

Finance & Resources Committee

10:00am, Thursday, 26th January 2023

Treasury Management: Mid-Year Report 2022/23

Executive/routine
Wards
Council Commitments

1. Recommendations

- 1.1 It is recommended that the Committee:
 - 1.1.1 notes the mid-year report on Treasury Management for 2022/23; and
 - 1.1.2 refers the report to City of Edinburgh Council for approval and subsequent remit by the City of Edinburgh Council to the Governance Risk and Best Value Committee for scrutiny.

Richard Carr

Interim Executive Director of Corporate Services

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Treasury Management: Mid-Term Report 2022/23

Treasury Management: Mid-Term Report 2022/23

2. Executive Summary

- 2.1 The purpose of this report is to give an update on Treasury Management activity undertaken in the first half of 2022/23.
- 2.2 In accordance with the Strategy set in March 2022 the Council has borrowed just £3.1m from the PWLB in the first half of the year. This borrowing relates to loans to the Edinburgh Living Mid-Market Rent LLP.
- 2.3 The investment return for 2022/23 is matching the Fund's benchmark, during a period of increasing interest rates while maintaining the security of the investments as a priority.

3. Background

- 3.1 The Council has adopted the CIPFA Code of Practice on Treasury Management in the Public Sector, and under the code, the mid-term report has been prepared setting out activity undertaken.

4. Main report

4.1 UK Interest Rates

- 4.1.1 During the last six months economic uncertainty continued due to the recovery from the COVID-19 pandemic, the war in Ukraine, high inflation rates and a deteriorating economic outlook. The Bank of England's (BoE) Monetary Policy Committee (MPC) increased UK Bank Rate at all four of their of their meeting during the first half of 2022/23 (and have subsequently increased Bank Rate further to 3.5%). Appendix 1 gives a summary of the first six months from the Council's Treasury Advisors.

4.2 Debt Management

4.2.1 The Council continued to fund its borrowing requirement by reducing its investments but also took the opportunity as previously mentioned to lock in a small amount of borrowing at an attractive rate of interest. Appendix 2 outlines the debt management activity during the period.

4.2.2 The £3.1m borrowed secured funding for Edinburgh Living MMR LLP.

4.3 Investment Out-turn

4.3.1 The Council's cash balances are pooled and invested via the Treasury Cash Fund subject to the limits set out in the Treasury Management Policy Statement. Appendix 3 provides detail on the Council's investments.

4.3.2 As can also be seen in Appendix 3 Treasury Cash Fund performance has performed in line with its benchmark with absolute investment returns increasing due to the increases in UK Bank Rate.

5. Next Steps

5.1 The Treasury team will continue to operate its Treasury Cash Fund with the aim of out-performing its benchmark of 7-day compounded Sterling Overnight Index Average (SONIA) and manage the Council's debt portfolio to minimise the cost to the Council while mitigating risk.

5.2 The Treasury team will also continue to review the Council's borrowing requirements, taking into account the significant planned capital investment set out in the ten-year capital plan, and the opportunities that the market presents.

6. Financial impact

6.1 The Treasury Cash Fund has generated significant additional income for the Council.

6.2 Loan charges associated with the borrowing will be managed within the approved budget.

7. Stakeholder/Community Impact

7.1 There are no adverse stakeholder/community impacts arising from this report.

8. Background reading/external references

8.1 None

9. Appendices

Appendix 1: Economic Background

Appendix 2: Debt Management Activity

Appendix 3: Investment Out-turn

Appendix 4: Debt outstanding 30th September 2022

Appendix 1

Economic Background

Our Treasury Advisors, Arlingclose summarised the financial markets and gilt yields over the first six months of the financial year as follows:

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.

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.

Appendix 2

Debt Management Activity

Figure A2.1 below shows the PWLB borrowing rates since April 2005.

