ITEM NO	

REPORT TO EXECUTIVE

DATE	**29 November 2023**
PORTFOLIO	**Resources and Performance Management**
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2023/24 Treasury Management Mid-Year Report

PURPOSE

1. To report treasury management activity for the first half of 2023/24 covering the period 1 April to 30 September 2023.

RECOMMENDATION

2. The Executive is requested to;

    - Note the treasury management activities undertaken during the period 1 April to 30 September 2023, and;

   Recommend that Full Council;

   - Endorse the quarterly update on the Treasury Management Strategy 2023/24 in compliance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management.

REASONS FOR RECOMMENDATION

3. - To inform members of the treasury management activity in the first half of 2023/24 and to fulfil statutory and regulatory requirements.

SUMMARY OF KEY POINTS

4. **<u>Background</u>**
The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. The first main function of treasury management operations is to ensure this cash flow is adequately planned, with surplus monies

being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return.

The second main function of the treasury management service is to ensure the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending commitments. This management of longer term cash may involve arranging long or short term loans, or using cash flow surpluses, and, on occasions, any current debt may be restructured to meet Council risk or cost objectives.

Treasury management is defined as:

> "The management of the organisation's borrowing, investments and cash flows, including its banking, money market and capital market transactions, the effective control of the risks associated with those activities, and the pursuit of optimum performance consistent with those risks."

The monitoring requirements for treasury activity were set out in the Treasury Management Strategy Statement (TMSS) which included the Prudential and Treasury Indicators for 2023/24 – 2025/26, approved by Full Council on 22 February 2023.

5. **<u>Introduction</u>**

This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (2021).

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Strategy which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by Full Council of an annual Treasury Management Strategy - including the Annual Investment Strategy and Minimum Revenue Provision Policy for the year ahead, **a Mid-year Review Report** and an Annual Report (stewardship report) covering activities during the previous year.
4. Additionally from 2023/24, quarterly reports for scrutiny to the Executive, to include updated Treasury/Prudential Indicators (Q2 being this Mid-year Review report). These are included at Appendix 1.
5. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
6. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Scrutiny Committee.

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first six months of 2023/24;
- A review of the Treasury Management Strategy and Annual Investment Strategy;
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of the Council's investment portfolio for 2023/24;
- A review of the Council's borrowing strategy for 2023/24;
- A review of any debt rescheduling undertaken during 2023/24;
- A review of compliance with Treasury and Prudential Limits for 2023/24.

6. **<u>Economic Update (Provided by Link Asset Services)</u>**

- The first half of 2023/24 saw:
- Interest rates rise by a further 100bps, taking Bank Rate from 4.25% to 5.25% and, possibly, the peak in the tightening cycle.
- Short, medium and long-dated gilts remain elevated as inflation continually surprised to the upside.
- A 0.5% m/m decline in real GDP in July, mainly due to more strikes.
- CPI inflation falling from 8.7% in April to 6.7% in August, its lowest rate since February 2022, but still the highest in the G7.
- Core CPI inflation declining to 6.2% in August from 7.1% in April and May, a then 31 years high.
- A cooling in labour market conditions, but no evidence yet that it has led to an easing in wage growth (as the 3myy growth of average earnings rose to 7.8% in August, excluding bonuses).
- The 0.5% m/m fall in GDP in July suggests that underlying growth has lost momentum since earlier in the year. Some of the weakness in July was due to there being almost twice as many working days lost to strikes in July (281,000) than in June (160,000). But with output falling in 10 out of the 17 sectors, there is an air of underlying weakness.
- The fall in the composite Purchasing Managers Index from 48.6 in August to 46.8 in September left it at its lowest level since COVID-19 lockdowns reduced activity in January 2021. At face value, it is consistent with the 0.2% q/q rise in real GDP in the period April to June, being followed by a contraction of up to 1% in the second half of 2023.
- The 0.4% m/m rebound in retail sales volumes in August is not as good as it looks as it partly reflected a pickup in sales after the unusually wet weather in July. Sales volumes in August were 0.2% below their level in May, suggesting much of the resilience in retail activity in the first half of the year has faded.
- As the growing drag from higher interest rates intensifies over the next six months, we think the economy will continue to lose momentum and soon fall into a mild recession. Strong labour demand, fast wage growth and government handouts have all supported household incomes over the past year. And with CPI inflation past its peak and expected to decline further, the economy has got through the cost-of- living crisis without recession. But even though the worst of

the falls in real household disposable incomes are behind us, the phasing out of financial support packages provided by the government during the energy crisis means real incomes are unlikely to grow strongly. Higher interest rates will soon bite harder too. We expect the Bank of England to keep interest rates at the probable peak of 5.25% until the second half of 2024. Mortgage rates are likely to stay above 5.0% for around a year.

