Appendix A

Harlow Council Treasury Management Outturn Report 2023/24

Introduction

The Authority has 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 treasury management semi-annual and annual reports.

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.

The 2021 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 23rd February 2023.

External Context

Economic background: UK inflation continued to decline from the 8.7% rate seen at the start of 2023/24. By the last quarter of the financial year headline consumer price inflation (CPI) had fallen to 3.4% in February, but was still above the Bank of England's 2% target at the end of the period. The core measure of CPI, i.e. excluding food and energy, also slowed in February to 4.5% from 5.1% in January, a rate that had stubbornly persisted for three consecutive months.

The UK economy entered a technical recession in the second half of 2023, as growth rates of -0.1% and -0.3% respectively were recorded for Q3 and Q4. Over the 2023 calendar year GDP growth only expanded by 0.1% compared to 2022. Of the recent monthly data, the Office for National Statistics reported a rebound in activity with economy expanding 0.2% in January 2024. While the economy may somewhat recover in Q1 2024, the data suggests that prior increases in interest rates and higher price levels are depressing growth, which will continue to bear down on inflation throughout 2024.

Labour market data provided a mixed message for policymakers. Employment and vacancies declined, and unemployment rose to 4.3% (3mth/year) in July 2023. The same month saw the highest annual growth rate of 8.5% for total pay (i.e. including bonuses) and 7.8% for regular pay growth (i.e. excluding bonuses). Thereafter, unemployment began to decline, falling to 3.9% (3mth/year) in January and pay growth also edged lower to 5.6% for total pay and 6.1% for regular pay, but remained above the Bank of England's forecast.

Having begun the financial year at 4.25%, the Bank of England's Monetary Policy Committee (MPC) increased Bank Rate to 5.25% in August 2023 with a 3-way split in the Committee's voting as the UK economy appeared resilient in the face of the dual headwinds of higher inflation and interest rates. Bank Rate was maintained at 5.25% through to March 2024. The vote at the March was 8-1 in favour of maintaining rates at this level, with the single dissenter preferring to cut rates immediately by 0.25%. Although financial markets shifted their interest rate expectations downwards with expectations of a cut in June, the MPC's focus remained on assessing how long interest rates would need to be restrictive in order to control inflation over the medium term.

In the Bank's quarterly Monetary Policy Report (MPR) released in August 2023 the near-term projection for services price inflation was revised upwards, goods price inflation widespread across products, indicating stronger domestic inflationary pressure with second-round effects in domestic prices and wages likely taking longer to unwind than they did to emerge. In the February 2024 MPR the Bank's expectations for the UK economy were positive for the first half of 2024, with a recovery from the mild recession in calendar H2 2023 being gradual. Headline CPI was forecast to dip below the 2% target quicker than previously thought due to declining energy prices, these effects would hold inflation slightly above target for much of the forecast horizon.

Following this MPC meeting, Arlingclose, the authority's treasury adviser, maintained its central view that 5.25% remains the peak in Bank Rate and that interest rates will most likely start to be cut later in H2 2024. The risks in the short-term are deemed to be to the downside as a rate cut may come sooner than expected, but then more broadly balanced over the medium term.

The US Federal Reserve also pushed up rates over the period, reaching a peak range of between 5.25-5.50% in August 2023, where it has stayed since. US policymakers have maintained the relatively dovish stance from the December FOMC meeting and at the meeting in March, economic projections pointed to interest rates being cut by a total of 0.75% in 2024.

Following a similarly sharp upward trajectory, the European Central Bank hiked rates to historically high levels over period, pushing its main refinancing rate to 4.5% in September 2023, where it has remained. Economic growth in the region remains weak, with a potential recession on the cards, but inflation remains sticky and above the ECB's target, putting pressure on policymakers on how to balance these factors.

