



TREASURY MANAGEMENT – THIRD QUARTERLY REVIEW 2022/2023

REPORT OF THE FINANCE DIRECTOR

1. PURPOSE OF REPORT

- 1.1 To report on the Treasury Management performance for the third quarter of 2022/2023.

2. INTRODUCTION

- 2.1 Sunderland City Council performs the treasury management function on behalf of the Authority.
- 2.2 This report sets out the Treasury Management performance for the third quarter of the financial year 2022/2023, in accordance with the requirements of the Treasury Management Policy and Strategy agreed by Authority. This information is based on the data provide by Sunderland City Council, which incorporates the agreed investment and borrowing figures of the Authority.

3. SUMMARY OF TREASURY MANAGEMENT PERFORMANCE FOR 2022/2023

- 3.1 The Authority's Treasury Management function continues to look at ways to maximise financial savings and increase investment returns to the revenue budget, whilst maintaining a balanced risk position. Public Works Loan Board (PWLB) rates have gradually risen since the start of the financial year but continue to be extremely volatile. In line with discussions with Link Asset Services, the Lead Authority has taken out £50 million of new borrowing during the financial year to support the financing requirements of the Council's Capital Programme. These rates were considered opportune at the time and will benefit the revenue budget over the longer. The Authority however has not taken any new borrowing as it continues strategically to use its reserves to fund its Capital Programme.
- 3.2 No refinancing of debt has been carried out in 2022/2023 during the period as rates have not been considered sufficiently favourable. The Authority's average interest rate on borrowing is low, currently 2.54%, and as such the Authority already benefits from this low cost of borrowing and from the ongoing savings from past debt rescheduling exercises. Based on advice from the Authority's treasury management advisor, performance continues to see the Authority's average borrowing rate compare favourably to all other authorities.

- 3.3 Treasury Management Prudential Indicators are regularly reviewed and the Authority is within the limits set for all its Treasury Management Prudential Indicators for 2022/2023. The statutory limit under section 3 (1) of the Local Government Act 2003, which is required to be reported separately, (also known as the Authorised Borrowing Limit for External Debt) was set at £52.816m for 2022/2023. The Authority's maximum external debt during the financial year to 31st December 2022 was £33.235m and is well within this limit. More details of all of the Treasury Management Prudential Indicators are set out in Section 2 of Appendix A for information.
- 3.4 The Authority's investment policy is regularly monitored and reviewed to ensure it has flexibility to take full advantage of any changes in market conditions which will benefit the Authority.
- 3.5 The Authority has benefitted from the fact that its investment income has been matched to the benchmark rate, currently 1.74% for 2022/2023 to 31st December 2022, instead of the average Money Market Fund (MMF) return. This is an increase from the 0.1% return assumed when the 2022/23 budget was approved in February 2022 and is also set to increase further at outturn because the Bank of England Base Rate has since increased to 4%. Whilst historic returns have been higher than the benchmark rate, the MMF rate has been adversely impacted by market volatility linked to Covid and now the continuing conflict in Ukraine. The investment policy continues to reflect the priority to 'protect' the funds of the Authority first and foremost. More details are set out in Section A3 of the Appendix to this report in respect of the Authority's Investment Strategy and Performance.
- 3.6 More detailed Treasury Management information is included in Appendix A for information.
- 3.7 The regular updating of the Authority's Authorised Lending List is required to take into account financial institution mergers and changes in institutions' credit ratings since the last report. The updated Approved Lending List is shown in Appendix C for information.

4. RECOMMENDATION

- 4.1 The Committee is requested to note the Treasury Management performance during the third quarter of 2022/2023.
- 4.2 Members are requested to note both the updated Lending List Criteria at Appendix B and the Approved Lending List at Appendix C.