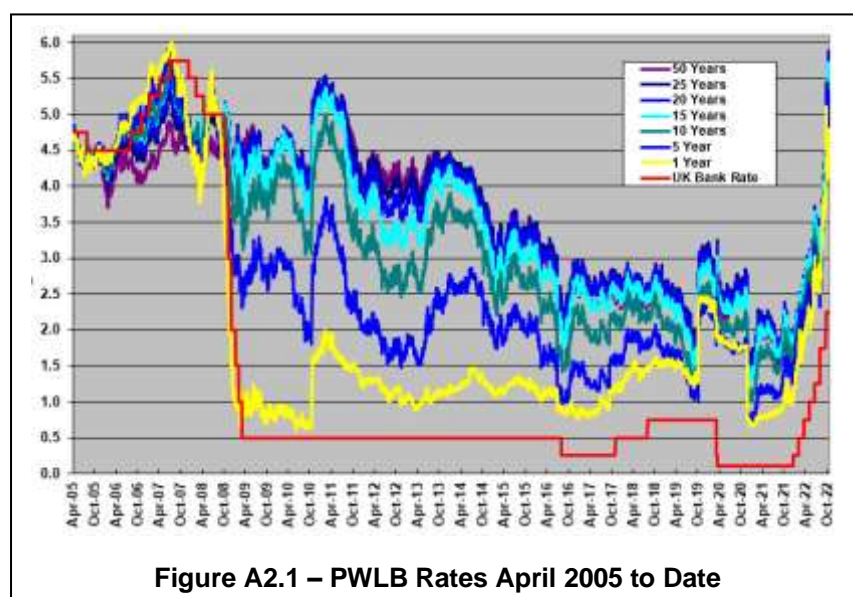


Figure A2.1 – PWLB Rates April 2005 to Date

Borrowing rates have risen dramatically since the Treasury Strategy for 2022/23 was approved. The Debt Management Strategy for 2022/23 as outlined in the Strategy Report was:

To address the borrowing requirement it is intended, subject to appropriate rates being available, to:

- *continue to reduce investment balances to temporarily fund capital expenditure;*
- *seek alternative sources of funds to the PWLB; and*
- *continue to lock out the risk on projects when the timing of capital expenditure becomes certain and interest rates are appropriate.*

We have previously highlighted significant concerns over the prospects for inflation and the medium-term outlook for interest rates and noted that this was the rationale for taking substantial PWLB borrowing during 2021/22 to lock in the low interest rates. However, Interest rates rose faster than had been anticipated. In the circumstances, we have continued to reduce investment balances to temporarily fund capital expenditure. We borrowed £18m in 2021/22 to cover future lending to Edinburgh Living for all projects which were already on site. However, early in the financial year one of the projects where the homes were being purchased from the Council by Edinburgh Living MMR LLP remained affordable at the prevailing borrowing rates. £3.1m was therefore borrowed to cover the loan to the LLP, retaining the pool of pre-borrowing for future projects.

Appendix 3

Investment Out-turn

The Council's cash balances are pooled and invested via the Treasury Cash Fund subject to the limits set out in the Treasury Management Policy Statement. Figure A3.1 below shows the daily investment in the Cash Fund since April 2009 highlighting the increased cash holdings due to borrowing. The Treasury Management strategy is to ensure that surplus funds are invested in accordance with the list of approved organisations for investment, minimising the risk to the capital sum and optimising the return on these funds consistent with those risks. The Cash Fund's Investment Strategy continues to be based around the security of the investments.

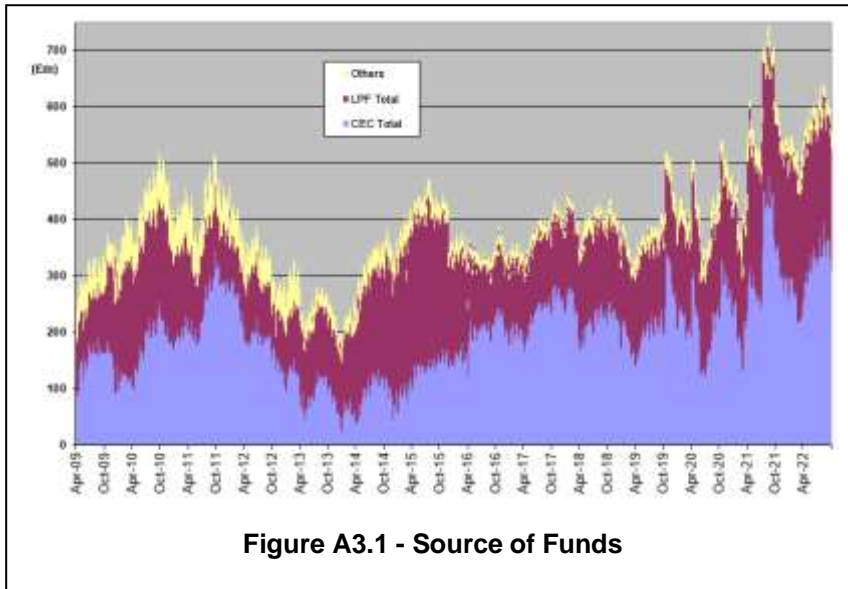


Figure A3.2 shows the rates achieved in the Friday auctions of UK Treasury Bills. As can be seen rates are increasing with each UK Bank Rate increase.