Financial markets: Sentiment in financial markets remained uncertain and bond yields continued to be volatile over the year. During the first half of the year, yields rose as interest rates continued to be pushed up in response to rising inflation. From October they started declining again before falling sharply in December as falling inflation and dovish central bank attitudes caused financial markets to expect cuts in interest rates in 2024. When it emerged in January that inflation was stickier than expected and the BoE and the Federal Reserve were data dependent and not inclined to cut rates soon, yields rose once again, ending the period some 50+ bps higher than when it started.

Over the financial year, the 10-year UK benchmark gilt yield rose from 3.44% to peak at 4.75% in August, before then dropping to 3.44% in late December 2023 and rising again to 3.92% (28th March 2024). The Sterling Overnight Rate (SONIA) averaged 4.96% over the period to 31st March.

Credit review: Early in the period, Moody's affirmed the long-term rating of Guildford BC but revised the outlook to negative. The agency also downgraded Warrington BC and Transport for London.

The following month Fitch revised the outlook on the UK sovereign to negative from stable. Moody's made the same revision to the UK sovereign, following swiftly after with a similar move for a number of local authorities and UK banks including Barclays Bank, National Westminster Bank (and related entities) and Santander.

During the last few months of the reporting period there were only a handful of credit changes by the rating agencies, then in March the collapse of Silicon Valley Bank (SVB) in the US quickly spilled over into worries of a wider banking crisis as Credit Suisse encountered further problems and was bought by UBS.

Credit Default Prices had been rising since the start of the period on the back of the invasion of Ukraine, and in the UK rose further in September/October at the time of the then-government's mini budget. After this, CDS prices had been falling, but the fallout from SVB caused a spike on the back of the heightened uncertainty. However, they had moderated somewhat by the end of the period as fears of contagion subsided, but many are still above their pre-March levels reflecting that some uncertainty remains.

On the back of this, Arlingclose reduced its recommended maximum duration limit for unsecured deposits for all UK and Non-UK banks/institutions on its counterparty list to 35 days as a precautionary measure. No changes were made to the names on the list.

As 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.

Local authorities remain under financial pressure, but Arlingclose continues to take a positive view of the sector, considering its credit strength to be high. Section 114 notices have been issued by only a handful of authorities with specific issues. While Arlingclose's advice for local authorities on its counterparty list remains unchanged, a degree caution is merited with certain authorities.

Local Context

On 31st March 2024, the Authority had borrowing and investments of £8.9m 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 usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.24 Actual £m
Total CFR	**370.97**
External borrowing	-270.83
Internal borrowing	**100.12**
Less: Usable reserves	-92.26
Less: Working capital	-16.82
Net investments	**-8.94**

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

The Authority pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

The treasury management position at 31st March 2024 and the change during the year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.23 Balance £m	Movement £m	31.3.24 Balance £m
Long-term borrowing	211.8	-	211.8
Short-term borrowing	22	37	59
Total borrowing	**233.8**	**37**	**270.8**
Long-term investments	4	-	4
Short-term investments	-	-	-
Cash and cash equivalents	21.1	-16.2	4.9
Total investments	**25.1**	**-16.2**	**8.9**
Net borrowing	**208.7**	**53.2**	**261.9**

The increase in short term borrowing relates to extra cash flow borrowing required following the purchase of a residential development within the town centre.

Borrowing Update

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.

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 and, where practicable, to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

The cost of both long and short-term borrowing rose dramatically over the year, with rates at the end of March around 2% - 4% higher than those at the beginning of April. Rate rises have been driven primarily by inflation and the need for central banks to control this by raising interest rates. The PWLB 10 year maturity certainty rate stood at 4.33% at 31st March 2023, 20 years at 4.70% and 30 years at 4.66%.

A new HRA PWLB rate of gilt yield plus 0.4% (0.4% below the currently available certainty rate) was announced on 15th March 2023. This rate was expected to be available from June 2023, initially for a period of one year and will now be available to June 2025. This discounted rate is to support local authorities borrowing for Housing Revenue Accounts and the delivery of social housing.

At 31st March 2024 the Authority held £270.8 of loans, (an increase of £22m from 31st March 2023), as part of its strategy for funding previous years' capital programmes. Outstanding loans on 31st March are summarised in Table 3 below.