Detailed Treasury Management Performance – Quarter 3 2022/2023**A1 Borrowing Strategy and Performance – 2022/2023**

- A1.1 The Borrowing Strategy for 2022/2023 was approved by the Authority on 14th March 2022.
- A1.2 The Borrowing Strategy is based upon interest rate forecasts from a wide cross section of City institutions. The view at the time of drafting the Treasury Management Policy and Strategy was that the 0.25% Bank of England (BoE) Base Rate would rise in 0.25% increments in June 2022, March 2023, March 2024 and March 2025 by which time it would stand at 1.25% within the forecast timeframe. PWLB borrowing rates were expected to rise, albeit gently, during 2022/2023 across all periods but could be subject to levels of volatility.
- A1.3 The Bank of England's (BoE) Monetary Policy Committee (MPC) voted to raise the Base Rate to 3.50% at its meeting on 15th December 2022 and then voted for a further increase to 4.00% at its meeting on 2nd February 2023 - the highest level since November 2008. This reflects their commitment to combat inflationary pressures, even at the risk hampering growth, to ensure headline CPI inflation drops back to its 2% target over a three-year timeframe
- A1.4 GDP fell by 0.3% quarter on quarter ending 30th September. Although recently released November 2022 GDP data saw a small rise, protracted and escalating strike action is expected to see the economy contract marginally overall in the final quarter of 2022. The BoE's latest forecasts predict a deeper and longer recession than market analysts were previously expecting, of eight quarters and with a peak-to-trough fall in real GDP of 2.9%.
- A1.5 CPI inflation looks to have peaked at 11.1% in October, a 41-year high, before falling to 10.7% in November and marginally further in December to 10.5%. Goods price inflation, which is largely driven by global factors, has peaked and the sharp rises in energy prices in 2022 mean that energy price inflation will fall sharply in 2023. Despite the cost-of-living squeeze, the BoE will want to see evidence that wage growth isn't spiralling upwards if extensive strike action is successful in achieving large pay increases.
- A1.6 Following increases in the BoE Base Rate, investment rates of return have increased significantly compared to previous years. However long-term borrowing rates are also currently high, and above the benchmark borrowing rate of 3.00%. Therefore, investment balances will be temporarily used where necessary pending borrowing rates reducing.
- A1.7 Link Asset Services, the Authority's treasury advisors, reviewed their interest rate forecasts in December 2022 and again in February 2023 following the MPC announcements of increases in the Base Rate and the continued volatility in the financial markets. They believe the MPC will need to see stronger signs of activity slowing, the labour market loosening and wage growth slowing before stopping rate rises. They believe the Government's policy of emphasising fiscal rectitude will probably mean the Bank Rate will not need to increase beyond 4.50%, which is much less than the peak of 5.25% expected by the financial markets. This position will be

monitored closely as any changes will impact on the Authority's debt and investment positions.

A1.8 Link's current forecast is that the BoE Base Rate will rise to 4.25% in March 2023 and will peak at 4.50% in May 2023, before gradually falling to 2.50% by September 2025. These forecasts, and MPC decisions, will be liable to further amendment as updated economic data becomes available and emerging developments in the financial markets.

A1.9 The following table shows the average PWLB rates for Quarters 1, 2 and 3 compared to the SONIA Overnight Rate used to benchmark investment returns.

2022/2023	Qtr 1* (Apr - Jun) %	Qtr 2* (Jul - Sep) %	Qtr 3* (Oct - Dec) %
SONIA Overnight Rate	0.89	1.55	2.75
1 year	2.32*	3.27*	4.16*
5 years	2.58*	3.25*	4.38*
10 years	2.84*	3.41*	4.44*
25 years	3.08*	3.79*	4.67*
50 years	2.81*	3.52*	4.20*

*rates take account of the 0.2% discount to PWLB rates available to eligible authorities.

A1.10 In line with discussions with the Authority's Treasury Management adviser, the Lead Authority has taken out £50 million of new borrowing to meet its capital financing requirement. The rate was considered opportune but PWLB rates continue to be monitored closely in line with future capital programme requirements. The new borrowing is summarised in the following table:

Duration	Date of the transaction	Start	Matures	Rate %	Loan Amount £m
48 years	02/08/2022	09/08/2022	09/08/2070	2.79*	50.0

*rate takes account of the 0.20% discount to PWLB rates available to the Council.

