Appendix 1 - Treasury Management Report Q3 2023/24

1. Introduction

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

1.2. This report includes the new requirement in the 2021 Code that mandates quarterly reporting of treasury management prudential indicators, effective from 1st April 2023.

1.3. The Council's treasury management strategy for 2023/24 was approved at a full Council meeting on 2 March 2023. The Council 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 Council's treasury management strategy.

2. External Context (provided by the Council's treasury management advisor, Arlingclose)

Economic background

2.1. The UK's inflation rates started to decline during the period, following the sharp drop seen earlier in the Eurozone and the US. However, despite the fall, the Consumer Price Index (CPI) remains significantly above the Bank of England's (BoE) 2% target, at 3.9% for November 2023. Market expectations for further increases in the Bank Rate decreased from October until the end of the year, suggesting that the peak of 5.25% reached in August 2023 was indeed the highest level for the Bank Rate.

2.2. Economic growth in the UK remained weak over the period, approaching recessionary levels. In the third quarter of 2023, the economy contracted by 0.1%, following no change in the second quarter. Monthly Gross Domestic Product (GDP) data showed a 0.3% contraction in October, following a 0.2% increase in September. Although other indicators have suggested a rebound in activity in the following months, GDP growth in the fourth quarter is expected to continue the weak trend.

2.3. The unemployment rate has remained around 4% throughout the year. The table below shows an extract of the reported annual unemployment rate over the past four quarters.

	Mar-23	Jun-23	Sep-23	Dec-23
Unemployment rate	3.9%	4.2%	4.1%	3.8%

2.4. Pay growth in the three months to October 2023 slowed down, with total pay growth at 7.2% and regular pay growth at 7.3%. Adjusted for inflation, real terms pay growth was positive at 1.3% for total pay and 1.4% for regular pay.

2.5. The annual Consumer Prince Index (CPI) inflation measure for the UK continued to fall from its October 2022 peak of 11.1% to 4.0% in December 2023 (lowest point being 3.9% in November 23). The largest downward contribution came from energy and food prices. The table below shows an extract of the reported CPI inflation over the past four quarters.

	Mar-23	Jun-23	Sep-23	Dec-23
CPI Inflation	10.1%	7.9%	6.7%	4.0%

2.6. The BoE's Monetary Policy Committee maintained the Bank Rate at 5.25% throughout the period, although a substantial minority continued to vote for a 25-basis point rate increase. The Bank continues to tighten monetary policy through asset sales, as it reduces the size of its balance sheet. Expectations for the Bank Rate in financial markets moderated during this period due to lower inflation and weakening data. The table below shows an extract or the Bank Rate over the past four quarters.

	Mar-23	Jun-23	Sep-23	Dec-23
BoE Bank Rate	4.25%	5.00%	5.25%	5.25%

2.7. Following the December MPC meeting, Arlingclose, the Council's treasury adviser, maintained its central view that the Bank Rate would peak at 5.25%. While short-term risks are generally balanced, there is a downside risk from economic activity weakening more than anticipated over the remaining time horizon.

2.8. The lagged effect of monetary policy together with the staggered fixed term mortgage maturities suggest that the full impact of Bank Rate rises on households is yet to be felt. Consumer confidence improved but is expected to reverse, leading to a slowdown in spending. Higher rates are also expected to impact the UK manufacturing and construction sectors, while the services sector has shown signs of recovery, possibly due to improving consumer confidence.

2.9. The US Federal Reserve maintained its key interest rate at 5.25-5.50% during this period. While policymakers initially emphasized the risks to inflation and the possibility of raising interest rates, their position gradually became more accommodative, leading to a relatively dovish outcome at the December FOMC meeting.

2.10. The European Central Bank continues to resist market policy loosening expectations. However, the Eurozone CPI rate has fallen sharply due to a marked slowdown in GDP growth.

Financial markets

2.11. Financial market sentiment and bond yields remained volatile, but the latter rapidly trended downwards towards the end of 2023 on signs of sharply moderating inflation and economic growth.

2.12. Gilt yields fell towards the end of the period. The 10-year UK benchmark gilt yield rose from 4.57% to peak at 4.67% in October before dropping to 3.54% by the end of December 2023. The table below shows the movement of the major benchmark gilt yields throughout the period.

