OPEN REPORT
GOVERNANCE AND RESOURCES COMMITTEE

Governance and Resources Committee – 15 February 2024

TREASURY MANAGEMENT MID-YEAR REPORT 2023/24

Report of the Director of Resources

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Wards Affected
All

Report Summary

This report summarises treasury management activities for the first six months of 2023/24 and seeks approval for the Treasury Management Mid-Year report for 2023/24.

Recommendations

That the Treasury Management Mid-Year Report for 2023/24 be received and approved.

List of Appendices

None

Background Papers
None

Consideration of report by Council or other committee
No

Council Approval Required
No

Exempt from Press or Public
No

Treasury Management Mid-Year Report 2023/24

1. Background

1.1 The Council has long adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Authority to approve, as a minimum, treasury management semi-annual and annual outturn reports.

1.2 This report includes the new requirement in the 2021 Code, mandatory from 1st April 2023, of quarterly reporting of the treasury management prudential indicators. The results from the first two quarters of 2023/24 are reported in this report. The non-treasury prudential indicators are incorporated in the Authority's capital monitoring report.

1.3 The Authority's treasury management strategy for 2023/24 was approved at a meeting on 2nd March 2023. The Council invests substantial sums of money and is therefore exposed to financial risks including the potential loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Authority's treasury management strategy.

2. External Context

2.1 UK inflation remained stubbornly high over much of the reporting period compared to the US and euro zone, keeping expectations elevated of how much further the Bank of England (BoE) would hike rates compared to the regions. However, inflation data published in the latter part of the period undershot expectations, causing financial markets to reassess the peak in the BoE Base Rate. This was followed very soon after by the BoE deciding to keep Base Rate on hold at 5.25% in September, against expectation for another 0.25% rise.

2.2 Economic growth in the UK remained relatively weak over the period. In calendar Q2 2023, the economy expanded by 0.4%, beating expectations of a 0.2% increase. However, monthly GDP data showed a 0.5% contraction in July, the largest fall to date in 2023 and worse than the 0.2% decline predicted which could be an indication the monetary tightening cycle is starting to cause recessionary or at the very least stagnating economic conditions.

2.3 July data showed the unemployment rate increased to 4.3% (3mth/year) while the employment rate rose to 75.5%. Pay growth was 8.5% for total pay (including bonuses) and 7.8% for regular pay, which for the latter was the highest recorded annual growth rate. Adjusting for inflation, pay growth in real terms were positive at 1.2% and 0.6% for total pay and regular pay respectively.

2.4 Inflation continued to fall from its peak as annual headline CPI declined to 6.7% in July 2023 from 6.8% in the previous month against expectations for a tick back up to 7.0%. The largest downward contribution came from food prices. The core rate also surprised on the downside, falling to 6.2% from 6.9% compared to predictions for it to only edge down to 6.8%.

2.5 The Bank of England's Monetary Policy Committee continued tightening monetary policy over most of the period, taking Bank Rate to 5.25% in August. Against expectations of a further hike in September, the Committee voted 5-4 to maintain Bank Rate at 5.25%. Each of the four dissenters were in favour of another 0.25% increase.

2.6 Financial market Bank Rate expectations moderated over the period as falling inflation and weakening data gave some indication that higher interest rates were working. Expectations fell from predicting a peak of over 6% in June to 5.5% just ahead of the September MPC meeting, and to then expecting 5.25% to be the peak by the end of the period.

2.7 Following the September MPC meeting, Arlingclose, the authority's treasury adviser, modestly revised its interest forecast to reflect the central view that 5.25% will now be the peak in Bank Rate. In the short term the risks are to the upside if inflation increases again, but over the remaining part of the time horizon the risks are to the downside from economic activity weakening more than expected.

2.8 GDP growth remains weak, with recent data showing the region expanded by only 0.1% in the three months to June 2023, the rate as the previous quarter.

3. Financial Markets

3.1 Financial market sentiment and bond yields remained volatile, with the latter generally trending downwards as there were signs inflation, while still high, was moderating and interest rates were at a peak.

3.2 Gilt yields fell towards the end of the period. The 5-year UK benchmark gilt yield rose from 3.30% to peak at 4.91% in July before trending downwards to 4.29%, the 10-year gilt yield rose from 3.43% to 4.75% in August before declining to 4.45%, and the 20-year yield from 3.75% to 4.97% in August and then fell back to 4.84%. The Sterling Overnight Rate (SONIA) averaged 4.73% over the period.