A1.11 High levels of volatility in the financial markets previously caused by the pandemic have been added to in 2022/2023 by the on-going conflict between Russia and Ukraine and heightened tensions between China, Taiwan and the United States. The overall balance of risks to economic growth in the UK is to the downside due to a number of factors. The risk that the BoE acts too soon or too far over the next year in raising the Base Rate could hamper economic growth and not have the intended impact on inflation. Significant issues remain unresolved over future UK/EU trade arrangements following Brexit and complications or lack of co-operation in discussions pose a threat.

A1.12 The Chancellor's Autumn Statement on 17th November 2022 helped restore the Government's fiscal credibility in the financial markets without deepening the recession. The package of £54.9bn fiscal tightening measures is heavily backloaded, with net handouts of £3.8bn in 2023/24 and £0.3bn in 2024/25. The largest fiscal support measure was the extension of the domestic Energy Price Guarantee until April 2024 and targeted assistance for those most in need with most of the tightening taking effect after 2024/25. By relaxing the fiscal rules requiring debt as a percentage of

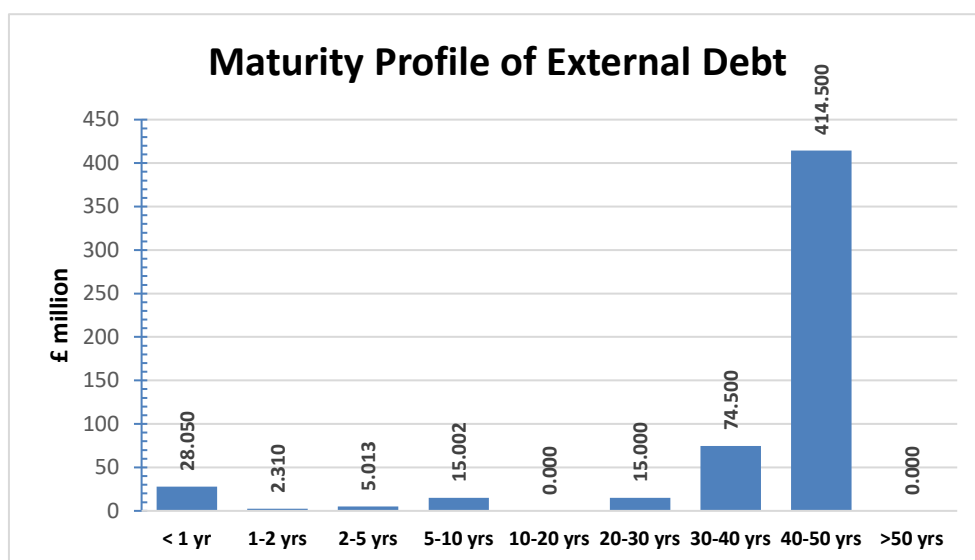
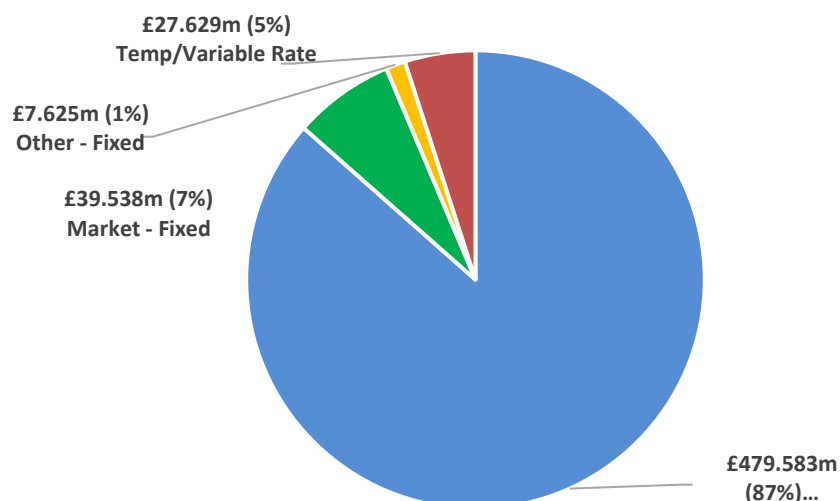
GDP to be falling in five years, rather than three, the Office for Budget Responsibility (OBR) in reviewing the package estimate this will be achieved, albeit by a slim margin.

