Appendix F

Treasury Management Report Q3 2023/24

Introduction

In February 2012 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 Authority to approve treasury management semi-annual and annual reports. This quarterly report provides an additional update.

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 non-treasury prudential indicators are incorporated in the Authority's normal quarterly capital monitoring report.

The Authority's treasury management strategy for 2023/24 was approved at a meeting on 24 January 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 rates finally started to decline, mirroring the sharp but earlier drop seen in the Eurozone and US. Despite the fall, the Consumer Price Index (CPI) remained substantially in excess in the Bank of England's (BoE) 2% target, at 3.9% for November 2023. Market expectations for further rises in Bank Rate fell from October through to year end, indicating that the 5.25% level reached in August 2023 was indeed the peak for Bank Rate.

Economic growth in the UK remained weak over the period, edging into recessionary territory. In calendar Q3 2023, the economy contracted by 0.1%, following no change in Q2. Monthly GDP data showed a 0.3% contraction in October, following a 0.2% rise in September. While other indicators have suggested a pickup in activity in the subsequent months, Q4 GDP growth is likely to continue the weak trend.

July data showed the unemployment rate increased to 4.2% (3mth/year) while the employment rate rose to 75.7%. Pay growth edged lower as the previous strong pay rates waned; total pay (including bonuses) growth was 7.2% over the three months to October 2023, while regular pay growth was 7.3%. Adjusting for inflation, pay growth in real terms were positive at 1.3% and 1.4% for total pay and regular pay respectively.

Inflation continued to fall from its peak as annual headline CPI declined to 3.9% (down from 4.6%) in November 2023. The largest downward contribution came from energy and food prices. The core rate also surprised on the downside, falling to 5.1% from 5.7%.

The BoE's Monetary Policy Committee held Bank Rate at 5.25% throughout the period, although a substantial minority continued to vote for a 25 basis point rate rise. The Bank continues to tighten monetary policy through asset sales, as it reduces the size of its balance sheet. Financial market Bank Rate expectations moderated over the period as falling inflation and weakening data showed that higher interest rates were working in the UK, US, and Eurozone.

Following the December MPC meeting, Arlingclose, the authority's treasury adviser, maintained its central view that 5.25% is the peak in Bank Rate. Short term risks are broadly balanced, 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, it is likely this will reverse at some point and spending will struggle. Higher rates will also impact exposed businesses; according to S&P/CIPS survey data, the UK manufacturing and construction sectors contracted during the quarter. The services sector recovered, however, with the PMI rising strongly in December, possibly due to improving consumer confidence.

The US Federal Reserve held its key interest rate at 5.25-5.50% over the period. While policymakers continued to talk up the risks to inflation and therefore interest rates, this stance ebbed over the quarter culminating in a relatively dovish outcome from the December FOMC meeting.

The European Central Bank continues to resist market policy loosening expectations, but the Eurozone CPI rate has fallen sharply as GDP growth as markedly slowed, hitting 2.4% in November (although rising to 2.9% on energy-related base effects).

Financial markets: 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.

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

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

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.

Following the issue of a Section 114 notice, in November Arlingclose advised against undertaking new lending to Nottingham City Council. After reducing its recommended duration on Warrington Borough Council to a maximum of 100 days in September, the local authority was subsequently suspended from the Arlingclose recommended list following a credit rating downgrade by Moody's to Baa1.

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.

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.

Local Context

On 31st March 2023, the Authority had net investments of £0.61m 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

	31.3.23 Actual £m
General Fund CFR	53.44
External borrowing	-30.33
Internal borrowing	23.21
Less: Balance sheet resources	-52.98
Net investments	**-29.87**

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

Table 2: Treasury Management Summary

	31.3.23 Balance £m	**Movement £m**	**31.12.23 Balance £m**	**31.12.23 Rate %**
Long-term borrowing				
- PWLB	-20.33	0.27	-20.06	1.92
Short-term borrowing	-10.00	10.00	-0.00	0.10
Total borrowing	**-30.33**	**10.27**	**-20.06**	
Long-term investments	10.42	-8.42	2.00	4.5
Short-term investments	18.00	-4.00	14.00	5.10
Cash and cash equivalents	1.45	8.25	9.70	5.28
Total investments	**29.87**	**4.25**	**25.70**	
Net investments	**0.46**	**-6.02**	**5.64**	

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 *is currently reviewing* its capital programme in light of the Prudential Code 2021 requirements and PWLB lending arrangements to ensure that borrowing to invest primarily for commercial return is no longer undertaken

The Authority currently holds £59.3m in commercial investments that were purchased prior to the change in the CIPFA Prudential Code. Before undertaking further additional borrowing the Authority will review the options for exiting these investments.

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.

Interest rates have seen substantial rises over the last two years, although these rises began to plateau in the later months of 2023. Rates over the last 3 quarters were at the peak between June and October, since then they have fallen back to lows last seen in April 2023. 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.