- The tightness of the labour market continued to ease, with employment in the three months to July falling by 207,000. The further decline in the number of job vacancies from 1.017m in July to 0.989m in August suggests that the labour market has loosened a bit further since July. That is the first time it has fallen below 1m since July 2021. At 3.0% in July, and likely to have fallen to 2.9% in August, the job vacancy rate is getting closer to 2.5%, which would be consistent with slower wage growth. Meanwhile, the 48,000 decline in the supply of workers in the three months to July offset some of the loosening in the tightness of the labour market. That was due to a 63,000 increase in inactivity in the three months to July as more people left the labour market due to long term sickness or to enter education. The supply of labour is still 0.3% below its pre-pandemic February 2020 level.
- But the cooling in labour market conditions still has not fed through to an easing in wage growth. While the monthly rate of earnings growth eased sharply from an upwardly revised +2.2% in June to -0.9% in July, a lot of that was due to the one-off bonus payments for NHS staff in June not being repeated in July. The headline 3myy rate rose from 8.4% (revised up from 8.2%) to 8.5%, which meant UK wage growth remains much faster than in the US and in the Euro-zone. Moreover, while the Bank of England's closely watched measure of regular private sector wage growth eased a touch in July, from 8.2% 3myy in June to 8.1% 3myy, it is still well above the Bank of England's prediction for it to fall to 6.9% in September.
- CPI inflation declined from 6.8% in July to 6.7% in August, the lowest rate since February 2022. The biggest positive surprise was the drop in core CPI inflation, which declined from 6.9% to 6.2%. That reverses all the rise since March and means the gap between the UK and elsewhere has shrunk (US core inflation is 4.4% and in the Euro-zone it is 5.3%). Core goods inflation fell from 5.9% to 5.2% and the further easing in core goods producer price inflation, from 2.2% in July to a 29-month low of 1.5% in August, suggests it will eventually fall close to zero. But the really positive development was the fall in services inflation from 7.4% to 6.8%. That also reverses most of the rise since March and takes it below the forecast of 7.2% the Bank of England published in early August.
- In its latest monetary policy meeting on 20 September, the Bank of England left interest rates unchanged at 5.25%. The weak August CPI inflation release, the recent loosening in the labour market and the downbeat activity surveys appear to have convinced the Bank of England that it has already raised rates far enough. The minutes show the decision was "finely balanced". Five MPC members (Bailey, Broadbent, Dhingra, Pill and Ramsden) voted for no change and the other four (Cunliffe, Greene, Haskel and Mann) voted for a 25bps hike.
- Like the US Fed, the Bank of England wants the markets to believe in the higher for longer narrative. The statement did not say that rates have peaked and once again said if there was evidence of more persistent inflation pressures "further tightening in policy would be required". Governor Bailey stated, "we'll be watching closely to see if further increases are needed". The Bank also retained

the hawkish guidance that rates will stay “sufficiently restrictive for sufficiently long”.

- This narrative makes sense as the Bank of England does not want the markets to decide that a peak in rates will be soon followed by rate cuts, which would loosen financial conditions and undermine its attempts to quash inflation. The language also gives the Bank of England the flexibility to respond to new developments. A rebound in services inflation, another surge in wage growth and/or a further leap in oil prices could conceivably force it to raise rates at the next meeting on 2nd November, or even pause in November and raise rates in December.
- The yield on 10-year Gilts fell from a peak of 4.74% on 17th August to 4.44% on 29th September, mainly on the back of investors revising down their interest rate expectations. But even after their recent pullback, the rise in Gilt yields has exceeded the rise in most other Developed Market government yields since the start of the year. Looking forward, once inflation falls back, Gilt yields are set to reduce further. A (mild) recession over the next couple of quarters will support this outlook if it helps to loosen the labour market (higher unemployment/lower wage increases).
- The pound weakened from its cycle high of $1.30 in the middle of July to $1.21 in late September. In the first half of the year, the pound bounced back strongly from the Truss debacle last autumn. That rebound was in large part driven by the substantial shift up in UK interest rate expectations. However, over the past couple of months, interest rate expectations have dropped sharply as inflation started to come down, growth faltered, and the Bank of England called an end to its hiking cycle.
- The FTSE 100 has gained more than 2% since the end of August, from around 7,440 on 31st August to 7,608 on 29th September. The rebound has been primarily driven by higher energy prices which boosted the valuations of energy companies. The FTSE 100’s relatively high concentration of energy companies helps to explain why UK equities outperformed both US and Euro-zone equities in September. Nonetheless, as recently as 21st April the FTSE 100 stood at 7,914.