A1.13 PWLB rates are expected to remain at around current levels until June 2023 before gradually falling through to December 2025. Link Asset Services predict PWLB rates standing at 4.20%, 4.40%, 4.60% and 4.30% for 5, 10, 25 and 50-year durations respectively by 31st March 2023 before falling to within the range 3.1%-3.5% for all durations by December 2025. With so many external influences weighing on the UK economy, interest rate forecasting remains very difficult. From time to time, gilt yields, and consequently PWLB rates, can be subject to exceptional levels of volatility which could occur at any time during the forecast period.

A1.14 The strategy for 2022/2023 is to adopt a pragmatic and flexible approach in identifying the low points in the interest rate cycle at which to borrow, and to respond to any changing circumstances to seek to secure benefit for the Authority. A benchmark financing rate of 3.00% for long-term borrowing was set for 2022/2023 in light of the views prevalent at the time the Treasury Management policy was set in March 2022.

A1.15 The Lead Authority's treasury portfolio position at 31st December 2022 is set out below which includes the Authority's total borrowing of £10.346m:

Borrowing Summary at: 31 December 2022		
	<u>Principal</u>	<u>Ave rate</u>
<u>Fixed</u>		%
PWLB	479,583,333	2.46
Market - Fixed	39,538,123	4.40
Other - Fixed	7,625,230	0.00
	<hr/> 526,746,686	<hr/> 2.57
<u>Variable</u>		
Temporary/Other - Variable	27,628,762	1.99
	<hr/> 27,629,762	<hr/> 1.99
TOTAL:	<hr/> 554,375,448	<hr/> 2.54



A2 Treasury Management Prudential Indicators – 2022/2023

A2.1 All external borrowing and investments undertaken in 2022/2023 have been subject to the monitoring requirements of the Prudential Code. Under the Code, Authorities must set borrowing limits (Authorised Borrowing Limit for External Debt and Operational Boundary for External Debt) and must also report on the Authority's performance for all of the other Treasury Management Prudential Indicators.

A2.2 The statutory limit under section 3(1) of the Local Government Act 2003 (which is also known as the Authorised Borrowing Limit for External Debt) was set by the Authority for 2022/2023 as follows:

	£m
Borrowing	38.359
Other Long-Term Liabilities	14.457
Total	52.816

The Operational Boundary for External Debt was set as shown below:-

	£m
Borrowing	33,359
Other Long-Term Liabilities	14.457
Total	<u>47.816</u>

- A2.3 Both the Authorised Limit and the Operational Limit include an element for long-term liabilities relating to PFI schemes and finance leases. These have been brought onto the Authority's Balance Sheet in compliance with International Financial Reporting Standards (IFRS).
- A2.4 The Authority's maximum external debt in respect of 2022/2023 (to 31st December 2022) was £33.235 million and is within the limits set by both of these indicators.
- A2.5 The table below shows that all other Treasury Management Prudential Indicators set by Sunderland City Council (which includes the Authority's data) have been complied with:

Prudential Indicators		2022/2023 (max at 31 st Dec 2022)	
		Limit	Actual
P9 Maturity Pattern		Upper Limit	
	Under 12 months	50%	6.74%
	12 months and within 24 months	60%	0.42%
	24 months and within 5 years	80%	0.99%
	5 years plus	100%	93.68%
	A lower limit of 0% for all periods		
P10 Upper limit for total principal sums invested for over 365 days		£75m	0

A3 Investment Strategy – 2022/2023

- A3.1 The Investment Strategy for 2022/2023 was approved by the Authority on 14th March 2022. The general policy objective for the Authority is the prudent investment of its treasury balances. The Authority's investment priorities in order of importance are:
- The **security** of capital;
 - The **liquidity** of its investments and then;
 - The Authority aims to achieve the **optimum yield** on its investments, but this is commensurate with the proper levels of security and liquidity.
- A3.2 As at 31st December 2022, funds managed by Sunderland City Council's in-house team on behalf of the Authority amounted to £27.514 million and all investments complied with the approved Annual Investment Strategy.
- A3.3 The table below shows the return received on these investments compared with the benchmark SONIA (Sterling Overnight Index Average) rate, which the Authority uses to assess its performance.