On 31st December, the PWLB certainty rates for maturity loans were 4.19% for 10-year loans, 4.90% for 20-year loans and 4.67% for 50-year loans. Their equivalents on 31st March 2023 were 4.33%, 4.70% and 4.41% respectively.

At 31st December 2023 the Authority held £20.06m of loans, (a decrease of £10.27m to 31st March 2023, as part of its strategy for funding previous years' capital programmes. Outstanding loans on 31st December are summarised in Table 3A below.

Table 3A: Borrowing Position

	31.3.23 Balance £m	**Net Movement £m**	**31.12.23 Balance £m**	**31.12.23 Weighted Average Rate %**	**31.12.23 Weighted Average Maturity (years)**
Public Works Loan Board	-20.33	0.27	-20.06	1.92	27.50
Local authorities (short-term)	-10.00	10.00	0.00	0.10	1.00
Total borrowing	**-30.33**	**10.27**	**-20.06**		

Table 3B: Long-dated Loans borrowed

	Amount £m	**Rate %**	**Period (Years)**
PWLB Maturity Loan 1	11.0	2.35	40
PWLB Maturity Loan 2	3.00	2.47	40
PWLB EIP Loan 1	5.00	1.05	15
PWLB EIP Loan 2	3.00	1.80	15
Total borrowing	**22.00**	**2.00**	

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.

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.

Treasury Management Investment Activity

CIPFA revised TM Code defines treasury management investments as those which arise from the Authority's cash flows or treasury risk management activity that ultimately represents balances which 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. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.23 Balance £m	Net Movement £m	31.12.23 Balance £m
Banks & building societies (unsecured)	0.00	0.00	0.00
Local authorities	18.00	-4.00	14.00
Local authorities -Long term	2.00	0.00	2.00
Money Market Funds	1.45	8.25	9.70
Other Pooled Funds			
- Property funds	3.64	0.00	3.64
- Multi asset income funds	4.34	0.00	4.34
- Real Estate Investment Trusts	0.45	0.00	0.45
Total investments	**29.88**	**4.25**	**34.13**

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 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.

Bank Rate increased by 1% over the period, from 4.25% at the beginning of April to 5.25% by the end of December. Short term rates peaked at 5.6% for 3-month rates and 6.6% for 12-month rates during the period, although these rates subsequently began to reduce towards the end of the period. Money Market Rates also rose and were between 5.12% and 5.35 by the end of December.

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	5.01	A+	7%	104	-0.08
31.12.2023	5.27	A+	38%	54	4.85
Similar LAs	**4.81**	**A+**	**57%**	**54**	**5.12**
All LAs	**4.80**	**A+**	**60%**	**11**	**4.95**

Externally Managed Pooled Funds: £8.43m of the Authority's investments is invested in externally managed strategic pooled multi-asset 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.

Financial market conditions remained volatile between October and December. Global government bond yields initially rose before inflation data undershooting estimates led to a rally with prices rising and yields falling on the premise that the major central banks' rate hiking cycles were over. Optimism that bond yields would fall further rapidly was tempered by tight labour markets and core inflation remaining above central banks' targets. Nevertheless, for existing longer-term investors in fixed income securities, the prospect of interest rate cuts in 2024 improved sentiment.

November and December were good months for UK, Euro area and US equity markets as investors priced in a soft landing with the economies avoiding recession. Despite cautionary central bank warnings that the full effects of monetary tightening are yet to be felt and corporate refinancing in coming years will be at higher levels, expectations of interest rate cuts helped propel sentiment. On 31st December 2023 the FTSE All Share index was 4232 compared with 4127 on 30th September and 4157 on 31st March. The MSCI All Countries World Index was 3169 compared to 2853 on 30th September and 2791 on 31st March.

Investor sentiment for UK commercial property remained subdued with caution showed by buyers and sellers. With interest rates and bond yields remaining relatively high and investors demanding higher yields, property prices remained under pressure. The outlook for offices remains challenging from changing working practices. This was evident in the capital value of the Authority's property fund(s) which were below those in March and September.

The combination of the above had a marginal negative effect on the combined value of the Authority's strategic funds since March 2023. The capital values of the Authority's equity, multi-asset and longer-dated bond funds improved and are now nearer their price on 31st March 2023.

The change in the Authority's funds' capital values and income return over the 9-month period to 31 December is shown in Table 4.

Income returns remained above budget at 35%. The Authority has budgeted £1m income from these investments in 2023/24. Income received up to 31st December was £934k.

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 (DLUHC) 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 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 DLUHC and Welsh Government also broadens the definition of investments to include all such assets held partially or wholly for financial return.