7. Interest Rate Forecast (Provided by Link Asset Services)

The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates.

The latest forecast on 25th September 2023 sets out a view that short, medium and long-dated interest rates will be elevated for some little while, as the Bank of England seeks to squeeze inflation out of the economy.

The PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1st November 2012.

Link Group Interest Rate View	25.09.23												
	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26
BANK RATE	5.25	5.25	5.25	5.00	4.50	4.00	3.50	3.00	2.75	2.75	2.75	2.75	2.75
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.00	2.80	2.80	2.80	2.80	2.80
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.10	2.90	2.90	2.90	2.90	2.90
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.20	3.00	3.00	3.00	3.00	3.00
5 yr PWLB	5.10	5.00	4.90	4.70	4.40	4.20	4.00	3.90	3.70	3.70	3.60	3.60	3.50
10 yr PWLB	5.00	4.90	4.80	4.60	4.40	4.20	4.00	3.80	3.70	3.60	3.60	3.50	3.50
25 yr PWLB	5.40	5.20	5.10	4.90	4.70	4.40	4.30	4.10	4.00	3.90	3.80	3.80	3.80
50 yr PWLB	5.20	5.00	4.90	4.70	4.50	4.20	4.10	3.90	3.80	3.70	3.60	3.60	3.60

8. **Autumn Statement (November 2023)**

The Economic Update and Interest Rate forecasts reflect the current economic positon at the time of this report, however there may be some changes following the Autumn Statement which is due to be announced on 22nd November 2023.

9. **Treasury Management Strategy update**

The Treasury Management Strategy (TMS) for 2023/24, which includes the Annual Investment Strategy, was approved by this Council on 22 February 2023. There are no policy changes to the TMS included in this report.

10. **The Council's Capital Position**

The table below shows the financing of the Original Capital Budget approved by Full Council on the 22 February 2023 and the latest Revised Capital Budget as per the established Budget Monitoring Cycle and included elsewhere on the agenda. The net increase is due to a combination of in year budget monitoring adjustments and reprofiling of capital expenditure into future years.

Capital	2023/24 Original Estimate £'000	2023/24 Revised Estimate £'000
Total Budget	**41,357**	**41,604**
Financed by:		
Capital receipts	2,547	3,358
Capital grants	22,525	21,719
Revenue	1,062	3,214
Total financing	**26,134**	**28,183**
Borrowing need	**15,223**	**13,313**

11. **Investment Portfolio 2023/24**

The Treasury Management Strategy Statement (TMSS) for 2023/24, which includes the Annual Investment Strategy, was approved by the Council on 22 February 2023. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

The Council will aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs and avoid high borrowing costs where possible (internal borrowing), but also to seek out value available in periods up to 12 months with high credit rated financial institutions where cashflow projections are considered robust, using the Link suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information. As per the approved Investment Strategy, longer-term investments will be carefully assessed.

Investment Counterparty criteria
The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

CDS prices
It is noted that sentiment in the current economic climate can easily shift, so it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances

The average daily level of funds deposited during the financial year to date is £4.5m with an average rate of return of 4.87%. Excluding longer-term property funds, the long-term loan to Burnley College and the Council's 'Sweep' account, the actual value of surplus funds under investment as at 30 September was £19m. These funds have been available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme.

The table below shows the amount invested as at 30 September 2023, and the rate of return against the market benchmark.

Counterparties	Date of Investment	Investment As at 30 Sept 2023 £m	Current Return	Benchmark (average return)*
HSBC (31 Day Notice)**	12/08/2020	4.0	5.00%	4.64%
Santander (31 Day Notice)**	04/05/2023	1.0	4.53%	4.64%
LCC SIS Instant Access**	08/06/2023	6.0	5.00%	4.74%
Lloyds Bank Corporate Markets – 3 mth fixed	09/08/2023	4.0	5.53%	4.44%
Goldman Sachs – 3 mth fixed	27/07/2023	2.0	5.05%	4.44%
Debt Mgmt Office (DMO)	28/09/2023	2.0	5.17%	4.71%
Burnley College Loan – 15 years fixed	28/03/2022	2.0	4.45%	NA

* Benchmark: SONIA Compounded Backward Looking rate for date of investment
** Rate is linked to movement in Bank Rate

The Council has an approved list of counterparties which governs treasury management investment activity. This list is a restricted list taking into consideration the credit rating of the institution concerned and there are also limits on the amount which can be invested with any particular institution from a particular sector e.g. building society, bank etc. and also any group of institutions within an overall banking group. As part of the daily operations of the treasury management dealings, in consultation with guidance from Link Asset Services and the money market brokers, decisions are taken by the Director of Resources, temporarily suspending/revising operations with individual counterparties. The latest deposit counterparties list was approved by the Full Council on 22 February 2023.