	2022/2023 Actual to 31/12/22 %	2022/2023 Benchmark to 31/12/22 %
Return on investments	1.74	1.74

- A3.4 Investments placed in 2022/2023 have been made in accordance with the approved Investment Strategy and comply with the Counterparty Criteria in place, shown in Appendix B, which is used to identify organisations on the Approved Lending List.
- A3.5 Investment rates available in the market have started to rise following a series of Base Rate increases announced by the Bank of England's Monetary Policy Committee (MPC). Since the MPC voted to raise the Base Rate by 0.15% to 0.25% at its meeting on 16th December 2021, there have been nine subsequent rises. The Base Rate currently stands at 4.00% with further increases expected.

Effective Date	BoE Base Rate %
19 Mar 2021	0.10
16 Dec 2021	0.25
3 Feb 2022	0.50
17 Mar 2022	0.75
5 May 2022	1.00
16 Jun 2022	1.25
4 Aug 2022	1.75
22 Sep 2022	2.25
3 Nov 2022	3.00
15 Dec 2022	3.50
2 Feb 2023	4.00

- A3.6 Whilst investment rates have improved recently, the Authority continues to follow a risk averse strategy when placing funds, prioritising security of capital whilst seeking to achieve the optimum return commensurate with risk. The Authority continues to follow advice from our Treasury Management advisors by placing funds in shorter dated liquid investments than previously.
- A3.7 Advice also continues that the above guidance is not applicable to institutions considered to be very low risk, mainly where the government holds shares in these organisations (i.e. RBS) and therefore have the UK Government rating applied to them, or separately in respect of Money Market Funds which are AAA rated.
- A3.8 The regular updating of the Authorised Lending List is required to take into account financial institution mergers and changes in institutions' credit ratings. Any changes since the last Treasury Management report are indicated in bold on the Approved Lending List is shown in Appendix C.

Lending List Criteria

Appendix B

Counterparty Criteria

The Council takes into account not only the individual institution's credit ratings issued by all three credit rating agencies (Fitch, Moody's and Standard & Poor's), but also all available market data and intelligence, the level of government support and advice from its Treasury Management advisers.

Set out below are the criteria to be used in determining the level of funds that can be invested with each institution. Where an institution is rated differently by the rating agencies, the lowest rating will determine the level of investment.

Fitch Long-Term Rating	Fitch Short-Term Rating	Moody's Long-Term Rating	Moody's Short-Term Rating	S&P's Long-Term Rating	S&P's Short-Term Rating	<u>Maximum Deposit</u> <u>£m</u>	<u>Maximum Duration</u>
AAA	F1+	Aaa	P-1	AAA	A-1+	120	2 Years
AA+	F1+	Aa1	P-1	AA+	A-1+	100	2 Years
AA	F1+	Aa2	P-1	AA	A-1+	80	2 Years
AA-	F1+	Aa3	P-1	AA-	A-1+	75	2 Years
A+	F1+	A1	P-1	A+	A-1	70	365 days
A+	F1	A1	P-1	A+	A-1	70	365 days
A	F1	A2	P-1	A	A-1	65	365 days
A-	F1	A3	P-1	A-	A-1	50	365 days
A-	F2	A3	P-2	A-	A-2	50	365 days
Local Authorities (limit for each local authority)						30	2 years
UK Government (including debt management office, gilts and treasury bills)						300	2 years
Money Market Funds (CNAV, LVNAV and VNAV) Maximum amount to be invested in Money Market Funds is £250m with a maximum of £50m in any one fund.						250	Liquid Deposits
Local Authority controlled companies						40	20 years

Where the UK Government holds a shareholding in an institution the UK Government's credit rating of AA- will be applied to that institution to determine the amount the Council can place with that institution for a maximum period of 2 years.