Benchmark Gilt Yield	Mar-23	Jun-23	Sep-23	Dec-23
5 year	3.36%	4.67%	4.29%	3.48%
10 year	3.49%	4.39%	4.45%	3.54%
20 year	3.82%	4.51%	4.84%	4.13%

2.13. The Sterling Overnight Rate (SONIA) averaged 5.19% over the period.

Credit review

2.14. Arlingclose maintained the advised maximum duration limit for all banks on its recommended counterparty list to 35 days over the period.

2.15. In October, Moody's revised the outlook on the UK's Aa3 sovereign rating to stable from negative. This led to similar rating actions on entities that include an element of government support in their own credit ratings, including banks and housing associations. Local authorities were, however, downgraded on expectations of lower government funding.

2.16. Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress, but no changes were made to recommended durations over the period.

2.17. 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.

3. Local Context

3.1. On 31 March 2023, the Council had net borrowing of £783.3m arising from its revenue and capital income and expenditure. The Capital Financing Requirement (CFR) measures the underlying need to borrow for capital purposes. A breakdown of the CFR is summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.03.23 Actual £m
General Fund CFR	720.4
HRA CFR	471.1
Total CFR[1]	**1,191.5**
Less: Other debt liabilities[2]	(22.0)
Borrowing CFR - comprised of:	**1,169.5**
External borrowing	783.3
Internal borrowing	386.2

[1]subject to audit
[2]finance leases, PFI liabilities and transferred debt that form part of the Council's total debt

3.2. The Council continued to pursue its long-standing strategy of keeping borrowing and investments below their underlying levels, also known as internal borrowing. This approach aims to manage both interest rate risk and refinancing risk. The goal is to minimise interest costs and provide flexibility when deciding whether the Council should take on additional borrowing from external sources.

3.3. The treasury management position on 31 December 2023 and the change over the year is shown in Table 2 below.

Table 2: Treasury Management Summary

Type of Borrowing/Investment	31.03.23 Balance £m	Movement £m	31.12.23 Balance £m	31.12.23 Weighted Av. Rate %
Long-term borrowing	718.3	(20.7)	742.1	3.12%
Short-term borrowing	65.0	(20.0)	45.0	5.69%
Total borrowing	**783.3**	**3.8**	**787.1**	**3.26%**
Short-term investment	15.0	(15.0)	0.0	0.00%
Cash and cash equivalents	78.9	(24.5)	54.4	5.23%
Total investments	**93.9**	**(39.5)**	**54.4**	**5.23%**
Net borrowing	**689.4**	**43.3**	**732.7**	

4. Borrowing Activity

4.1. CIPFA's 2021 Prudential Code emphasises that local authorities should not borrow to invest primarily for financial returns. Local authorities should not make any investment or spending decision that increase the capital financing requirement, resulting in new borrowing, unless such decisions are directly and primarily related to the functions of the local authority. Local authorities are no longer permitted to secure PWLB loans for purchasing investment assets primarily for yield unless the loans are for refinancing purposes.

4.2. The Council has not invested in assets primarily for financial return or that are not primarily related to the functions of the Council. It has no plans to do so in the future.

Borrowing strategy and activity during the period

4.3. As outlined in the treasury strategy, the Council's primary objective when borrowing is to strike an appropriately low-risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective. The Council's borrowing strategy continues to address the key issue of affordability without compromising longer-term stability of the debt portfolio.

4.4. There has been a significant increase in the cost of both short-term and long-term borrowing over the past 2 years, although these rises began to bottom in the later months of 2023. Rates over the last three quarters were at their peak between June and October, since then they have fallen back to lows last seen in April 2023.

4.5. Gilt yields have remained volatile, facing upward pressure following signs that UK growth had been more resilient and inflation stickier than expected. However more recent signs of slowing inflation and the perception of an increasingly struggling economy have now begun to change this sentiment, resulting in falling gilt yields and, consequently, PWLB rates.

4.6. The table below shows the rates offered across the various PWLB maturities on 31 December 2023. The rates shown include the 0.20% certainty discount rate offered by the PWLB to qualifying authorities.

