive, the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The Council's CFR relates to liabilities arising from finance leases entered into in recent years in respect of various items of plant and equipment and housing.

The Council currently has no external borrowing.

Prudential Indicators	**2022/23 original estimate £m**	**2022/23 revised estimate £m**
CFR	**25.7**	**29.8**
Debt – operational boundary		
Borrowing	10.0	10.0
Other long-term liabilities	20.0	20.0
Total operational boundary	**30.0**	**30.0**
Debt – authorised boundary		
Borrowing	30.0	30.0
Other long-term liabilities	30.0	30.0
Total authorised boundary	**60.0**	**60.0**

Other prudential indicators

Other indicators designed to control overall borrowing and exposures to interest rate movements are included in the summary table below, which will require the approval of full Council.

Prudential and treasury indicators - summary

	2022/23	**2022/23**
	Original estimate	**Revised estimate**
Total capital expenditure	£58.0m	117.9
Ratio of financing costs to net revenue stream	0.0%	0.0%
Net borrowing requirement (net investments for Bromley)		
brought forward 1 April	£380.1m	£377.1m
carried forward 31 March	£400.0m	£390.6m
in year borrowing requirement (reduction in net investments for Bromley)	£19.9m	£13.5m
Estimated CFR as at 31 March (finance lease liabilities)	£25.7m	£29.8m
Annual change in CFR	£0.0m	£4.1m

TREASURY MANAGEMENT INDICATORS	2022/23 Original estimate	2022/23 Revised estimate
Authorised limit for external debt -		
Borrowing	£30.0m	£30.0m
other long-term liabilities	£30.0m	£30.0m
TOTAL	**£60.0m**	**£60.0m**
Operational boundary for external debt -		
borrowing	£10.0m	£10.0m
other long-term liabilities	£20.0m	£20.0m
TOTAL	**£30.0m**	**£30.0m**
Upper limit for fixed interest rate exposure	100%	100%
Upper limit for variable rate exposure	20%	20%
Upper limit for total principal sums invested beyond year-end dates	£170.0m	£170.0m