The Code of Practice for Treasury Management in the Public Services recommends that consideration should also be given to country, sector, and group limits in addition to the individual limits set out above; these new limits are as follows:

Appendix B (continued)

Country Limit

It is proposed that only non-UK countries with a minimum sovereign credit rating of AA+ by all three rating agencies will be considered for inclusion on the Approved Lending List.

It is also proposed to set a total limit of £50m which can be invested in other countries provided they meet the above criteria. A separate limit of £300m will be applied to the United Kingdom and is based on the fact that the government has done and is willing to take action to protect the UK banking system.

Country	Limit £m
UK	300
Non-UK	50

Sector Limit

The Code recommends a limit be set for each sector in which the Council can place investments. These limits are set out below:

Sector	Limit £m
Central Government	300
Local Government	300
UK Banks	300
Money Market Funds	250
UK Building Societies	100
Foreign Banks	50

Group Limit

Where institutions are part of a group of companies e.g. Lloyds Banking Group, Santander and RBS, the total limit of investments that can be placed with that group of companies will be determined by the highest credit rating of a counterparty within that group, unless the government rating has been applied. This will apply provided that:

- the UK continues to have a sovereign credit rating of AA-; and
- that market intelligence and professional advice is taken into account.

Proposed group limits are set out in Appendix C.

Approved Lending List

Appendix C

	Fitch		Moody's		Standard & Poor's			
	L Term	S Term	L Term	S Term	L Term	S Term	Limit £m	Max Deposit Period
UK	AA-		Aa3		AA		300	
Lloyds Banking Group							Group Limit 70	
Lloyds Bank Plc (RFB)	A+	F1	A1	P-1	A+	A-1	70	365 days
Lloyds Bank Corporate Markets plc (NRFB)	A+	F1	A1	P-1	A	A-1	65	365 days
Bank of Scotland Plc (RFB)	A+	F1	A1	P-1	A+	A-1	70	365 days
Royal Bank of Scotland Group (See Note 1)							Group Limit 75	
The Royal Bank of Scotland Plc (RFB)	A+	F1	A1	P-1	A	A-1	75	2 years
National Westminster Bank Plc (RFB)	A+	F1	A1	P-1	A	A-1	75	2 years
NatWest Markets plc (NRFB)	A+	F1	A1	P-1	A-	A-2	75	2 years
Santander UK plc	A+	F1	A1	P-1	A	A-1	65	365 days
Barclays Bank plc (NRFB)	A+	F1	A1	P-1	A	A-1	65	365 days
Barclays Bank plc (RFB)	A+	F1	A1	P-1	A	A-1	65	365 days
Clydesdale Bank */**	A-	F2	A3	P-2	A-	A-2	50	365 days
Co-Operative Bank Plc **	B+	B	Ba1	NP	-	-	0	
Goldman Sachs International Bank	A+	F1	A1	P-1	A+	A-1	70	365 days
HSBC Bank plc (NRFB)	AA-	F1+	A1	P-1	A+	A-1	70	365 days
HSBC UK Bank plc (RFB)	AA-	F1+	A1	P-1	A+	A-1	70	365 days
Nationwide BS	A	F1	A1	P-1	A+	A-1	65	365 days
Standard Chartered Bank	A+	F1	A1	P-1	A+	A-1	70	365 days
Close Brothers Ltd	A-	F2	Aa3	P-1	-	-	50	365 days
SMBC Bank International Ltd	A-	F1	A1	P-1	A	A-1	50	365 days
Top Building Societies (by asset value)								