Table 3A: Borrowing Position

	31.3.23 Balance £m	**Net Movement £m**	**31.3.24 Balance £m**
Public Works Loan Board	211.8	-	211.8
Local authorities (short-term)	22.0	37.0	59.0
Total borrowing	**233.8**	**37.0**	**270.8**

Table 3B: Long-dated Loans borrowed

	Amount £m	Rate %	Period (Years)
PWLB Maturity Loan 1	3	4.5	40
PWLB Maturity Loan 2	41.767	3.5	30
PWLB Maturity Loan 3	41.767	3.46	26
PWLB Maturity Loan 4	41.767	3.21	18
PWLB Maturity Loan 5	41.767	3.37	22
PWLB Maturity Loan 6	41.767	2.92	14
Total borrowing	**211.837**		

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

Treasury Investment Activity

CIPFA published a revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes on 20th December 2021. These define treasury management investments as investments that arise from the organisation'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 year, the Authority's investment balances ranged between £8.9 and £25.1 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

<table>
<tr><th></th><th>31.3.23
Balance
£m</th><th>Net
Movement
£m</th><th>31.3.24
Balance
£m</th><th>31.3.24
Income Return
%</th><th>31.3.23
Weighted Average Maturity
days</th></tr>
<tr><td>Banks & building societies (unsecured)</td><td>2.7</td><td>-1.9</td><td>0.9</td><td>4</td><td>1</td></tr>
<tr><td>Government (incl. local authorities)</td><td rowspan="2">8.4</td><td>-8.4</td><td>0</td><td rowspan="2">4.05</td><td rowspan="2">11</td></tr>
<tr><td>Money Market Funds</td><td>-6</td><td>4</td></tr>
<tr><td>Other Pooled Funds:</td><td>10</td><td></td><td></td><td>4.1</td><td>1</td></tr>
<tr><td>- Cash plus funds</td><td>2</td><td>-</td><td>2</td><td>0</td><td>-</td></tr>
<tr><td>- Property funds</td><td>2</td><td>-</td><td>2</td><td>3.62</td><td>-</td></tr>
<tr><td>Total investments</td><td>25.1</td><td>-16.3</td><td>8.9</td><td>15.77</td><td>13</td></tr>
</table>

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.

Bank Rate increased by 1% over the period, from 4.25% at the beginning of April 2023 to 5.25% by the end March 2024. Short term rates peaked at 5.7% for 3-month rates and 6.7% for 12-month rates during the period, although these rates subsequently began to decline towards the end of the period. By end March 2024, the rates on DMADF deposits ranged between 5.08% and 5.19%. The return on the Council's sterling Low Volatility Net Asset Value (LVNAV) Money Market Funds ranged between 4.00% - 4.12% p.a in early April and between 5.14% and 5.27% at the end of March.

Given the risk of short-term unsecured bank investments, the Authority has invested in alternative and/or higher yielding asset classes as shown in table 4 above. £4m that is available for longer-term investment invested in pooled property and cash plus funds. The amount invested was maintained during 2023/24.

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	4.48	AA-	60%	4	2.65
31.03.2024	5.09	A+	100%	1	5.21
Similar LAs	4.9	A+	61%	50	5.2
All LAs	4.82	A+	61%	9	5.17

*Weighted average maturity

Externally Managed Pooled Funds: £4m of the Authority's investments is invested in externally managed strategic pooled cash plus and 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 an average total return of
3.34%, comprising income return of 4.98% which is used to support services in year, and a capital return of -1.64% (i.e. unrealised capital loss of £63k).

Tighter financial conditions, higher bond yields and challenges in some segments of commercial real estate (e.g. offices post-COVID, high street shops and shopping centres) saw commercial property values fall during 2022, with a large fall in the final calendar quarter.

Dividends continued to be received from the Authority's cash plus and property funds, the payout increasing for most funds in the portfolio.

The change in the Authority's funds' capital values and income earned over the 12-month period is shown in Table 4.

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 period total returns should exceed cash interest rates.