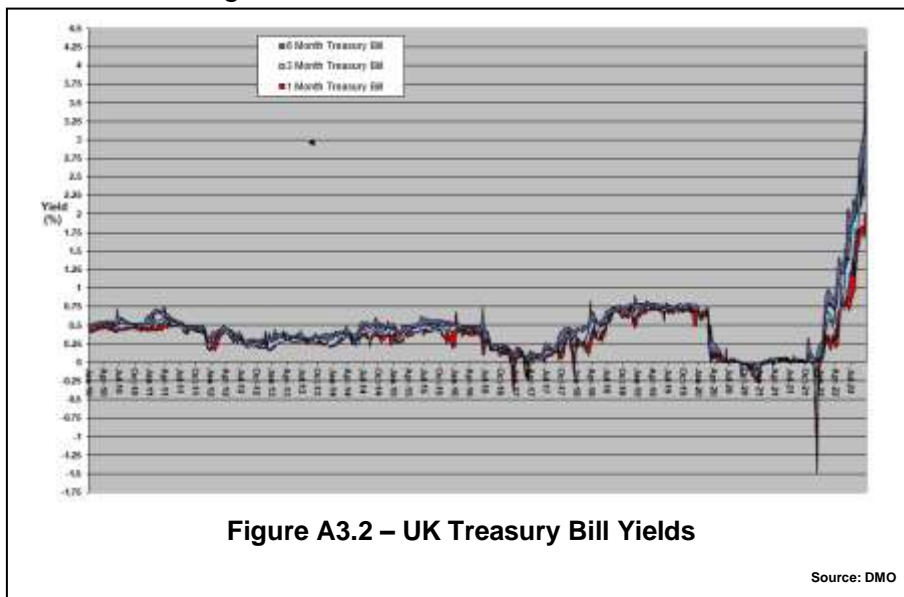
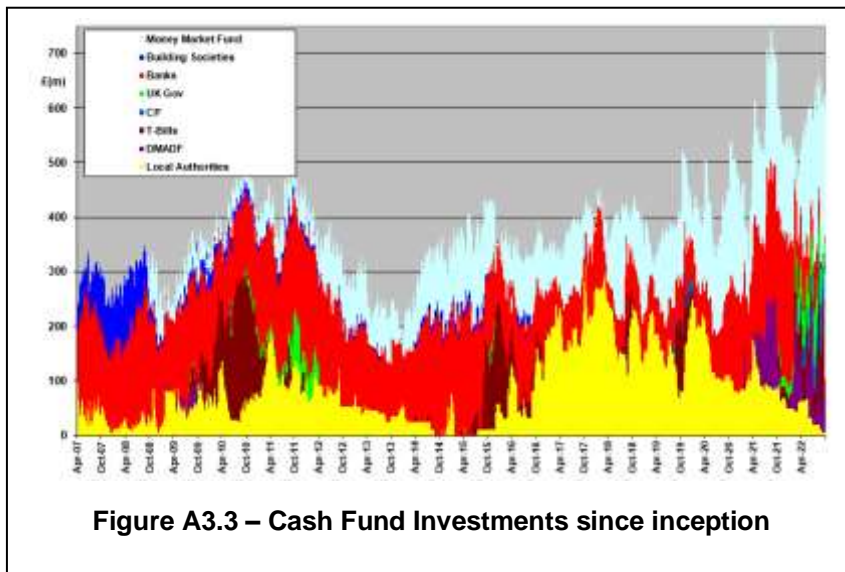
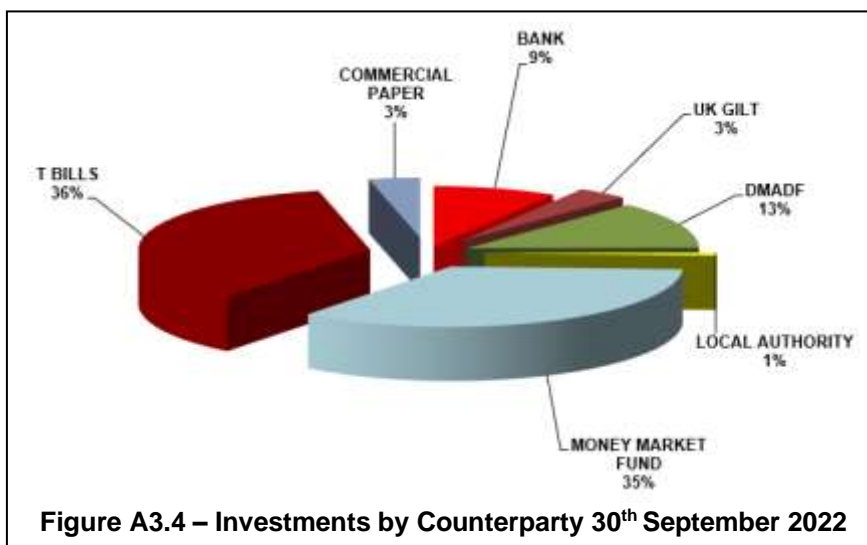


