<table>
<tr><td colspan="3">Bath & North East Somerset Council</td></tr>
<tr><td>MEETING</td><td colspan="2">Cabinet</td></tr>
<tr><td rowspan="2">MEETING DATE:</td><td rowspan="2">10th November 2022</td><td>EXECUTIVE FORWARD PLAN REFERENCE:</td></tr>
<tr><td>E 3366</td></tr>
<tr><td>TITLE:</td><td colspan="2">Treasury Management Performance Report to 30th September 2022</td></tr>
<tr><td>WARD:</td><td colspan="2">All</td></tr>
<tr><td colspan="3">AN OPEN PUBLIC ITEM</td></tr>
<tr><td colspan="3">List of attachments to this report:
Appendix 1 – Performance Against Prudential Indicators
Appendix 2 – The Council’s Investment Position at 30th September 2022
Appendix 3 – Average monthly rate of return for 1st 6 months of 2022/23
Appendix 4 – The Council’s External Borrowing Position at 30th September 2022
Appendix 5 – Arlingclose’s Economic & Market Review Q2 of 2022/23
Appendix 6 – Interest & Capital Financing Budget Monitoring 2022/23
Appendix 7 – Summary Guide to Credit Ratings
Appendix 8 – Extract from Treasury Management Risk Register</td></tr>
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1 THE ISSUE

1.1 Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy’s Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code), which requires the Council to approve a Treasury Management Strategy before the start of each financial year, review performance during the year, and approve an annual report after the end of each financial year.

1.2 This report gives details of performance against the Council’s Treasury Management Strategy for 2022/23 for the first six months of 2022/23.

2 RECOMMENDATION

The Cabinet agrees that;

2.1 The Treasury Management Report to 30th September 2022, prepared in accordance with the CIPFA Treasury Code of Practice, is noted.

2.2 The Treasury Management Indicators to 30th September 2022 are noted.

3 THE REPORT

Summary

3.1 The estimated average rate of investment return for the first six months of 2022/23 is 1.32%, which is 0.05% above the benchmark rate which has averaged 1.27% over the period.

3.2 The Council's Prudential Indicators for 2022/23 were agreed by Council in February 2022 and performance against the key indicators is shown in **Appendix 1**. All indicators are within target levels.

3.3 The Council's revenue budget for interest & capital financing costs for 2022/23 is currently forecast £950k under budget, due to higher than budgeted investment income and a delay to borrowing requirements and associated interest costs. This is due to both the increase in interest rates since the budget was set, along with the continuing high levels of cash balances currently held following the advance payment of grants and the profiling of capital expenditure. The breakdown of the 2022/23 revenue budget for interest and capital financing, and the forecast year end position is included in **Appendix 6**.

Summary of Returns

3.4 The Council's investment position as at 30th September 2022 is given in **Appendix 2**, along with the previous quarter's position for comparison. The balance of deposits as at 30th September 2022, compared to those of the previous four quarters, are also set out in the charts in this appendix.

3.5 Gross estimated interest earned on investments totalled £580k. **Appendix 3** details the investment performance, showing the average rate of interest earned over this period was 1.32%, which was 0.05% above the benchmark rate of average 7 day SONIA (1.27%). This excess is mainly due to the £5m investment held in the CCLA Local Authority Property Fund and £5m invested in ESG focussed funds, which are long term strategic investment earning a higher estimated rate of interest of 4.20%, based on the first six months of 2022/23. The prior year comparators are also included in this appendix.

3.6 Following the discontinuation of published 7 Day LIBID rates, from 2022/23 onwards the Council is benchmarking its investments rates to the average 7 Day SONIA (Sterling Overnight Index Average) rate as an alternative. This is being used as the comparative benchmark as SONIA can be seen as the average interest rate at which a selection of financial institutions lend to one another with a maturity of 1 day (overnight), therefore reflecting the callable nature of the majority of the Council's short-term investments.

Summary of Borrowings

3.7 The Council's external borrowing as at 30th September 2022 totalled £217.3 million and is detailed in **Appendix 4**. Due to the levels of cash balances currently held by the Council, there has not been any new borrowing taken out during the quarter. A summary of the current movement in borrowing during 2022/23 is shown in the following table:

2022/23 Borrowing Portfolio Movements	**£m**
2022/23 Opening Balance	**218.287**
New Loans Taken	0.000
Loans Repaid	0.000
PWLB Annuity Loan principal repayments	(0.947)
2022/23 Revised Balance	**217.340**

3.8 The Council's Capital Financing Requirement (CFR) as at 31st March 2022 was £328.2 million. This represents the Council's underlying need to borrow to finance capital expenditure, and demonstrates that the borrowing taken to date relates to funding historical capital spend.