	Fitch		Moody's		Standard & Poor's			
	L Term	S Term	L Term	S Term	L Term	S Term	Limit £m	Max Deposit Period
Nationwide BS (see above)								
Coventry BS	A-	F1	A2	P-1			50	365 days
Leeds BS	A-	F1	A3	P-2	-	-	50	365 days
Principality BS **	BBB+	F2	Baa2	P-2	-	-	0	
Skipton BS	A-	F1	A2	P-1	-	-	50	365 days
West Bromwich BS **			Ba3	NP	-	-	0	
Yorkshire BS	A-	F1	A3	P-2	-	-	50	365 days
Money Market Funds							250	Liquid
Prime Rate Stirling Liquidity	AAA		AAA		AAA		50	Liquid
Insight Liquidity Fund	AAA		-		AAA		50	Liquid
Aberdeen Liquidity Fund (Lux)	AAA				AAA		50	Liquid
Deutsche Managed Sterling Fund			Aaa		AAA		50	Liquid
Foreign Banks have a combined total limit of £50m								
Australia	AAA		Aaa		AAA		50	
Australia and New Zealand Banking Group Ltd	A+	F1	Aa3	P-1	AA-	A-1+	50	365 days
Commonwealth Bank of Australia	A+	F1	Aa3	P-1	AA-	A-1+	50	365 days
National Australia Bank	A+	F1	Aa3	P-1	AA-	A-1+	50	365 days
Westpac Banking Corporation	A+	F1	Aa3	P-1	AA-	A-1+	50	365 days
Canada	AA+		Aaa		AAA		50	
Bank of Nova Scotia	AA-	F1+	Aa2	P-1	A+	A-1	50	365 days
Royal Bank of Canada	AA-	F1+	Aa1	P-1	AA-	A-1+	50	2 years
Toronto Dominion Bank	AA-	F1+	Aa1	P-1	AA-	A-1+	50	2 years
Denmark	AAA		Aaa		AAA		50	
Danske A/S	A	F1	A2	P-1	A+	A-1	50	365 days
Finland	AA+		Aa1		AA+		50	
OP Corporate Bank plc	WD	WD	Aa3	P-1	AA-	A-1+	50	2 years
Germany	AAA		Aaa		AAA		50	
DZ Bank AG (Deutsche Zentral-Genossenschaftsbank)	AA-	F1+	Aa2	P-1	A+	A-1	50	365 days
Landwirtschaftliche Rentenbank	AAA	F1+	Aaa	P-1	AAA	A-1+	50	2 years

	Fitch		Moody's		Standard & Poor's			
	L Term	S Term	L Term	S Term	L Term	S Term	Limit £m	Max Deposit Period
NRW Bank	AAA	F1+	Aa1	P-1	AA	A-1+	50	2 years
Netherlands	AAA		Aaa		AAA		50	
Bank Nederlandse Gemeenten	AAA	F1+	Aaa	P-1	AAA	A-1+	50	2 years
Cooperatieve Rabobank U.A.	A+	F1	Aa2	P-1	A+	A-1	50	365 days
Nederlandse Waterschapsbank NV			Aaa	P-1	AAA	A-1+	50	2 years
Singapore	AAA		Aaa		AAA		50	
DBS Bank Ltd	AA-	F1+	Aa1	P-1	AA-	A-1+	50	2 years
Oversea Chinese Banking Corporation Ltd	AA-	F1+	Aa1	P-1	AA-	A-1+	50	2 years
United Overseas Bank Ltd	AA-	F1+	Aa1	P-1	AA-	A-1+	50	2 years
Sweden	AAA		Aaa		AAA		50	
Svenska Handelsbanken AB	AA	F1+	Aa2	P-1	AA-	A-1+	50	2 years
Switzerland	AAA		Aaa		AAA		50	
Credit Suisse AG	BBB+	F2	A3	P-2	A-	A-	0	
UBS AG	AA-	F1+	Aa2	P-1	A+	A-1	50	365 days
USA	AAA		Aaa		AA+		50	
Bank of New York Mellon	AA	F1+	Aa1	P-1	AA-	A-1+	50	2 years
JP Morgan Chase Bank NA	AA	F1+	Aa1	P-1	A+	A-1	50	365 days
Wells Fargo Bank NA	AA-	F1+	Aa1	P-1	A+	A-1	50	365 days

Note 1 Nationalised / Part Nationalised

The counterparties in this section will have the UK Government's AA- rating applied to them thus giving them a credit limit of £75m.

*/** The Clydesdale Bank (under the UK section) is owned by National Australia Bank

** These will be revisited and used only if they meet the minimum criteria (ratings of A- and above)

Any bank which is incorporated in the United Kingdom and controlled by the Prudential Regulation Authority (PRA) is classed as a UK bank for the purposes of the Approved Lending List.