4. Credit Review

4.1 Having completed a review of its credit advice on unsecured deposits at UK and non-UK banks following concerns of a wider financial crisis after the collapse of Silicon Valley Bank purchase of Credit Suisse by UBS, as well as other well-publicised banking sector issues, in March Arlingclose reduced the advised maximum duration limit for all banks on its recommended counterparty list to 35 days. This stance continued to be maintained at the end of the period.

4.2 During the second quarter of the period, Moody's revised the outlook on Svenska Handelsbanken to negative from stable, citing concerns around the Swedish real estate sector.

4.3 Having put the US sovereign rating on Rating Watch Negative earlier in the period, Fitch took further action in August, downgrading the long-term rating to AA+, partly around ongoing debt ceiling concerns but also an expected fiscal deterioration over the next couple of years.

4.4 Following the issue of a Section 114 notice, in September Arlingclose advised against undertaking new lending to Birmingham City Council, and later in the month cut its recommended duration for Warrington Borough Council to a maximum of 100 days.

4.5 Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress and although no changes were made to recommended durations over the period, Northern Trust Corporation was added to the counterparty list.

4.6 Heightened 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.

5. Local Context

5.1 On 31st March 2023 the Authority had net investments of £22.4m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.03.23 Actual £000
General Fund CFR	5,690
External Borrowing	(5,450)
Internal (over) borrowing	**240**
Usable reserves	25,527
Working capital	(3,122)
Net Investments	**22,405**

5.2 The treasury management position at 31st March and the change over the six months' is shown in table 2 below.

Table 2: Treasury Management Summary

	31.3.23 Balance £000	Movement £000	30.9.23 Balance £000	30.9.23 Rate % (Total return)
Total borrowing	(5,450)	0	(5,450)	4.1
Long-term investments*	875	4	879	
Short-term investments	2,000	7,000	9,000	
Cash and cash equivalents	19,530	148	19,678	
Total investments	22,405	7,152	29,557	4.67
Net Investments	**16,955**	**7,152**	**24,107**	

*The Long-term investment refers to the £1 million invested in the CCLA property Investment fund. The figure above represents the current capital value of this fund.

6. Borrowing

6.1 CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement and so may lead to new borrowing, unless directly and primarily related to the functions of the Authority. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield unless these loans are for refinancing purposes.

6.2 The Council has not invested in assets primarily for financial return or that are not primarily related to the functions of the Authority. It has no plans to do so in future. As outlined in the treasury management strategy, the Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing lower interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective. The Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

6.3 There has been a substantial rise in the cost of both short- and long-term borrowing over the last 18 months. Bank Rate rose by 1% from 4.25% at the beginning of April to 5.25% at the end of September. Bank Rate was 2% higher than at the end of September 2022.

6.4 UK gilt yields were volatile, mainly facing upward pressure since early April following signs that UK growth had been more resilient, inflation stickier than expected, and that the Bank of England saw persistently higher rates through 2023/24 as key to dampening domestic demand. Gilt yields, and consequently PWLB borrowing rates, rose and broadly remained at elevated levels. On 30th September, the PWLB certainty rates for maturity loans were 5.26% for 10-year loans, 5.64% for 20-year loans and 5.43% for 50-year loans. Their equivalents on 31st March 2023 were 4.33%, 4.70% and 4.41% respectively.]

6.5 At 30th September 2023 the Authority held a PWLB Loan of £5,450,000 (the same position as at 31st March 2023), as part of its strategy for funding previous years' capital programmes.

7. Treasury Investment Activity

7.1 The CIPFA Treasury Management Code now defines treasury management investments as those investments which arise from the Authority's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

7.2 The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the half year to 30 September 2023, the Authority's investment balances ranged between £18.274 and £29.826 million due to timing differences between income and expenditure. The investment position at 30th September 2023 is shown in table 3 below.

Table 3: Treasury Investment Position

Investment Held	31.03.2023 Balance £'000	Movement in year £'000	30.09.2023 Balance £'000	30.09.23 Income Return %	31.03.23 Weighted Average Maturity Days
Banks & Building Societies	130	-35	95		
Central Government	4,000	6,321	10,321		
Local Authorities	5,000	10,000	15,000		
Money Market Funds	12,400	-9,138	3,262		
CCLA Property Fund	875	4	879		
Total Investments	**22,405**	**7,152**	**29,557**	**5.20**	***59**

**Weighted average days to maturity across the portfolio. Money Market Funds and the Council's operational bank accounts are held for immediate access.*

7.3 Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

7.4 As demonstrated by the liability benchmark in part 11 of this report, the Authority expects to be a long-term investor and treasury investments therefore include both short-term low risk instruments to manage day-to-day cash flows and longer-term instruments where limited additional risk is accepted in return for higher investment income to support local public services.