3.9 The difference between the CFR and the current borrowing of £217.3 million represents re-investment of the internal balances including reserves, reducing the in-year borrowing costs in excess of the potential investment returns.

3.10 Following Local Government Reorganisation in 1996, Avon County Council's residual debt is administered by Bristol City Council. All successor Unitary Authorities make an annual contribution to principal and interest repayment, for which there is a provision in the Council's revenue budget. The amount of residual debt outstanding as at 31st March 2022 apportioned to Bath & North East Somerset Council is £10.5m. Since this borrowing is managed by an external body and treated in the Council's Statement of Accounts as a deferred liability, it is not included in the borrowing figures referred to in paragraph 3.7.

Strategic & Tactical Decisions

As shown in the charts in **Appendix 2**, the investment portfolio of £64.4 million as at 30th September 2022 is diversified across Money Market Funds, Local Authorities, Strategic funds and in highly rated UK & Foreign Banks. The Council uses AAA rated Money Market funds to maintain short term liquidity.

3.11 The Council does not hold any direct investments with banks in countries within the Eurozone reflecting both on the underlying debt issues in some Eurozone countries and the low levels of interest rates.

3.12 The Council's investment portfolio as at 30th September 2022 includes a total of £10m invested longer term, including £5m in ESG focussed funds and £5m in a property fund, as listed below:

- £5m CCLA Local Authorities Property Fund.
- £3m FP Foresight UK Infrastructure Income Fund.
- £2m VT Gravis Clean Energy Income Fund.

3.13 The Council's average investment return for the first six months for short-term investments is currently 0.95%, which is 0.70% above the budgeted level of 0.25%. The estimated average return for the first six months on the £10m long-term strategic investments is estimated to be 4.2%, slightly above the budgeted rate of 3.5%. The combined average return on all investments is 1.32%. The current forecast is for an overachievement of interest income from investments of £450k due to the Council's cash balances being higher than was forecast when the budget was set, as well as recent increases in interest rates.

Investment Type	**Average YTD Investment Return**
Short Term Investments Total	**0.95%**
Long Term Strategic Investments (Estimated)*:	
CCLA Local Authorities Property Fund	3.5%
FP Foresight UK Infrastructure Income Fund	5.2%
VT Gravis Clean Energy Income Fund	4.4%
Long Term Strategic Investments Total (Est.)	**4.2%**
Overall Total (Estimated)	**1.32%**

* The investment returns on the Long Term Strategic Investments are currently estimates based on the previous quarter. The actual return for the second quarter is not available until it's been declared a month after the quarter has finished.

Future Strategic & Tactical Issues

3.14 The Council's Treasury Management Advisor's economic and market review for the second quarter of 2022/23 is included in **Appendix 5**.

3.15 Over the April-September period 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 unprecedented period in fixed income markets, with a direct impact on PWLB rates.

3.16 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%

3.17 The benefits of the Council's current policy of internal borrowing will continue to be monitored against forecast movements in borrowing rates and the Council's cash position. Any future borrowing decisions, should they be required during the remainder of the year, will be discussed with our treasury advisors in terms of duration and timing given the current volatility in the gilt market and PWLB interest rates.

3.18 A review of the capital programme is being undertaken by the Council's Capital Strategy Group to assess potential for pausing, re-phasing or holding projects that are reliant on borrowing, to mitigate potential future revenue pressure if borrowing interest rates remain at their current elevated levels.

Budget Implications

3.19 The breakdown of the 2022/23 revenue budget for interest and capital financing, and the forecast year end position based on the period April to September 2022, is included in **Appendix 6**. An overall underspend of £0.950m is currently forecast due to higher than budgeted investment income and a delay in borrowing. This is due to both the increase in interest rates since the budget was set, along with the temporary high levels of cash balances currently held following the advance payment of grants and the profiling of capital expenditure.

4 STATUTORY CONSIDERATIONS

4.1 This report is for information only.

5 RESOURCE IMPLICATIONS (FINANCE, PROPERTY, PEOPLE)

5.1 The financial implications are contained within the body of the report.

6 RISK MANAGEMENT

6.1 A risk assessment related to the issue and recommendations has been undertaken, in compliance with the Council's decision making risk management guidance.

6.2 The Council’s lending & borrowing list is regularly reviewed during the financial year and credit ratings are monitored throughout the year. All lending/borrowing transactions are within approved limits and with approved institutions. Investment and borrowing advice is provided by our Treasury Management consultants, Arlingclose.