Figure A3.3 shows in detail the distribution on Cash Fund investments since inception in 2007. This shows increased investment in UK Treasury Bills, UK Gilts, commercial paper in ring-fenced banks and the Governments Debt Management Agency Deposit Facility (DMADF).



As can be seen in Figure A3.4, 1% of the fund was invested in a Local Authority deposit, 36% with UK Treasury Bills, 3% with UK Gilts, 13% invested with DMADF, 12% was invested with Banks in call accounts split between instant access and commercial paper with ring-fenced institutions and 35% on deposit with Money Market Funds.



The strategy is to seek Local Authority and UK Treasury Bill trades which add value to relative MMF/Bank rates and make a positive performance contribution. There has been little interest from local authorities for many remain cash rich and rates remain relatively low due to large cash balances. Treasury will continue to monitor yield increases and take advantage of any opportunity to achieve an increase rate with Government backed investments.

As can be seen in Figure A3.5 the weighted average life of the fund was 35 days at the end of September. The duration on the portfolio is mainly made up from UK Treasury Bills with the longest maturing in January alongside a UK Gilt. One local authority deposit matures in March.

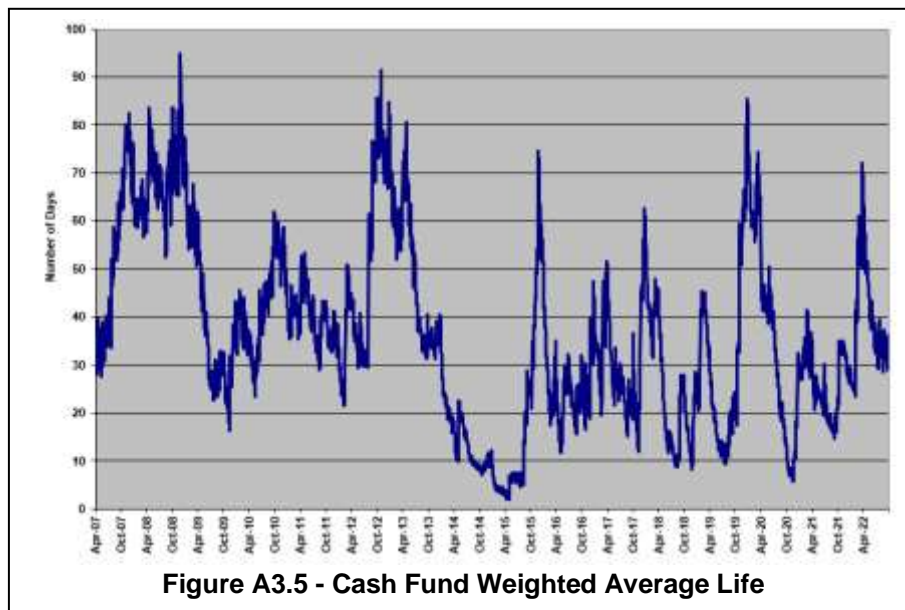


Figure A3.5 - Cash Fund Weighted Average Life

Cash Fund Performance

The annualised rate of return for the Cash Fund for the six months to September 2022 was 1.12% against a benchmark of 1.13%. Figure A3.6 below shows the daily investment performance of the Cash Fund against its benchmark since April 2011. As can be seen, recent Cash Fund performance remained slightly below the benchmark which increased more quickly with increases in UK Bank Rate than the cash fund rate. Treasury will continue to seek trades which add value while retaining security of investments.