7.5 Bank Rate increased by 1%, from 4.25% at the beginning of April to 5.25% by the end of September. Short-dated cash rates rose commensurately, with 3-month rates rising to around 5.25% and 12-month rates to nearly 6%. The rates on Debt Management Account Deposit Facility (DMADF) deposits also rose, ranging between 4.8% and 5.4% by the end of June and Money Market Rates between 4.6% and 4.9%.

7.6 £1m was invested in The CCLA Property fund on 30th September 2018 this was set aside for longer-term investment and is invested in externally managed strategic pooled property funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long term-price stability. These funds generated receipts of £40,784 (3.62% return) in 2022/23. Income returns remained broadly consistent at 3.87%. The Authority has budgeted £31,000 income from these investments in 2023/24. Income received up to 30th September was £21,897. The capital value at 30th September has increased slightly to £879,075 from £875,466 at 31st March 2023, but this still represents a capital loss to date of £120,925.

7.7 In April 2023 the Department for Levelling Up, Housing and Communities published the full outcome of the consultation on the extension of the statutory override on accounting for gains and losses on pooled investment funds. The override has been extended for two years until 31st March 2025, but no other changes have been made; whether the override will be extended beyond the new date is unknown but commentary to the consultation outcome suggests not. The Authority will discuss with Arlingclose the implications for the investment strategy and what action may need to be taken.

7.8 The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 4 below.

Table 4: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure*	Weighted Average Maturity (days)	Rate of Return %
31.03.2023	4.71	A+	58%	21	4.04
30.09.2023	4.37	AA-	12%	59	5.20
Similar LAs	4.43	AA-	56%	63	4.71
All LAs	4.47	AA-	59%	13	4.79

* Bail-in is one of the stabilisation tools available to the Bank of England as resolution authority under the Banking Act 2009. Bail-in ensures investors, rather than public funds, bear losses where a firm fails. Therefore, a higher bail-in exposure reflects a higher financial risk.

8. Non-Treasury Investments

8.1 The definition of investments in the Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).

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

8.3 The Authority held £1.65m of such investments in directly owned property. These investments generated £0.1m of investment income in 2022-23 for the Council after taking account of direct costs, representing a rate of return of 6.17%. This is higher than the return earned on treasury investments but reflects the additional risks to the authority of holding such investments. The actual rate of return for 2023-24 is expected to be similar and will be reported in the Treasury Out-turn report.

9. Treasury Performance

9.1 Table 5 below shows interest received at 30th September 2023 compared to the budget.

Table 5 Interest Received

Type Of Investment	Actual Interest 30.09.23 £'000	Profiled Budget 30.09.23 £'000	(Under)/Over 30.09.23 £'000	Forecast Out Turn predicted 31.03.24 £'000
Long Term Investment				
CCLA Property Fund	**22**	**16**	**6**	
Instant Access:				
Money Market Funds	138	102	36	
Lloyds bank Account	0	0	0	
Total Interest on Cash available immediately	**138**	**102**	**36**	
Fixed Term Investments:		0		
Debt Management Office	104	0		
UK Treasury Gilts	43			
Local Authorities	233			
Total Interest Earned on Fixed Term Investments	**380**	**2**	**378**	
Total Interest at 30th September	**540**	**1**	**420**	**1,250**

10. Compliance

10.1 The Director of Resources reports that all treasury management activities undertaken during the quarter complied fully with the principles in the Treasury Management Code and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 6 below.

Table 6: Investment Limits

	2023/24 Max £'000	**30.09.23 Actual £'000**	**2023/24 Limit £'000**	**Complied?**
Banks Unsecured per bank (£2m per counterparty)	127	56	2,000	✓

Banks – Council's Own banker (Lloyds)	296	38	7,000	✓
Local Authorities per Authority Maximum amount in the period in total	4,000 per Authority 17,000 invested in total	4,000 per Authority 6,000 invested in total	4,000 per Authority	✓
Money Market Funds (per fund) Maximum amount in the period in total	4,000 per fund 12,400	 3,262	4,000 per fund	✓
UK Government	10,321	10,321	Unlimited	✓
Pooled Funds	879	879	4,000	✓

10.2 Compliance with the Authorised Limit and Operational Boundary for external debt is demonstrated in table 7 below.

Table 7: Debt and the Authorised Limit and Operational Boundary

	H1 2023/24 Maximum £ '000	**30.9.23 Actual £ '000**	**2023/24 Operational Boundary £ '000**	**2023/24 Authorised Limit £ '000**	**Complied?**
Borrowing	5,450	5,450	9,000	12,000	✓

11. Treasury Management Prudential Indicators

11.1 Table 5 above shows interest received at 30th September 2023 compared to the budget.

11.2 As required by the 2021 CIPFA Treasury Management Code, the Authority monitors and measures the following treasury management prudential indicators.