6.3 The CIPFA Treasury Management in the Public Services: Code of Practice requires the Council nominate a committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies. The Corporate Audit Committee carries out this scrutiny.

6.4 In addition, the Council maintain a risk register for Treasury Management activities, which is regularly reviewed and updated where applicable during the year. An extract from the risk register, detailing how the top 5 risks are managed, is included as **Appendix 8**.

7 EQUALITIES

7.1 As this report contains performance information for noting only, an Equality Impact Assessment is not considered necessary.

8 CLIMATE CHANGE

8.1 The Council will continue to avoid any direct treasury management investments in fossil fuel related companies and will engage with its advisors to explore and assess the potential for any future investment opportunities in funds with a Renewable Energy & Sustainability focus as these products continue to be developed by the market in response to the Climate & Nature Emergency agenda.

8.2 An ESG section is included the Treasury Management Strategy document for 2022/23, with the treasury team monitoring investment options permitted under the new guidelines.

8.3 The Council holds £5m in longer term investments, split across two ESG focussed Strategic Funds, as detailed under 3.13.

9 OTHER OPTIONS CONSIDERED

9.1 None

10 CONSULTATION

10.1 Consultation has been carried out with the Cabinet Member for Resources, Chief Finance Officer and Monitoring Officer.

Contact person	*Gary Adams - 01225 47 7107; Jamie Whittard - 01225 47 7213 Gary_Adams@BATHNES.GOV.UK: Jamie_Whittard@BATHNES.GOV.UK*
Background papers	*2022/23 Treasury Management & Investment Strategy*
Please contact the report author if you need to access this report in an alternative format	

APPENDIX 1
Performance against Treasury Management Indicators agreed in Treasury Management Strategy Statement

1. Treasury Borrowing limits

These limits include current commitments and proposals in the budget report for capital expenditure, plus additional headroom over & above the operational limit for unusual cash movements.

The Authorised limits for external debt include current commitments and proposals in the budget report for capital expenditure, plus additional headroom over and above the operational limit for unusual cash movements.

The Operational boundary for external debt is based on the same estimates as the authorised limit but without the additional headroom for unusual cash movements. This level also factors in the proposed approach to use internal cash-flow and future capital receipts as the preferred financing method for the capital programme.

	2022/23 Prudential Indicator	**Actual as at 30th Sept. 2022**
Operational boundary – borrowing	£435m	£217.3m
Operational boundary – other long-term liabilities	£4m	£0m
Operational boundary – TOTAL	**£439m**	**£217.3m**
Authorised limit – borrowing	£464m	£217.3m
Authorised limit – other long-term liabilities	£4m	£0m
Authorised limit – TOTAL	**£468m**	**£217.3m**

2. Security: Average Credit Rating*

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. A summary guide to credit ratings is set out at **Appendix 7**.

	2022/23 Prudential Indicator	**Actual as at 30th Sept. 2022**
	Rating	Rating
Minimum Portfolio Average Credit Rating	A-	AA+

* *The calculation excludes the strategic investment in the CCLA Local Authority Property Fund and ESG focussed Investment Funds, which are unrated.*

3. Liquidity

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

Liquidity risk indicator	**2022/23 Prudential Indicator**	**Minimum During Quarter**	**Date of minimum**
Minimum total Cash Available within 3 months	£15m	£52.2m	28-Sep-22

4. Interest rate exposures
This indicator is set to control the Council's exposure to interest rate risk. The upper limit represents the maximum one-year revenue impact of a 1% rise or fall in interest rates.

	2022/23 Prudential Indicator	**Actual as at 30th Sept. 2022**
Upper limit on one-year revenue impact of a 1% rise in interest rates	+/- £1m	£0.469m
Upper limit on one-year revenue impact of a 1% fall in interest rates	+/- £1m	£0.469m

The impact of this limit is that the Council should never be holding a maturity adjusted net debt / investment position on variable rates of more than £100m.

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at new market rates, which includes amounts which are maturing each year in PWLB annuity loans.

5. Maturity Structure of borrowing
This indicator is set to control the Council's exposure to refinancing risk.

	Upper Limit	**Lower Limit**	**Actual as at 30th Sept. 2022**
	%	%	%
Under 12 months	50	Nil	2.3
12 months and within 24 months	50	Nil	0
24 months and within 5 years	75	Nil	0
5 years and within 10 years	75	Nil	6.9
10 years and within 25 years	100	25	49.7
Over 25 years	100		41.1

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date that the lender can demand repayment. For LOBO's, this is shown at the date of maturity.