The Authority held £59.3m of investments in directly owned property as shown in the table below:

Property	Purchase date	Purchase Price	Sector
Challenge House, Tewkesbury	Dec-16	£9,083,736	Office
Challenge House, Tewkesbury	Dec-16	£6,055,024	Industrial
Retail units, Clevedon	Jul-06	£2,299,110	Retail
The Chase, Hertford	Nov-17	£3,937,861	Office
SPL House, Ellesmere Port	Nov-17	£3,770,482	Industrial
Wickes, Trowbridge	Dec-17	£5,929,910	Retail
Edmund House, Leamington	Aug-18	£3,862,877	Office
M&S, Walton on the Naze	Oct-18	£4,653,141	Retail
Vaughan Park, Tipton	May-20	£9,688,943	Industrial
Volvo, Crawley	Dec-20	£10,050,365	Alternatives
Total		**£59,333,248**	

These investments generated £3.05m of investment income for the Authority after taking account of direct costs, representing a rate of return of 5.14%.

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	Actual %	Benchmark %	Over/ under
Borrowing	**-0.37**	**-0.47**	**0.10**	**2.00**		
Treasury investments	**0.93**	**0.75**	**0.18**	**5.22**	**5.18**	**Over**
Total	**0.56**	**0.28**	**0.28**			

The borrowing interest rate is fixed, long term PWLB loans, therefore no benchmark is available.

Consultations

In December DLUHC published two consultations: a "final" consultation on proposed changes to regulations and statutory guidance on MRP closing on 16th February and a "call for views" on capital measures to improve sector stability and efficiency closing on 31st January.

Draft regulations and draft statutory guidance are included in the MRP consultation. The proposals remain broadly the same as those in June 2022 – to limit the scope for authorities to (a) make no MRP on parts of the capital financing requirement (CFR) and (b) to use capital receipts in lieu of a revenue charge for MRP.

In its call for views on capital measures, Government wishes to engage with councils to identify and develop options for the use of capital resources and borrowing to support and encourage 'invest-to-save' activity and to manage budget pressures without seeking exceptional financial support. Whilst Government has identified some options including allowing authorities to capitalise general cost pressures and meet these with capital receipts, there is no commitment to take any of the options forward.

None of the proposed options suggested in the consultation will effect the council as we provide fully for MRP using revenue for all our investment properties as per the guidance.

Compliance

The Executive Director: Resources & S151 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.

Table 8: Investment Limits

	Q1 - Q3 Maximum	**31.12.23 Actual**	**2023/24 Limit**	**Complied?** Yes/No
Any single organisation, except the UK Government	2m	2m	3m	Yes
Limit per non-UK country	**0m**	**0m**	**3m**	Yes

Unsecured investments with banks and building societies	**2m**	**0m**	**2m**	Yes
Money Market Funds	**3m**	**3m**	**3m**	Yes
Strategic pooled funds	**10m**	**6m**	**10m**	Yes
Real Estate Investment Trusts	**2m**	**0.45m**	**2m**	Yes

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 8 below.

Table 7: Debt Limits

	Q1 - Q3 Maximum	**31.12.23 Actual**	**2023/24 Operational Boundary**	**2023/24 Authorised Limit**	**Complied?** Yes/No
Borrowing	30.33m	20.06m	40.00m	50.00m	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.

Treasury Management Indicators

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

1. 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 £[X]m required to manage day-to-day cash flow.

	31.3.23 Actual	**31.3.24 Forecast**	**31.3.25 Forecast**	**31.3.26 Forecast**
Loans CFR	**53.54**	**52.59**	**51.62**	**50.62**
Less: Balance sheet resources	52.98	51.4	52.4	53.4
Net loans requirement	0.56	1.19	-0.78	-2.78
Plus: Liquidity allowance	10.00	10.00	10.00	10.00
Liability benchmark	**10.56**	**11.19**	**9.22**	**7.22**
Existing borrowing	**30.33**	**19.79**	**19.26**	**18.73**

Following on from the medium-term forecast above, the long-term liability benchmark assumes capital expenditure funded by borrowing.

Whilst borrowing may be above the liability benchmark, strategies involving borrowing which is significantly above the liability benchmark carry higher risk.

2. 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	31.12.23 Actual	Complied?
Under 12 months	0%	100%	0%	Yes
12 months and within 24 months	0%	100%	0%	Yes
24 months and within 5 years	0%	100%	0%	Yes
5 years and within 10 years	0%	100%	0%	Yes
10 years and above	0%	100%	100%	Yes

The periods in the table should match those in your 2023/24 TMSS

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

3. 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	2024/25	2025/26	No fixed date
Limit on principal invested beyond year end	£16m	£14m	£12m	£10m
Actual principal invested beyond year end	£0m	£0m	£0m	£10m
Complied?	Yes	Yes	Yes	Yes

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

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. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	2023/24 Target	31.12.23 Actual	Complied?
Portfolio average credit rating	A	A+	Yes

Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a 1 month period, without additional borrowing.

	31.12.23 Actual	2023/24 Target	Complied?
Total cash available within 1 months	£9.7m	£7m	Yes

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 31st December.

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

	31/3/23	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%	5.37%
20-year PWLB certainty rate, maturity loans	4.70%	4.90%
50-year PWLB certainty rate, maturity loans	4.41%	4.67%

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.