11.3 **The Liability Benchmark**

This new indicator compares the Authority's actual existing borrowing against a liability benchmark that has been calculated to show the lowest risk level of borrowing. The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. It represents an estimate of the cumulative amount of external borrowing the Council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level of £7m required to manage day-to-day cash flow.

	31.03.23 Actual £'000	31.03.24 Forecast £'000	31.03.25 Forecast £'000	31.03.26 Forecast £'000
Capital Financing Requirement	5,700	5,600	5,500	5,500
External Borrowing	(5,500)	(5,500)	(5,500)	(5,500)
Internal/(over) Borrowing	**200**	**100**	**0**	**0**
Balance Sheet Resources (Reserves)	(22,800)	(11,200)	(10,700)	(10,800)
Investments	22,600	11,100	10,700	10,800
New Borrowing	**0.0**	**0.0**	**0.0**	**0.0**
Net Loan Requirement	(17,100)	(5,600)	(5,200)	(5,400)
Liquidity Allowance	7,000	7,000	7,000	7,000
Liability Benchmark	**(10,100)**	**1,400**	**1,800**	**1,600**

11.4 For 2023/24 the liability benchmark shows a net loan requirement of £5.6 million. This is the forecast level of net borrowing, calculated as treasury investment minus external borrowing. As this is a positive cash flow, this shows that the Council has sufficient funds available and has not needed to borrow to fund its capital programme.

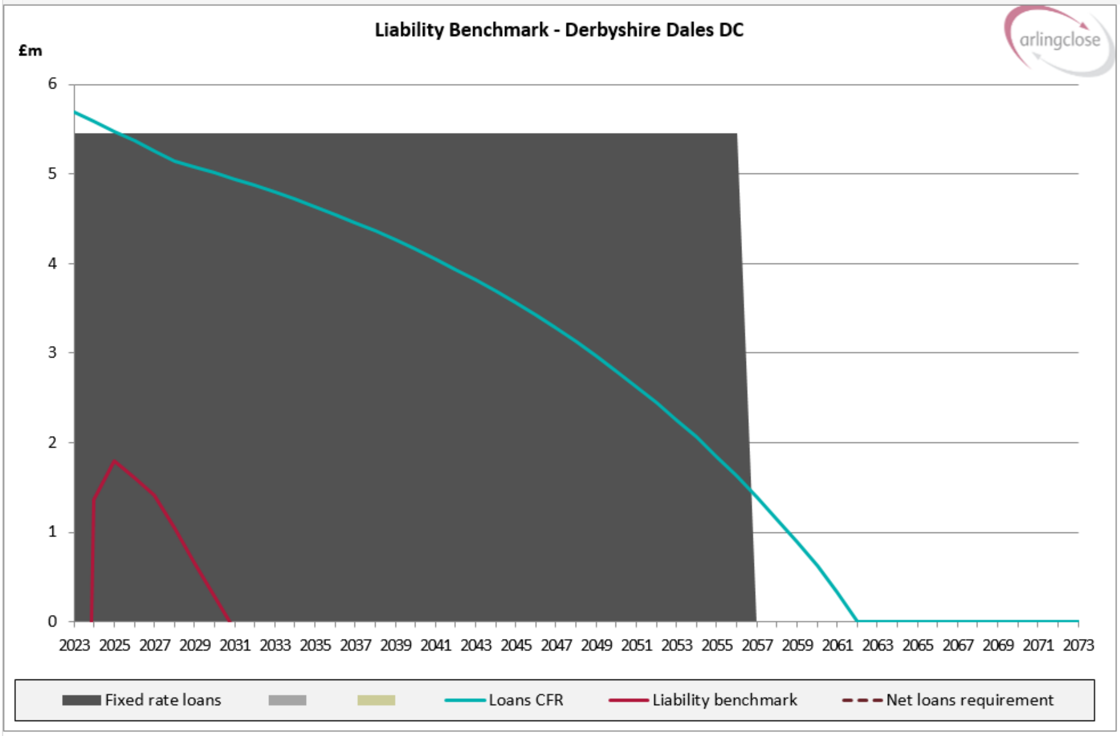
11.5 The Liquidity Allowance is an estimate of the minimum level of short-term investments needed to provide an adequate, but not excessive level of liquidity for daily cashflow management.