6. Upper limit for total principal sums invested for over 364 days
The purpose of this indicator is to control the Authority'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 will be:

Price risk indicator	**2022/23 Prudential Indicator**	**Actual as at 30th Sept. 2022**
Limit on principal invested beyond 31st March 2023	£50m	£10m*
Limit on principal invested beyond 31st March 2024	£20m	£10m*
Limit on principal invested beyond 31st March 2025	£10m	£10m*

*The Council includes the CCLA LA Property Fund & two long term ESG focussed Investment Funds against this indicator as they are both held as Long Term Strategic Investments.

APPENDIX 2

The Council's Investment position at 30th September 2022

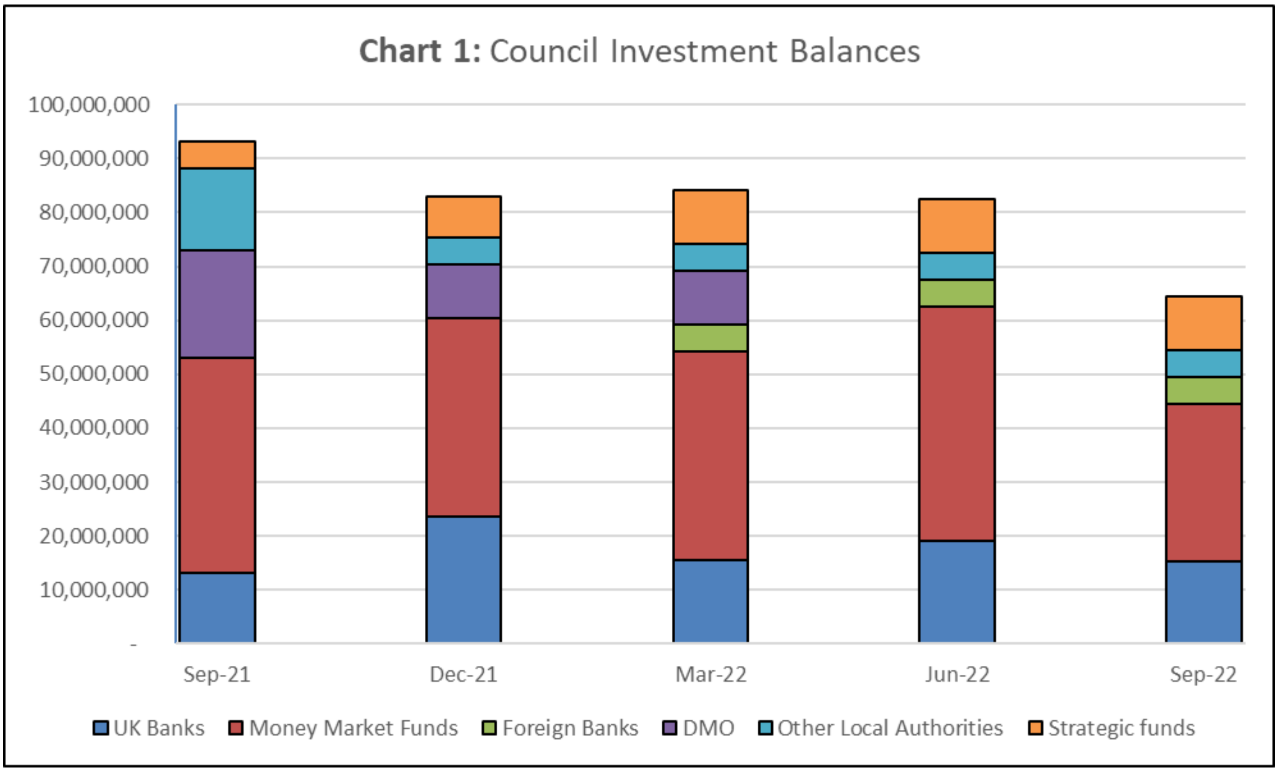
The term of investments is as follows:

Term Remaining	Balance at 30th Sept. 2022	Comparator Balance at 30th June 2022
	£m	£m
Notice (instant access funds)	39.4	57.6
Up to 1 month	5.0	5.0
1 month to 3 months	10.0	5.0
3 months to 6 months	0	5.0
6 months to 12 months	0	0
Strategic Funds	10.0	10.0
Total	**64.4**	**82.6**

The investment figure is made up as follows:

	Balance at 30th Sept. 2022	Comparator Balance at 30th June 2022
	£m	£m
B&NES Council	61.5	79.9
Schools	2.9	2.7
Total	**64.4**	**82.6**

The Council had a total average net positive balance of £87.4m during the period April 2022 to September 2022.