Within the approved list of counterparties is scope to invest sums with other Local Authorities, up to a maximum of £8m, and not to exceed £6m per Local Authority. The Council has reinstated the Shared Investment Scheme (SIS) facility with Lancashire County Council to provide instant access to sums on deposit as an alternative to the

'Sweep' account. The SIS rate is linked to movement in the Bank Rate (unlike the Sweep account), and thus provides an improved return on sums deposited plus is instantly accessible to provide improved liquidity should this be necessary when compared to current notice account arrangements (31 day notice required).

The table below shows the maximum amount invested with any of the counterparties at any one time during the period April 2023 to 30 September 2023 against the maximum limits approved in the 2023/24 Treasury Management Strategy.

Counterparties	Maximum Limits £m	Highest level of Investment 2023/24 (£m)
HSBC*	50.0	13.0
Santander	4.0	4.0
Lloyds Bank Corporate Markets	4.0	4.0
Goldman Sachs	4.0	4.0
Lancashire CC SIS	6.0	6.0

*Includes Sweep Account balance

Property Funds

12. The council made two investments totalling £2m in property funds in 2018/19 for the purpose of increasing and diversifying our risk in investment income receivable and to help alleviate future revenue budget pressures.Dividends are receivable in the month following quarter end and for the period April to June 2023 amounted to £18,309 earning an average yield of 3.7%, compared to £16,379 for the same period 2022/23.

Borrowing

13. The Council's capital financing requirement (CFR) for 2023/24 is £80.097m. The CFR denotes the Council's underlying need to borrow for capital purposes. Below is a summary of the Councils' external indebtedness, as at 1 April 2023, and as at 30 September 2023.

Borrowing	1 Apr 23 £'000	30 Sept 23 £'000	Change Apr – June £'000
Public Works Loan Board	59,510	59,234	(276)
Temporary Market Loans	13	13	-
Total	**59,523**	**59,247**	**(276)**

PWLB Loans – No maturity loan repayments were made during the period 1 April to 30 September 2023. Two scheduled annuity repayments were made during the period totalling £276k.

Temporary Market Loans – The Council entered into a temporary loan for cashflow purposes during the reporting period, as previously reported in the first quarter, as below:

Loan	Loan Advanced £'000	Date From	Date To	Interest Rate	Total Interest Payable £'000
London Borough of Havering	3,000	21/04/2023	05/05/2023	4.15%	4.78
Total	**3,000**				**4.78**

14. **Debt Rescheduling**

Debt rescheduling opportunities have been very limited in the current economic climate and following the various increases in the margins added to gilt yields recently linked to increases in the Bank Rate. No debt rescheduling has been undertaken to date in the current financial year. Only prudent and affordable debt rescheduling will be considered.

15. **Compliance with Treasury & Prudential Limits**

It is a statutory duty for the Council to determine and keep under review its affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved Treasury Management Strategy.

During the financial year to date the Council's treasury management activities operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy in compliance with the Council's Treasury Management Practices.

An extract of the Prudential and Treasury Indicators are shown in Appendix 1.

16. **Interest Payable on External Borrowing / Interest Receivable**

Provision is made in the revenue budget to meet the net interest payable on external borrowing. The figure in the original budget for 2023/24 was set at £2,068,168 and remains unchanged, although delaying any decision to externalise borrowing will reduce the amount of interest payable in the year.

The total interest receivable for temporary deposits placed in the period 1 April to 30 September 2023 is £437k, excluding dividends due for the period. The budget for the year for interest and dividend receipts was approved at £575k. On current projections, owing to a rising bank rate environment during the period, additional interest from temporary surplus monies on deposit, is forecast to exceed the budget by £170k.

The above will help support the Council's Revenue Account and ensure a balanced financial position.

FINANCIAL IMPLICATIONS AND BUDGET PROVISION

17. None arising as a direct result of this report.

POLICY IMPLICATIONS

18. Compliance with the revised CIPFA Code of Practice on Treasury Management and the Council's approved Treasury Management Strategy Statement (TMSS).

DETAILS OF CONSULTATION

19. None.

BACKGROUND PAPERS

20. None.

FURTHER INFORMATION	
PLEASE CONTACT:	**Craig Finn – Principal Accountant**