The Authority had budgeted £75,000 income from these investments in 2023/24. Income received was £201,000, whilst a further £40,000 has been declared and is due to be paid by April/May.

The DLUHC published a consultation on the IFRS 9 pooled investment fund statutory override for English authorities for fair value gains and losses on pooled investment funds which was due to expire with effect from 2023/24. The options under evaluation were to allow the override to lapse, to extend it, or to make it permanent. The override will be extended for two years and therefore remain in place for the 2023/24 and 2024/25 financial years. Under the Regulations, gains and losses resulting from unrealised fair value movements relating to treasury pooled investment funds, that otherwise must be recognised in profit or loss under IFRS 9, are not charges to the revenue account, and must be taken into an unusable reserve account.

Non-Treasury Investments

The definition of investments in CIPFA's revised 2021 Treasury Management Code 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 broadens the definition of investments to include all such assets held partially or wholly for financial return.

The Council has lent money to its subsidiary and a local business, to support local public services and stimulate local economic growth.

HTS (Property and Environment) Ltd is a wholly owned subsidiary of Harlow Council which began trading on 1 February 2017. The Council provided a £0.670m was loaned to HTS for the purchase of vehicles and plant and machinery. The balance outstanding at 31 March 2024, for principal and interest, was £0.139m.

As part of a property scheme the Council loaned HTS £1.011m for the purchase of five houses. At 31 March 2024 the balance outstanding, for principal and interest, was £0.973m. Interest is charged at 4% over 40 years. This scheme also involved an equity share investment of £0.450m by the Council.

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

	Actual £m	**Budget £m**	**Over/ (under)**
Long Term Borrowing	7.009	8.77	1.761
Short Term Borrowing	1.939	0	0.151
Total borrowing	**8.948**	**8.77**	**1.912**
Long Term Investments	0.201	0.456	0.255
Short Term Investments	1.29	0	0.49

Total treasury investments	0.608	0.456	0.745

Compliance

The Chief Finance Officer reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 7 below.

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 7 below.

Table 7: Debt Limits

	2023/24 Maximum	**31.3.24 Actual**	**2023/24 Operational Boundary £000**	**2023/24 Authorised Limit £000**	**Complied?** Yes/No
Total debt	270,800	270,800	310,200	325,200	Yes

Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

Table 8: Investment Limits

	2023/24 Maximum	**31.3.24 Actual**	**2023/24 Limit**	**Complied? Yes/No**
Any single organisation, except the UK Government (FIBCA)	£4m	£890k	£4m	Yes
Any group of organisations under the same ownership	£2m	£2m	£2m per group	Yes
Any group of pooled funds under the same management	£2m	£2m	£5m per manager	Yes
Negotiable instruments held in a broker's nominee account	Nil	Nil	£5m per broker	Yes
Limit per non-UK country	Nil	Nil	£2m per country	Yes
Registered providers and registered social landlords	Nil	Nil	£5m in total	Yes

Unsecured investments with building societies	Nil	Nil	£2m in total	Yes
Loans to unrated corporates	Nil	Nil	£2m in total	Yes
Money Market Funds	£20m	£4m	£20m in total	Yes
Real Estate Investment Trusts	Nil	Nil	£5m in total	Yes
UK Government (DMO)	£51m	Nil	Unlimited	Yes

Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

Interest rate risk indicator	31.3.24 Actual	2023/24 Limit	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	£296,356	£400,000	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	£296,356	£400,000	Yes

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

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:

	31.3.24 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	22%	25%	0%	Yes
12 months and within 24 months	15%	50%	0%	Yes
24 months and within 5 years	0%	100%	0%	Yes
5 years and within 10 years	31%	100%	0%	Yes
10 years and above	32%	100%	0%	Yes

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.

Principal Sums Invested for Periods Longer than a year: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2022/23	2023/24	2024/25
Actual principal invested beyond year end	£4m	£4m	£4m
Limit on principal invested beyond year end	£5m	£5m	£5m
Complied?	Yes	Yes	Yes