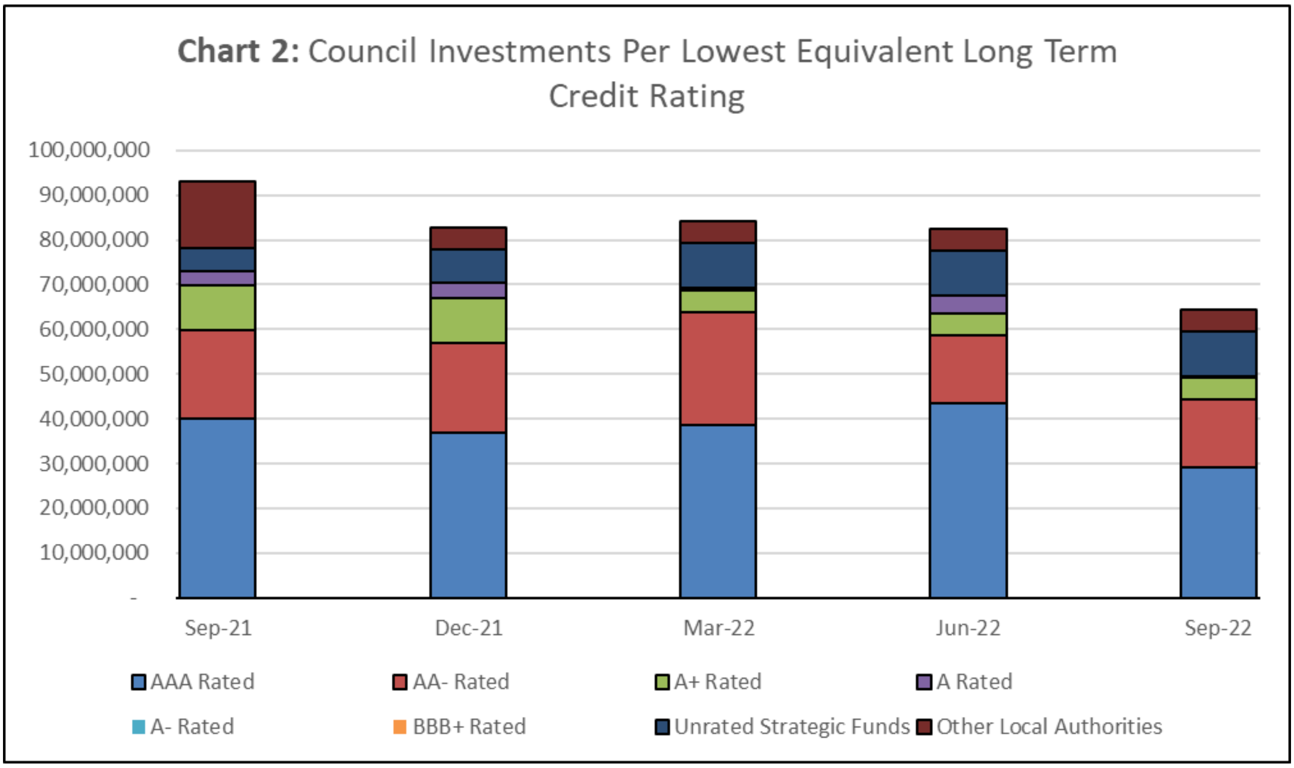


Chart 2: Council Investments Per Lowest Equivalent Long Term Credit Rating
100,000,000
90,000,000
80,000,000
70,000,000
60,000,000
50,000,000
40,000,000
30,000,000
20,000,000
10,000,000
-
Sep-21
Dec-21
Mar-22
Jun-22
Sep-22
AAA Rated
AA- Rated
A+ Rated
A Rated
A- Rated
BBB+ Rated
Unrated Strategic Funds
Other Local Authorities