PWLB Maturity	Mar-23	Jun-23	Sep-23	Dec-23
10 year	4.33%	5.25%	5.26%	4.19%
20 year	4.70%	5.36%	5.64%	4.90%
50 year	4.41%	4.95%	5.43%	4.67%

4.7. On 15 June 2023, a new HRA PWLB rate was made available to qualifying authorities. This rate offers a further 0.40% discount to the currently available certainty rate. This discounted rate is intended to support local authorities borrowing for the Housing Revenue Account and for refinancing existing HRA loans. This rate will now be available until June 2025.

4.8. As part of its strategy for funding previous and current years' capital programmes, the Council held £787.1m in loans on 31 December 2023, an increase of £3.8m compared to 31 March 2023. The outstanding loans at 31 December are summarised in Table 3 on the following page.

Table 3: Borrowing Position

	31.03.23		31.12.23	30.12.23	31.12.23

Type of Borrowing	Balance £m	Net Movement £m	Balance £m	Weighted Ave. Rate %	Weighted Ave. Maturity Years
Public Works Loan Board	593.3	48.8	642.1	2.87%	25.1
Banks (LOBO)	125.0	(25.0)	100.0	4.73%	34.8
Local authorities	65.0	(20.0)	45.0	5.69%	0.5
Total borrowing	**783.3**	**3.8**	**787.1**	**3.26%**	**25.0**

4.9. The Council's short-term borrowing costs (from other local authorities) have continued to increase with the rise in the Bank Rate. The average rate of the Council's short-term loans at 31 December 2023 was 5.69% compared to 3.16% at 31 March 2023. As a result, the Council has taken fewer new short-term loans compared to previous years.

4.10. The Council has a significant capital program that extends into the foreseeable future. A large proportion of this program will need to be financed by borrowing. This borrowing will be undertaken by the Council during the current and upcoming years. The Council's borrowing decisions are not based on any single outcome for interest rates, and it maintains a balanced portfolio of short and long-term borrowing.

LOBO Loans

4.11. The Council currently holds £50m of LOBO (Lender's Option, Borrowing Option) loans, with call dates within the next 12 months. The Council has engaged with treasury management advisors Arlingclose, to assess the likelihood of loan option exercise. If the option is exercised, the Council plans to repay the loan at no additional cost. In doing so, the Council will use any available cash or borrow from other local authorities or the PWLB to repay the LOBO loans.

5. Treasury Investment Activity

5.1. The CIPFA Treasury Management Code now defines treasury management investments as investments that result from the Council's cash flows or treasury risk management activity. These investments represent balances that need to be invested until the cash is needed for use in the course of business.

5.2. The Council holds significant invested funds, which represent income received in advance of expenditure, as well as balances and reserves held. Throughout the period, the Council's investment balances ranged between £164.9m and £54.4m due to timing differences between income and expenditure. The investment position on 31 December 2023 is shown in Table 4 below.

Table 4: Treasury Investment Position

Type of Investment	31.03.23 Balance £m	Net Movement £m	31.12.23 Balance £m	30.12.23 Weighted Ave. Rate %	31.12.23 Weighted Ave. Maturity
Debt Management Office	93.9	(59.5)	34.4	5.19%	1 day
Money market funds	-	20.0	20.0	5.29%	1 day
Total Investments	**93.9**	**(39.5)**	**54.4**	**5.23%**	**1 day**

5.3. Both the CIPFA Code and government guidance require the Council 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 Council aims to strike an appropriate balance between risk and return when making treasury investments, while minimising the risk of incurring losses from defaults and receiving unsuitably low investment income.

5.4. The Bank Rate increased by 1%, rising from 4.25% at the beginning of April to 5.25% by the end of September and maintained at that level to the end of December. Short-dated cash rates increased accordingly, with 3-month rates reaching approximately 5.25% and 12-month rates coming close to 6%.

5.5. At the end of December 2023, the Debt Management Account Deposit Facility's (DMADF) deposit rates ranged between 5.11% and 5.19%. The Money Market rates also ranged between 5.24% and 5.31%.

5.6. 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 Ave. Maturity (Days)	Rate of Return
31.03.2023	3.67	AA-	38%	10	3.96%
31.12.2023	4.12	AA-	37%	1	5.23%
Similar Local Authorities	4.82	A+	67%	19	5.08%
All Local Authorities	4.80	A+	63%	11	5.25%

Scoring:
AAA = highest credit quality = 1; D = lowest credit quality = 26
Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

6. Treasury Performance

6.1. The budget for treasury investment income for 2023/24 was set at £2.3m. This was based on a treasury investment portfolio of £65m with an average rate of return of 3.50%. The most recent forecast for the year indicates an average rate of return of 4.84%. Therefore, the Council expects to exceed its budget for treasury investment income.

