Appendix A

Treasury Management Mid-Year Report 2023/24

Introduction

In December 2017 the Authority 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 council to approve, as a minimum, treasury management semi-annual and annual outturn reports.

This report includes the new requirement in the 2021 Code, mandatory from 1st April 2023, of quarterly reporting of the treasury management prudential indicators, which will commence in quarter 3. The non-treasury prudential indicators are incorporated in the Authority's normal quarterly revenue and capital monitoring report.

The Authority's treasury management strategy for 2023/24 was approved at a meeting on 23rd February 2023. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the 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.

External Context

Economic background: UK inflation remained stubbornly high over much the 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 BoE Bank Rate. This was followed very soon after by the BoE deciding to keep Bank Rate on hold at 5.25% in September, against expectation for another 0.25% rise.

Economic growth in the UK remained relatively weak over the period. In calendar Q2 2023, the economy expanded by 0.2%. 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.

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.

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%.

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.

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.

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.

The lagged effect of monetary policy together with the staggered fixed term mortgage maturities over the next 12-24 months means the full impact from Bank Rate rises are still yet to be felt by households. As such, while consumer confidence continued to improve over the period, the GfK measure hit -21 in September, it is likely this will reverse at some point. Higher rates will also impact business and according to S&P/CIPS survey data, the UK manufacturing and services sector contracted during the quarter with all measures scoring under 50, indicating contraction in the sectors.

The US Federal Reserve increased its key interest rate to 5.25-5.50% over the period, pausing in September following a 0.25% rise the month before, and indicating that it may have not quite completed its monetary tightening cycle.

Having fallen throughout 2023, annual US inflation started to pick up again in July 2023, rising from 3% in June, which represented the lowest level since March 2021, to 3.2% in July and then jumping again to 3.7% in August, beating expectations for a rise to 3.6%. Rising oil prices were the main cause of the increase. US GDP growth registered 2.1% annualised in the second calendar quarter of 2023, down from the initial estimate of 2.4% but above the 2% expansion seen in the first quarter.

The European Central Bank increased its key deposit, main refinancing, and marginal lending interest rates to 4.00%, 4.50% and 4.75% respectively in September, and hinted these levels may represent the peak in rates but also emphasising rates would stay high for as long as required to bring inflation down to target.

Although continuing to decline steadily, inflation has been sticky, Eurozone annual headline CPI fell to 5.2% in August while annual core inflation eased to 5.3% having stuck at 5.5% in the previous two months. 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.

Financial markets: 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.

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.

Credit review: 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.

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.

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.

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 on Warrington Borough Council to a maximum of 100 days.

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.

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.

<u>Local Context</u>

On 31st March 2023, the Authority had net borrowing of £208.8m 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

	31.3.23 Actual £m
General Fund CFR	96.8
HRA CFR	205.5
Total CFR	**302.3**
Less: *Other debt liabilities	1.3
Borrowing CFR	**301.0**
External borrowing**	(233.8)
Internal (over) borrowing	67.2
Less: Balance sheet resources	85.1
Investments	25
Net borrowing	**(208.8)**

* finance leases, PFI liabilities and transferred debt that form part of the Authority's total debt

** shows only loans to which the Authority is committed and excludes optional refinancing

The treasury management position at 30th September and the change over the six months' is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.23 Balance £m	Movement £m	30.9.23 Balance £m	30.9.23 Rate
Long-term borrowing Short-term borrowing	(211.8) (22.0)	- 11.0	(211.8) (11.0)	(3.3%) (4.6%)
Total borrowing	**(233.8)**	**11.0**	**(222.8)**	**(4%)**
Long-term investments Cash and cash equivalents	3.9 21.1	- 5.6	3.9 26.7	22%* 4.7%
Total investments	**25**	**5.6**	**30.6**	**4.5%**
Net borrowing	**(208.8)**	**16.6**	**(192.2)**	

* The return for long term investments is total return for the Council's investment in a property fund which was unusually high due to increasing property prices. These returns would not be expected to occur in the long term. Income returns were 4.3% which is a more accurate view as to long term returns.

Borrowing

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.

The Authority 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.

Borrowing strategy and activity

As outlined in the treasury 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.

There was 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.

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.

A new PWLB HRA rate which is 0.4% below the certainty rate was made available from 15th June 2023. Initially available for a period of one year which has now been extended to June 2025, this discounted rate is to support local authorities borrowing for the Housing Revenue Account and for refinancing existing HRA loans, providing a window of opportunity for HRA-related borrowing and to replace the Authority's £41.7m loans relating to the HRA maturing in March 2026.

At 30th September the Authority held £211.8m of loans from the PWLB, the same figure held as at 31st March 2023, as part of its strategy for funding previous years' capital programmes.
These had a weighted average interest rate of 3.3% and a weighted average maturity of 11 years. The loans individually have maturities of between 3 and 25 years. As at 30th September, the Council held £11m of short-term loans from other Local Authorities, a decrease on the figure held at 31st March 2023 which was £22m. These had a weighted average interest rate of 4.6%.