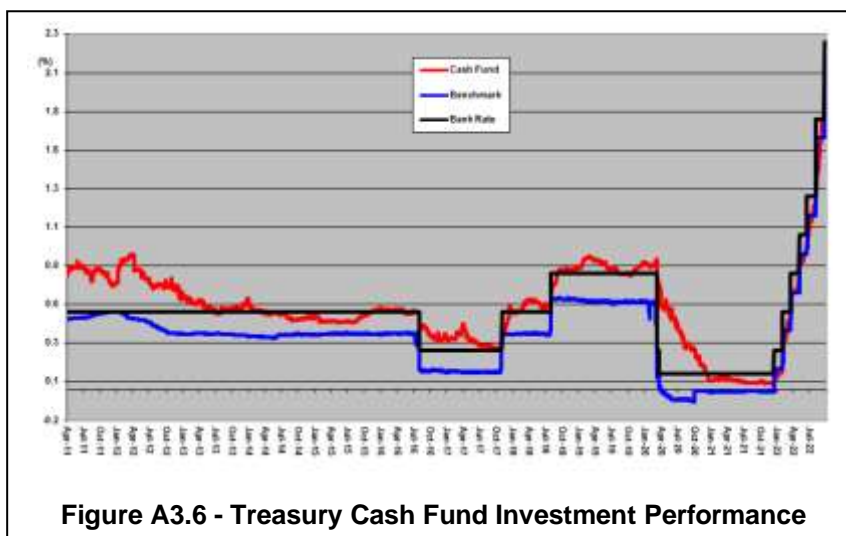


Figure A3.6 - Treasury Cash Fund Investment Performance

Appendix 4

Debt outstanding 30th September 2022

Market Debt (non LOBO)

Loan Type	Start Date	Maturity Date	Principal Outstanding (£)	Interest Rate (%)	Annual Interest (£)
M	08/10/2020	08/10/2045	57,392,301.61	2.613	1,511,165.09
M	30/06/2005	30/06/2065	5,000,000.00	4.4	220,000.00
M	07/07/2005	07/07/2065	5,000,000.00	4.4	220,000.00
M	21/12/2005	21/12/2065	5,000,000.00	4.99	249,500.00
M	28/12/2005	24/12/2065	12,500,000.00	4.99	623,750.00
M	14/03/2006	15/03/2066	15,000,000.00	5	750,000.00
M	18/08/2006	18/08/2066	10,000,000.00	5.25	525,000.00
M	01/02/2008	01/02/2078	10,000,000.00	3.95	395,000.00
			121,642,025.46		

Market Debt (LOBO)

Loan Type	Start Date	Maturity Date	Principal Outstanding (£)	Interest Rate (%)	Annual Interest (£)
M	12/11/1998	13/11/2028	3,000,000.00	4.75	142,500.00
M	15/12/2003	15/12/2053	10,000,000.00	5.25	525,000.00
M	18/02/2004	18/02/2054	10,000,000.00	4.54	454,000.00
M	28/04/2005	28/04/2055	12,900,000.00	4.75	612,750.00
M	01/07/2005	01/07/2065	10,000,000.00	3.86	386,000.00
M	24/08/2005	24/08/2065	5,000,000.00	4.4	220,000.00
M	07/09/2005	07/09/2065	10,000,000.00	4.99	499,000.00
M	13/09/2005	14/09/2065	5,000,000.00	3.95	197,500.00
M	03/10/2005	05/10/2065	5,000,000.00	4.375	218,750.00
M	23/12/2005	23/12/2065	10,000,000.00	4.75	475,000.00
M	06/03/2006	04/03/2066	5,000,000.00	4.625	231,250.00
M	17/03/2006	17/03/2066	10,000,000.00	5.25	525,000.00
M	03/04/2006	01/04/2066	10,000,000.00	4.875	487,500.00
M	03/04/2006	01/04/2066	10,000,000.00	4.875	487,500.00
M	03/04/2006	01/04/2066	10,000,000.00	4.875	487,500.00
M	07/04/2006	07/04/2066	10,000,000.00	4.75	475,000.00
M	05/06/2006	07/06/2066	20,000,000.00	5.25	1,050,000.00
M	05/06/2006	07/06/2066	16,500,000.00	5.25	866,250.00
			172,400,000.00		