6.2. The interest costs on external borrowing for 2023/24 are forecast to be in line with the budget at Q3 at £35.5m (£18.6m HRA, £16.9m General Fund).

7. Compliance

7.1. The Director of Finance reports that all treasury management activities carried out during the period complied fully with the principles in the Treasury Management Code and the Council's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 6 below.

Table 6: Investment Limits

	31.12.23 Actual	2023/24 Limit	Complied?
Any single organisation, except the UK Central Government	£5m each	£5m each	Yes
Money market funds	£20m in total	£20m in total	Yes

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

Table 7: Debt Limits

	31.12.23	2023/24	2023/24	

	Actual £m	Operational Boundary £m	Authorised Limit £m	Complied?
Borrowing	787.6	1,402.3	1,452.3	Yes
PFI and Finance Leases	21.1	21.1	23.2	Yes
Total debt	**808.7**	**1,423.4**	**1,475.5**	**Yes**

7.3. The operational boundary is a management tool for in-year monitoring. Therefore, it is not significant if the operational boundary is breached on occasion due to variations in cash flow, and this is not considered a compliance failure. However, the council's debt remained well below this limit throughout the entire financial year.

8. Treasury Management Indicators

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

Security

8.2. The Council has adopted a voluntary measure to assess its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. To calculate this score, a value is assigned to each investment based on its credit rating (AAA=1, AA+=2, etc.), and the arithmetic average is taken, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	31.12.23 Actual	2023/24 Target	Complied?
Portfolio average credit score	4.12 (AA-)	7.0 (A-)	Yes

Liquidity

8.3. The Council has adopted a voluntary measure to monitor its exposure to liquidity risk. This is done by tracking the amount of cash available to meet unexpected payments over a rolling three-month period, without borrowing additional funds.

	31.12.23 Actual	2023/24 Target	Complied?
Total cash available within 3 months	54.4	20.0	Yes

Interest Rate Exposures

8.4. This indicator is set to control the Council's exposure to interest rate risk. During the period, the Bank Rate increased by 1%, rising from 4.25% in April to 5.25% by the end of September.

	31.12.23 Actual	2023/24 Target	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	£0.3m	£2m	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	£0.3m	£2m	Yes

8.5. 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

8.6. 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:

	31.12.23 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	13.3%	50%	0%	Yes
12 months and within 24 months	1.7%	40%	0%	Yes
24 months and within 5 years	4.4%	40%	0%	Yes
5 years and within 10 years	11.7%	40%	0%	Yes
10 years and within 20 years	17.9%	40%	0%	Yes
20 years and within 30 years	10.5%	40%	0%	Yes
30 years and with 40 years	13.5%	50%	0%	Yes
40 years and within 50 years	27.0%	50%	0%	Yes
50 years and above	0.0%	40%	0%	Yes

8.7. For context, the changes in interest rates during the quarter were:

	31.03.23	31.12.23
Bank rate	4.25%	5.25%
1-year PWLB certainty rate, maturity loans	4.78%	5.13%
5-year PWLB certainty rate, maturity loans	4.31%	4.19%
10-year PWLB certainty rate, maturity loans	4.33%	4.37%
20-year PWLB certainty rate, maturity loans	4.70%	4.90%
50-year PWLB certainty rate, maturity loans	4.41%	4.67%

8.8. In the past, the Council has extensively used short-term borrowing (less than 1 year in duration) from other local authorities as an alternative to longer-term borrowing from the PWLB. This was due to lower interest rates at the time, resulting in revenue savings.

8.9. However, short-term borrowing exposes the Council to refinancing risk. This is the risk that rates will rise quickly over a short period of time and will be at significantly higher rates when loans mature, and new borrowing is required. With this in mind, the Council has set a limit on the total amount of short-term local authority borrowing as a proportion of all borrowing.

	31.12.23 Actual	2023/24 Target	Complied?
Upper limit on short-term borrowing from other local authorities as a percentage of total borrowing	5.7%	30%	Yes