11.6 The Liability Benchmark represents the lowest risk level of borrowing considering credit, liquidity, and market risks. For 2023/24 this shows a negative benchmark of £1.4 million and shows that the council has net investments. As can be seen in the table above, for future years the Council has a positive net loan requirement of circa £5m, this is after allowing for a fully funded capital programme.

11.7 The benchmark assumes that reserves will decrease and that no further capital grants and receipts will be received other than those identified in the Capital programme reported to Members on 14th December 2023.It also assumes that Creditors, Debtors and Provisions will increase by 2.5%. each year.

11.8 Taking into account the liquidity allowance of £7m, the lowest risk level of borrowing is circa £1.4m – £1.8m. The benchmark is just that and it will change over time and therefore acts as a guide only.

11.9 The Liability benchmark continues to reduce as the CFR reduces and further cash is available for investment until 2056 when the debt is repaid.



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

	Upper Limit	**Lower Limit**	**30.09.23 Actual**	**Complied?**
Under 12 months	35%	0%	0%	✓
12 months and within 24 months	50%	0%	0%	✓
24 months and within 5 years	65%	0%	0%	✓
5 years and within 10 years	80%	0%	0%	✓
10 years and above	100%	100%	100	✓

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

11.11 Long-term Treasury Management Investments

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 prudential limits on the long-term treasury management limits are:

	2023/24 £'000	**2024/25 £'000**	**2025/26 £'000**

Limit on principal invested beyond year end	5,000	5,000	5,000
Actual principal invested beyond year end	1,000	1,000	1,000
Complied?	✓	✓	✓

11.12 Long-term investments with no fixed maturity date include strategic pooled funds, real estate investment trusts and directly held equity but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

Additional Indicators

11.13 Security - The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio.

	2023/24 Target	**30.09.23 Actual**	**Complied?**
Portfolio average credit rating	A	AA-	✓

11.14 Liquidity - The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount.

	30.9.23 Actual £'000	**2023/24 Target £'000**	**Complied?**
Total cash available within 3 months	19,678	7,000	✓

11.15 Interest Rate Exposures This indicator is set to control the Authority's exposure to interest rate risk. Bank Rate rose by 1.25% from 4.25% on 1st April to 5.25% by 30th September. This indicator has been calculated based on the Council's variable rate investments at 30th September 2023.

Interest rate risk indicator	**2023/24 Target £'000**	**30.09.23 Actual £'000**	**Complied?**
Upper limit on one-year revenue impact of a 1% rise in interest rates	400	42	✓
Upper limit on one-year revenue impact of a 1% fall in interest rates	400	(42)	✓

12. Policy Implications

12.1 This is a compliance report in respect of Treasury Management policy and the Treasury Management Strategy that was approved in March 2023.

13. Financial and Resource Implications

13.1 Financial Information is contained within the report.

13.2 The budget for investment income in the first half-year to 30th September 2023 is £118,500. Actual Investment income earnt for the period is £538,885. The Council has generated £420,385 more in investment income than budgeted in the half-year. This is due to more focussed treasury management and interest rates being higher than expected during 2023/24.

13.3 The forecast out-turn for 2023/24 is £1.2m, which is £963,000 more than in the budget that was set in March 2023.

13.4 The overall risk associated with this report's recommendations is assessed as low.

14. Legal Advice and Implications

14.1 This report summarises treasury management activities for the first six months of 2023/24 and seeks approval for the Treasury Management Mid-Year report for 2023/24.

14.2 The report complies with best practice and government guidance on the preparation of the treasury management strategy statement.

14.3 The Legal risk connected to the decision making contained in this report has been assessed as low.

15. Equalities Implications

15.1 None

16. Climate Change Implications

16.1 No detailed climate change impact assessment is required. However, it is acknowledged that environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing. Therefore, the Council's Treasury Management Strategy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level.

17. Risk Management

16.2 This strategy sets in place a proposed structure and systems that place security of investments above yield. The risk is therefore assessed as low.

Report Authorisation

Approvals obtained from:-

	Named Officer	**Date**
Chief Executive	Paul Wilson	05/02/2024
Director of Resources/ S.151 Officer (or Financial Services Manager)	Karen Henriksen	07/02/2024
Monitoring Officer (or Legal Services Manager)	Helen Mitchell	7/2/2024