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Outstanding loans on 30th September are summarised in Table 3A below.

Table 3A: Borrowing Position

	31.3.23 Balance £m	Net Movement £m	30.9.23 Balance £m	30.9.23 Weighted Average Rate %	30.9.23 Weighted Average Maturity (years)
Public Works Loan Board	(211.8)	-	(211.8)	(3.3%)	11
Banks (LOBO)					
Banks (fixed-term)					
Local authorities (long-term)					
Local authorities (short-term)	(22.0)	11.0	(11.0)	(4.6%)	N/A
Total borrowing	**(233.8)**	**11.0**	**(222.8)**	**(4%)**	

In the near future the Council plans to undertake any new borrowing required on a short term, variable rate basis to avoid locking in the current high interest rate for an extended period. If interest rates fall as is expected in the next 18-24 months' the Council will look to gain more certainty over future interest rates by borrowing on a longer-term basis.

Table 3B: Long-dated Loans borrowed *(if applicable to your borrowing activity)*

	Amount £m	Rate %	Period Remaining (Years)
PWLB Maturity Loan 1 (PW494496)	(3)	(4.5%)	25
PWLB Maturity Loan 2 (PW500037)	(41.8)	(3.5%)	19
PWLB Maturity Loan 3 (PW500038)	(41.8)	(3.5%)	15
PWLB Maturity Loan 4 (PW500039)	(41.8)	(3.2%)	7
PWLB Maturity Loan 5 (PW500040)	(41.7)	(3.4%)	11
PWLB Maturity Loan 6 (PW500041)	(41.7)	(2.9%)	3
Total borrowing	**(211.8)**	**(3.3%)**	

The Authority's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short-term and long-term borrowing was maintained.

There remains a strong argument for diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields + 0.80%. The Authority will evaluate and pursue these lower cost solutions and opportunities with its advisor Arlingclose.

The UK Infrastructure Bank is one alternative source of funding which offers funding at gilt yields + 0.40% (0.40% below the PWLB certainty rate) and the possibility of more flexible funding structures than the PWLB. Funding from UKIB is generally only available for certain types of projects that meet its criteria of green energy, transport, digital, water and waste. The minimum loan size is £5 million.

Loans restructuring: The continuing rise in gilt yields since early 2022 resulted in some of the Authority's PWLB loans being in or close to a discount position if repaid early. However, as the prepaid loans would need to be replaced by new loans at higher interest rates, this isn't a cost-effective option for the Authority.

Other Debt Activity

Although not classed as borrowing, the Council also owned vehicles that were funded via a finance lease as at 30th September. The outstanding liability for these vehicles calculated at the most recent year end figure of 31st March 2023 was £1.3m.

Treasury Investment Activity

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.

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the half year, the Authority's investment balances ranged between £18.6 million and £46.7 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.23 Balance £m	Net Movement £m	30.9.23 Balance £m	30.9.23 Income Return	30.9.23 Weighted Average Maturity days
Banks & building societies (unsecured)	2.7	(1.6)	1.1	5.0%	1
Government (incl. local authorities)	8.4	(2.8)	5.6	N/A	N/A
Money Market Funds	10.0	10.0	20.0	5.2%	1
Cash Plus Fund	2.0	-	2.0	4.4%	N/A
Property Fund	1.9	-	1.9	4.9%	N/A*
Total investments	**25.0**	**5.6**	**30.6**	**4.9%**	

** The Council's property fund does not have a set period to maturity. Cash can be redeemed on request after a notice period is given. It is considered a long-term investment as there is price risk associated with needing to make a withdrawal at short notice.*

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.

As demonstrated by the liability benchmark in this report, the Authority expects to be a long-term borrower and new treasury investments are therefore primarily made to manage day-to-day cash flows using short-term low risk instruments. The existing portfolio of strategic pooled funds will be maintained to diversify risk into different asset classes and boost investment income.

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 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%.

The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below.

Table 5: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return

31.03.2023 30.09.2023	4.48 4.44	AA- AA-	60% 79%	4 1	3.71% 5.01%
Similar LAs **All LAs** **(as at 31.03.2023)**	**4.74** **4.71**	**A+** **A+**	**63%** **59%**	**56** **12**	**3.55%** **3.66%**

Externally Managed Pooled Funds: £3.9m of the Authority's investments is invested in externally managed funds comprising £1.9m in a strategic pooled property fund and £2m in a cash plus bond fund. The short-term security and liquidity of these funds are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds generated an average total return of £86,895 (4.65%) for the period 01 April 2023 to 30 September 2023, comprising a £73,219 income return which is used to support services in year, and £13,676 of unrealised capital loss.

Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's medium- to long-term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year minimum period total returns will exceed cash interest rates.

Statutory override: 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.

Non-Treasury Investments

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).