APPENDIX 3

Average rate of return on investments for 2022/23

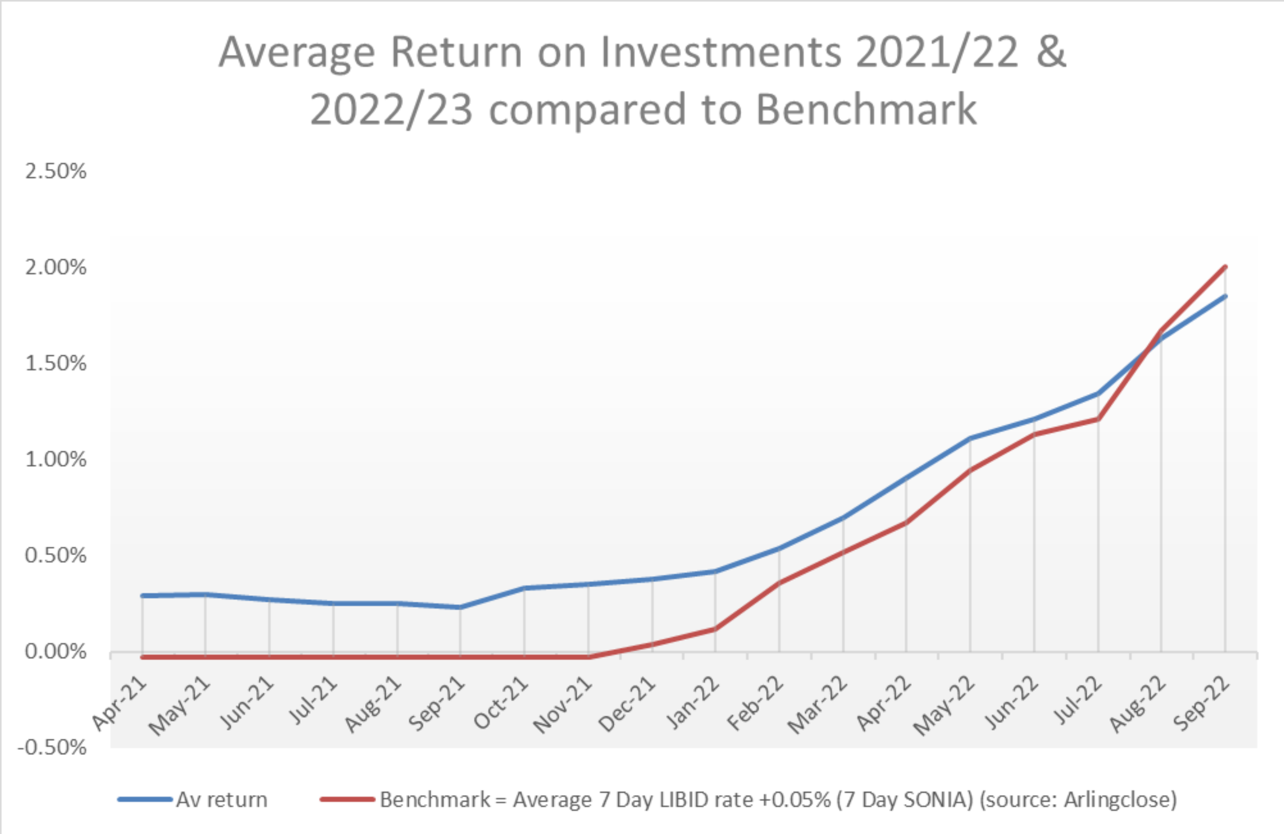
	Average rate of interest earned	Benchmark = Average 7 Day SONIA rate	Performance against Benchmark
April 2022*	0.90%	0.67%	+0.23%
May 2022*	1.11%	0.94%	+0.18%
June 2022*	1.21%	1.13%	+0.08%
July 2022#	1.34%	1.21%	+0.13%
August 2022#	1.63%	1.67%	-0.04%
September 2022#	1.85%	2.00%	-0.15%
Average#	**1.32%**	**1.27%**	**+0.05%**

* Updated from Q1 Report to reflect ACTUAL Strategic Investment returns (these were included as estimates in Q1 report, due to timing of report dispatch)

Includes **estimates** for Q2 Strategic Investments returns – actuals will not be known until after dispatch so will be updated in Q3 report.

For Comparison, the average rate of return on investments for 2021/22 was as follows:

	Average rate of interest earned	Benchmark = Average 7 Day LIBID rate +0.05% (7 Day SONIA – 0.08%)	Performance against Benchmark %
April 2021	0.29%	-0.03%	+0.32%
May 2021	0.30%	-0.03%	+0.33%
June 2021	0.27%	-0.03%	+0.30%
July 2021	0.25%	-0.03%	+0.28%
August 2021	0.25%	-0.03%	+0.28%
September 2021	0.23%	-0.03%	+0.27%
October 2021	0.33%	-0.03%	+0.36%
November 2021	0.35%	-0.03%	+0.38%
December 2021	0.38%	0.04%	+0.34%
January 2022	0.42%	0.12%	+0.30%
February 2022	0.54%	0.36%	+0.18%
March 2022	0.70%	0.52%	+0.18%
Average	**0.36%**	**0.06%**	**+0.30%**