PWLB Loans

Loan Type	Start Date	Maturity Date	Principal Outstanding (£)	Interest Rate (%)	Annual Interest (£)
M	16/02/1995	03/02/2023	2,997,451.21	8.625	258,530.17
M	24/04/1995	25/03/2023	10,000,000.00	8.5	850,000.00
M	05/12/1995	15/05/2023	5,200,000.00	8	416,000.00
M	20/09/1993	14/09/2023	2,997,451.21	7.875	236,049.28
M	20/09/1993	14/09/2023	584,502.98	7.875	46,029.61
M	08/05/1996	25/09/2023	10,000,000.00	8.375	837,500.00
M	13/10/2009	13/10/2023	5,000,000.00	3.87	193,500.00
M	05/12/1995	15/11/2023	10,000,000.00	8	800,000.00
M	10/05/2010	10/05/2024	10,000,000.00	4.32	432,000.00
M	28/09/1995	28/09/2024	2,895,506.10	8.25	238,879.25
M	14/05/2012	14/11/2024	10,000,000.00	3.36	336,000.00
A	14/12/2009	14/12/2024	2,065,863.38	3.66	96,956.99
M	17/10/1996	25/03/2025	10,000,000.00	7.875	787,500.00
M	10/05/2010	10/05/2025	5,000,000.00	4.37	218,500.00
M	16/11/2012	16/05/2025	20,000,000.00	2.88	576,000.00
M	13/02/1997	18/05/2025	10,000,000.00	7.375	737,500.00
M	20/02/1997	15/11/2025	20,000,000.00	7.375	1,475,000.00
A	01/12/2009	01/12/2025	4,057,234.04	3.64	176,932.55
M	21/12/1995	21/12/2025	2,397,960.97	7.875	188,839.43
M	21/05/1997	15/05/2026	10,000,000.00	7.125	712,500.00
M	28/05/1997	15/05/2026	10,000,000.00	7.25	725,000.00
M	29/08/1997	15/11/2026	5,000,000.00	7	350,000.00
M	24/06/1997	15/11/2026	5,328,077.00	7.125	379,625.49
M	07/08/1997	15/11/2026	15,000,000.00	6.875	1,031,250.00
M	13/10/1997	25/03/2027	10,000,000.00	6.375	637,500.00
M	22/10/1997	25/03/2027	5,000,000.00	6.5	325,000.00
M	13/11/1997	15/05/2027	3,649,966.00	6.5	237,247.79
M	17/11/1997	15/05/2027	5,000,000.00	6.5	325,000.00
M	13/12/2012	13/06/2027	20,000,000.00	3.18	636,000.00
M	12/03/1998	15/11/2027	8,677,693.00	5.875	509,814.46
M	06/09/2010	06/09/2028	10,000,000.00	3.85	385,000.00
M	14/07/2011	14/07/2029	10,000,000.00	4.9	490,000.00
E	14/07/1950	03/03/2030	1,895.62	3	62.56
M	14/07/2011	14/07/2030	10,000,000.00	4.93	493,000.00
E	15/06/1951	15/05/2031	2,109.12	3	68.54
M	06/09/2010	06/09/2031	20,000,000.00	3.95	790,000.00
M	15/12/2011	15/06/2032	10,000,000.00	3.98	398,000.00
M	15/09/2011	15/09/2036	10,000,000.00	4.47	447,000.00
M	22/09/2011	22/09/2036	10,000,000.00	4.49	449,000.00
M	10/12/2007	10/12/2037	10,000,000.00	4.49	449,000.00
M	08/09/2011	08/09/2038	10,000,000.00	4.67	467,000.00
M	15/09/2011	15/09/2039	10,000,000.00	4.52	452,000.00
M	06/10/2011	06/10/2043	20,000,000.00	4.35	870,000.00