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

The Council held £1.8m of investments made for services purposes. This included £1.3 m of loans made to wholly owned subsidiaries HTS (Property and Environment) Ltd, HTS (Housing and Property) Ltd and Harlow Property Ltd as at 30th September 2023. A

decision was made by the shareholder subcommittee in November that the properties are due to be sold on the open market in 2024/25 and loans repaid in full to the council.
The investments also include an equity investment of £0.45m as at 30th September 2023 in HTS (Housing & Property) Ltd.

The Council held £23.6m of investments made for commercial purposes as at 30th September 2023. These consisted of four historically owned properties and includes £22.4m for the Harvey Centre that was purchased by the council in December 2022. The properties generated a small income of £42k in the first half of the 2023/24 financial year and approx. £492k for the Harvey Centre.

Treasury Performance

The Authority measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 6 below.

Table 6: Performance

30/09/2023 - Interest (payable)/receivable	Actual £	Budget £	Over/ under	Actual %
External borrowing:				
Public Works Loan Board (GF)	(406,908)			3.3%
Public Works Loan Board (HRA)	(3,097,899)			3.3%
Local Authorities	(188,400)			4.3%
Total borrowing	(3,693,207)			
Finance leases	(22,750)			
Total Interest Payable (GF)	(618,058)	(886,148)	(268,090)	
Total Interest Payable (HRA)	(3,369,904)	(3,554,823)	(184,919)	
Treasury Investments:				
Banks (unsecured)	81,000			5.0%
Money Market Funds	382,000			5.2%
UK Government (DMO)	282,000			4.7%
Strategic Pooled Funds				
- CCLA LA's Property Fund	47,000			4.9%
- Royal London Cash Plus Fund	40,000			4.4%
Total Interest Receivable (GF)	832,000	525,000	307,000	

Compliance

The Chief Finance Officer 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 7 below.

Table 7: Investment Limits

	H1 Maximum £m	30.9.23 Actual £m	2023/24 Limit £m	Complied?
Any single organisation*, except the UK Government (Barclays Call Account)	4.0	1.1	4.0 each	Yes
UK central government (DMO)	20.1	5.6	Unlimited	Yes
Any group of organisations under the same ownership		-	2.0 per group	Yes
Any group of pooled funds under the same management (CCLA LAPF & Royal London)	4.0	3.9	5.0 per manager	Yes
Negotiable instruments held in a broker's nominee account		-	5.0 per broker	Yes
Foreign countries		-	2.0 per country	Yes
Registered providers and registered social landlords		-	1.0 in total	Yes
Unsecured investments with building societies		-	1.0 in total	Yes
Loans to unrated corporates		-	2.0 in total	Yes
Money Market Funds	20.0	20.0	20.0 in total	Yes
Real Estate Investment Trusts		-	2.0 in total	Yes

Treasury Management Prudential Indicators

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

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

	30.9.23 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	0%	25%	0%	Yes
12 months and within 24 months	0%	50%	0%	Yes
24 months and within 5 years	20%	100%	0%	Yes
5 years and within 10 years	20%	100%	0%	Yes
10 years and above	60%	100%	0%	Yes

Time periods start on the first day of each financial year.

Principal Sums Invested for Periods Longer than a year: The purpose of this indicator is to control the Council'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 were:

	2023/24	2024/25	2025/26
Actual principal invested beyond year end	£3.9m	£3.9m	£3.9m
Limit on principal invested beyond year end	£4m	£4m	£4m
Complied?	Yes	Yes	Yes

£1.9m consists of the Council's investment in a property fund. Although the fund can be accessed within a year, fund volatility means that it should be considered as a long-term investment. £1.9m is the actual amount invested at 30th September 2023, it is assumed that this will not change for the sake of the indicator above. The remaining £2m consists of the Council's investment in a Cash Plus fund which has been considered a long-term investment since 2018/19 year end, as there is no intention to redeem.

Future Changes to Reporting Requirements

From 1st April 2023 the Council will need to report on treasury management under the new requirements of the 2021 Prudential and TM Codes. This will include a requirement to report on treasury management including prudential indicators on a quarterly rather than semi-annual basis. There is a new prudential indicator on the net income from commercial and service investments as a proportion to net revenue stream. The liability benchmark will also need to be reported on quarterly.

Arlingclose's Economic Outlook for the remainder of 2023/24 (based on 7th November 2023 interest rate forecast)

	Current	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26
Official Bank Rate													
Upside risk	0.00	0.25	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	1.00	1.00
Central Case	5.25	5.25	5.25	5.25	5.00	4.75	4.25	4.00	3.75	3.50	3.25	3.00	3.00
Downside risk	0.00	0.00	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00

The changes in interest rates during the quarter were:

	31/3/23	30/9/23
Bank Rate	4.25%	5.25%
1-year PWLB certainty rate, maturity loans	4.78%	5.69%
5-year PWLB certainty rate, maturity loans	4.31%	5.22%
10-year PWLB certainty rate, maturity loans	4.33%	5.26%
20-year PWLB certainty rate, maturity loans	4.70%	5.64%
50-year PWLB certainty rate, maturity loans	4.41%	5.43%

The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at new market rates.