Average Return on Investments 2021/22 & 2022/23 compared to Benchmark
2.50%
2.00%
1.50%
1.00%
0.50%
0.00%
-0.50%
Apr-21
May-21
Jun-21
Jul-21
Aug-21
Sep-21
Oct-21
Nov-21
Dec-21
Jan-22
Feb-22
Mar-22
Apr-22
May-22
Jun-22
Jul-22
Aug-22
Sep-22
Av return
Benchmark = Average 7 Day LIBID rate +0.05% (7 Day SONIA) (source: Arlingclose)

APPENDIX 4

Council's External Borrowing at 30th September 2022

Lender	Amount outstanding @ 30th June 2022	Change in Quarter	Amount outstanding @ 30th Sept. 2022	Start date	End date	Interest rate
	£	£	£			
Long term						
PWLB489142	10,000,000	-	**10,000,000**	15/10/2004	15/10/2034	4.75%
PWLB497233	5,000,000	-	**5,000,000**	12/05/2010	15/08/2035	4.55%
PWLB497234	5,000,000	-	**5,000,000**	12/05/2010	15/02/2060	4.53%
PWLB498834	5,000,000	-	**5,000,000**	05/08/2011	15/02/2031	4.86%
PWLB498835	10,000,000	-	**10,000,000**	05/08/2011	15/08/2029	4.80%
PWLB498836	15,000,000	-	**15,000,000**	05/08/2011	15/02/2061	4.96%
PWLB503684	5,300,000	-	**5,300,000**	29/01/2015	08/04/2034	2.62%
PWLB503685	5,000,000	-	**5,000,000**	29/01/2015	08/10/2064	2.92%
PWLB505122	16,210,402	-	**16,210,402**	20/06/2016	20/06/2041	2.36%
PWLB508126	8,769,505	-	**8,769,505**	06/12/2018	20/06/2043	2.38%
PWLB508202	9,586,307	-	**9,586,307**	12/12/2018	20/06/2068	2.59%
PWLB508224	4,375,462	-	**4,375,462**	13/12/2018	20/06/2043	2.25%
PWLB505744	8,196,276	(191,874)	**8,004,402**	24/02/2017	15/08/2039	2.28%
PWLB505966	8,422,529	(167,716)	**8,254,813**	04/04/2017	15/02/2042	2.26%
PWLB506052	7,157,675	(142,677)	**7,014,998**	08/05/2017	15/02/2042	2.25%
PWLB506255	6,638,222	-	**6,638,222**	10/08/2017	10/04/2067	2.64%
PWLB506729	8,602,616	-	**8,602,616**	13/12/2017	10/10/2042	2.35%
PWLB506995	8,629,260	-	**8,629,260**	06/03/2018	10/10/2042	2.52%
PWLB506996	8,949,910	-	**8,949,910**	06/03/2018	10/10/2047	2.62%
PWLB507749	8,934,808	(159,624)	**8,775,184**	10/09/2018	20/07/2043	2.42%
PWLB508485	19,364,192	(110,690)	**19,253,502**	11/02/2019	20/07/2068	2.52%
PWLB509840	9,149,528	(173,683)	**8,975,845**	04/09/2019	20/07/2044	1.40%
KBC Bank N.V *	5,000,000	-	**5,000,000**	08/10/2004	08/10/2054	4.50%
KBC Bank N.V *	5,000,000	-	**5,000,000**	08/10/2004	08/10/2054	4.50%
Commerzbank AG Frankfurt*	10,000,000	-	**10,000,000**	27/04/2005	27/04/2055	4.50%
Medium term						
Portsmouth C.C.	5,000,000	-	**5,000,000**	19/12/2019	19/12/2022	1.65%
Total Borrowing	**218,286,693**	**(946,265)**	**217,340,428**			

*All LOBO's (Lender Option / Borrower Option) have reached the end of their fixed interest period and have reverted to the variable rate of 4.50%. The lender has the option to change the interest rate at 6 monthly intervals. Should the lender use the option to change the rate, then at this point the borrower has the option to repay the loan without penalty.

The "Change in Quarter" movement on some of the PWLB loans reflects that these loans have an annuity repayment profile, so repayments of principal are made on a 6 monthly basis throughout the life of the loans.

APPENDIX 5: Arlingclose Economic & Market Review

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.

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.

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

UK inflation remained extremely high. Annual headline CPI hit 10.1% in July, 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.