M	09/08/2011	09/02/2046	20,000,000.00	4.8	960,000.00
M	23/01/2006	23/07/2046	10,000,000.00	3.7	370,000.00
M	23/01/2006	23/07/2046	10,000,000.00	3.7	370,000.00
M	19/05/2006	19/11/2046	10,000,000.00	4.25	425,000.00
M	07/01/2008	07/01/2048	5,000,000.00	4.4	220,000.00
A	24/03/2020	24/03/2050	14,011,287.23	1.64	234,715.95
A	26/03/2020	26/03/2050	4,663,035.29	1.49	71,004.13
A	26/03/2021	26/03/2051	9,614,327.97	1.75	171,644.97
A	12/07/2021	12/07/2051	38,980,830.65	1.78	707,484.79
M	27/01/2006	27/07/2051	1,250,000.00	3.7	46,250.00
M	16/01/2007	16/07/2052	40,000,000.00	4.25	1,700,000.00
M	30/01/2007	30/07/2052	10,000,000.00	4.35	435,000.00
M	13/02/2007	13/08/2052	20,000,000.00	4.35	870,000.00
M	20/02/2007	20/08/2052	70,000,000.00	4.35	3,045,000.00
M	22/02/2007	22/08/2052	50,000,000.00	4.35	2,175,000.00
M	08/03/2007	08/09/2052	5,000,000.00	4.25	212,500.00
M	30/05/2007	30/11/2052	10,000,000.00	4.6	460,000.00
M	11/06/2007	11/12/2052	15,000,000.00	4.7	705,000.00
M	12/06/2007	12/12/2052	25,000,000.00	4.75	1,187,500.00
M	05/07/2007	05/01/2053	12,000,000.00	4.8	576,000.00
M	25/07/2007	25/01/2053	5,000,000.00	4.65	232,500.00
M	10/08/2007	10/02/2053	5,000,000.00	4.55	227,500.00
M	24/08/2007	24/02/2053	7,500,000.00	4.5	337,500.00
M	13/09/2007	13/03/2053	5,000,000.00	4.5	225,000.00
A	14/10/2019	10/04/2053	104,750,808.43	2.69	2,832,296.87
M	12/10/2007	12/04/2053	5,000,000.00	4.6	230,000.00
A	01/07/2021	01/07/2053	48,867,526.62	1.98	993,421.87
M	05/11/2007	05/05/2057	5,000,000.00	4.6	230,000.00
M	15/08/2008	15/02/2058	5,000,000.00	4.39	219,500.00
A	25/01/2019	25/01/2059	2,593,078.97	2.65	69,548.05
A	11/06/2019	11/06/2059	1,222,443.71	2.23	27,613.76
A	01/10/2019	01/10/2059	1,284,067.74	1.74	22,448.09
A	02/10/2019	02/10/2059	38,250,958.78	1.8	691,722.20
A	05/11/2019	05/11/2059	6,900,131.28	2.96	206,456.25
A	28/11/2019	28/11/2059	1,262,575.05	3.03	38,664.01
A	02/12/2019	02/12/2059	2,718,126.50	3.03	83,237.57
A	20/01/2020	20/01/2060	1,911,997.78	1.77	34,316.53
A	20/01/2020	20/01/2060	442,750.38	2.97	13,291.81
M	04/10/2019	04/04/2060	40,000,000.00	1.69	676,000.00
A	07/12/2021	07/12/2060	18,929,684.58	1.8	343,793.42
M	02/12/2011	02/12/2061	5,000,000.00	3.98	199,000.00
A	07/12/2021	07/12/2061	4,128,600.24	1.79	74,543.62
A	19/05/2022	19/05/2062	3,096,067.00	2.86	88,248.03
A	24/03/2022	24/03/2063	17,877,239.67	2.65	473,746.85
M	26/03/2020	26/03/2070	10,000,000.00	1.29	129,000.00

M	12/07/2021	12/07/2071	50,000,000.00	1.74	870,000.00
M	23/12/2021	23/12/2071	25,000,000.00	1.45	362,500.00
			1,173,111,248.50		

SALIX INTEREST FREE

Loan Type	Start Date	Maturity Date	Principal Outstanding (£)	Interest Rate (%)	Annual Interest (£)
Z	31/03/2015	01/04/2023	180,289.74	0.00	0.00
Z	22/09/2015	01/10/2023	65,939.91	0.00	0.00
Z	29/03/2019	01/04/2029	97,985.02	0.00	0.00
			344,214.67		