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.

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.

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.

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.

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.

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%.

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%.

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

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

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.

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.

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.

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.

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 Authority's counterparty list recommended by Arlingclose remains under constant review.

APPENDIX 6

Interest & Capital Financing Costs – Budget Monitoring 2022/23

April 2022 to September 2022	YEAR END POSITION Budgeted Spend or (Income) £'000	Forecast Spend or (Income) £'000	Forecast over or (under) spend £'000	ADV/FAV
Interest & Capital Financing				
- Debt Costs	8,031	7,531	(500)	FAV
- Internal Repayment of Loan Charges	(13,052)	(13,052)	0	
- Ex Avon Debt Costs	980	980	0	
- Minimum Revenue Provision (MRP)	9,678	9,678	0	
- Interest on Balances	(425)	(875)	(450)	FAV
Total	**5,212**	**4,262**	**(950)**	**FAV**

APPENDIX 7

Summary Guide to Credit Ratings

Rating	Details
AAA	Highest credit quality – lowest expectation of default, which is unlikely to be adversely affected by foreseeable events.
AA	Very high credit quality - expectation of very low default risk, which is not likely to be significantly vulnerable to foreseeable events.
A	High credit quality - expectations of low default risk which may be more vulnerable to adverse business or economic conditions than is the case for higher ratings.
BBB	Good credit quality - expectations of default risk are currently low but adverse business or economic conditions are more likely to impair this capacity.
BB	Speculative - indicates an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time.
B	Highly speculative - indicates that material default risk is present, but a limited margin of safety remains. Capacity for continued payment is vulnerable to deterioration in the business and economic environment.
CCC	Substantial credit risk - default is a real possibility.
CC	Very high levels of credit risk - default of some kind appears probable.
C	Exceptionally high levels of credit risk - default is imminent or inevitable.
RD	Restricted default - indicates an issuer that has experienced payment default on a bond, loan or other material financial obligation but which has not entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, and which has not otherwise ceased operating.
D	Default - indicates an issuer that has entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, or which has otherwise ceased business.

APPENDIX 8

Extract from Treasury Management Risk Register – Top 5 Risks

			Current Risk Score											Trend			
	Risk Nr	Description	Likelihood					Impact					This Period	Periods Ago			Management Action
			1	2	3	4	5	1	2	3	4	5					
			L		M	H		L		M	H			1	2	3	
1	R01	Liquidity Risk - The risk that cash will not be available when it is needed, that ineffective management of liquidity creates additional unbudgeted costs, and that the organisation's business/service objectives will be thereby compromised.		2						3			6	6	6	6	Obtain approval of annual Treasury Management Strategy by February Council. Carry out weekly reviews of investment portfolio and planned actions. Carry out monthly dashboard meeting with Chief Finance Officer. Consider short and medium term cash balances and cashflows to inform any short - medium term borrowing requirement.
2	R02	Interest Rate Risk - The risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately				4				3			12	9	9	4	Monitor interest rates on a monthly basis and compare with budget to determine impact on Council finances and report through monthly Treasury Dashboard. Report implication of interest rate changes to Cabinet as part of quarterly Treasury Management Performance Report. Explore alternative potential investment products following new freedoms - including corporate bonds, gilts, Certificate of Deposits etc. Discussion with our treasury advisors on any new borrowing in terms of duration and timing given the current volatility in the gilt market and PWLB interest rates.
3	R04	Inflation Risk - The risk that prevailing levels of inflation cause an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately.				4				3			12	12	9	4	Liaise with Chief Finance Officer to ensure Inflation both current and projected forms part of the medium term financial planning framework.
4	R05	Credit and Counterparty Risk - The risk of failure by a third party to meet its contractual obligations to the organisation under an investment, borrowing, capital, project or partnership financing, particularly as a result of the third party's diminished creditworthiness, and the resulting detrimental effect on the organisation's capital or current (revenue) resources.			3						4		12	12	12	12	Complete annual review of Counterparty List with external advisors to feed into Treasury Management Strategy. Regular review of counterparty financial standing through use of credit ratings, credit default swap rates and national press coverage and liaison with Chief Finance Officer and external advisors to consider any issues / change in circumstances of counterparties.
5	R09	Key Personnel - There is a risk that staff absence results in the inability to process Treasury Management transactions.			3					3			9	9	9	9	Produce & maintain a Business Continuity Plan to manage staff absences Provide refresher training and periodically ask secondary process operators to run the treasury process to ensure that there are a number of people able to perform the treasury activity