Report of:	Meeting	Date
Councillor Lesley McKay, Resources Portfolio Holder and Clare James, Corporate Director Resources (and S.151 Officer)	Council	30 November 2023

Treasury Management Activity 2023/24 (Mid-year Review)

1. Purpose of report

1.1 To report on the overall position and activities in respect of Treasury Management for the first half of the financial year 2023/24, covering the six month period from April to September 2023.

2. Corporate priorities

2.1 An informed Council who have an understanding of Treasury Management activity, in line with the approved Treasury Management Policy and Strategy Statements and Treasury Management Practices

3. Recommendations

3.1 That the Mid-year Review Report on Treasury Management Activity for the first half of the 2023/24 financial year be noted, in line with requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA's) 'Treasury Management in the Public Services: Code of Practice (revised 2021)'.

3.2 That approval be given to increase the 'External Debt – Operational Boundary (Borrowing)' level from £13.452m to £15.925m for 2023/24 and to future years as detailed in the Prudential Indicators (see Appendix 1) and 5.4.3. This will bring the level in line with the Capital Financing Requirement and the current capital programme, taking into account any potential cash flow implications.

4. Background

4.1 Treasury Management

4.1.1 CIPFA has set out a clear definition of treasury management activities:

> "The management of the organisation's borrowing, investments and cash flows, 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."

4.1.2 The council operates a balanced budget, which broadly means cash raised during the year will fund cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, making sure that there is adequate liquidity cover before considering the optimisation of investment returns.

4.1.3 Another function of the treasury management service is the funding of the council's capital programme. The capital programme provides 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 operations. This management of longer term cash flow may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet council risk or cost objectives.

4.1.4 This report has been written in accordance with the requirements of CIPFA's 'Treasury Management in the Public Services: Code of Practice (revised 2021)' (the Code). The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies, objectives and approach to risk management of the Council's treasury management activities.
- Creation and maintenance of suitable Treasury Management Practices (TMPs) which set out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.
- Creation and maintenance of Investment Management Practices (IMPs) for investments that are not for treasury management purposes.
- Receipt by the full Council of an annual Treasury Management Strategy Statement – including the Annual Investment Strategy, Capital Strategy and Minimum Revenue Provision Policy – for the year ahead, a Mid-year

Review Report and an Annual Report, covering activities during the previous year.
- 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. For this Council the Corporate Director Resources (and S.151 Officer) is responsible for treasury management.
- Delegation by the Council of the role of scrutiny of the treasury management strategy and policies to a specific named body. For this Council the delegated body is the Overview and Scrutiny Committee.

4.1.5 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 half of the 2023/24 financial year.
- A review of the Treasury Management Strategy Statement 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 (not applicable).
- A review of compliance with Treasury and Prudential Limits for 2023/24.

5. Key issues and proposals

(The following economic update 5.1 to 5.2 is largely extracted from an update provided by the Council's Treasury Management Advisors, Link Group, issued on 7 October 2023).

5.1 Economics Update

5.1.1 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% month on month (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 year high.
- A cooling in labour market conditions, but no evidence yet that it has led to an easing in wage growth (as the 3 month year on year growth of average earnings rose to 7.8% in August, excluding bonuses).

5.1.2 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). With output falling in 10 out of the 17 sectors, there is an air of underlying weakness.

5.1.3 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% quarter to quarter (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.

5.1.4 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.

5.1.5 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% for around a year.

5.1.6 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.

5.1.7 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 three month average of the annual rate (3myy) 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.

5.1.8 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. 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.

5.1.9 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.

5.1.10 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 2 November, or even pause in November and raise rates in December.

5.1.11 The yield on 10-year Gilts fell from a peak of 4.74% on 17 August to 4.44% on 29th September, mainly on the back of investors revising down their interest rate expectations. 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).

5.1.12 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 era 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.

5.1.13 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.

5.2 Interest Rates Forecast

5.2.1 The council's treasury advisor, Link Group, provided the following forecasts on 25 September 2023 (PWLB rates are certainty rates):

Link Group Interest Rate View – 25/09/2023						
	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
Bank Rate View	5.25	5.25	5.25	5.00	4.50	4.00
3 Month average earnings	5.30	5.30	5.30	5.00	4.50	4.00
6 Month average earnings	5.60	5.50	5.40	5.10	4.60	4.10
12 Month average earning	5.80	5.70	5.50	5.20	4.70	4.20
5yr PWLB Rate	5.10	5.00	4.90	4.70	4.40	4.20
10yr PWLB Rate	5.00	4.90	4.80	4.60	4.40	4.20
25yr PWLB Rate	5.40	5.20	5.10	4.90	4.70	4.40
50yr PWLB Rate	5.20	5.00	4.90	4.70	4.50	4.20

5.2.2 The latest forecast on 25 September 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.

5.3 Treasury Management Strategy Statement and Annual Investment Strategy Update

5.3.1 The Treasury Management Strategy Statement (TMSS) for 2023/24 was approved by this Council on 20 April 2023.

5.3.2 The underlying TMSS approved previously requires revision in the light of economic and operational movements during the year. The proposed changes are set out below and further supporting details are provided in later sections of the report:

Prudential Indicator	2023/24 Original £000	2023/24 Revised £000
External Debt – Operational Boundary (Borrowing)	13,452	15,925

5.4 The Council's Capital Position (Prudential Indicators)

5.4.1 Prudential Indicator for Capital Expenditure

5.4.1.1 The following table shows the updated budget position for capital expenditure and the changes since the 2023/24 capital programme was agreed as part of the 2023/24 budget process. More detail can be found in the Cabinet report dated 18 October 2023 which provided the month 5 update.

	2023/24 Original Estimate £000	Movements		Current Position as at 31/08/23 £000
		2023/23 Slippage £000	Portfolio Holder / Cabinet Decision £000	
Total Capital Expenditure	18,420	3,912	(4,304)	18,028

5.4.2 Changes to the Financing of the Capital Programme

5.4.2.1 The table below shows how the capital expenditure will be financed:

Funding Source	2023/24 Original Estimate £000	Current Position as at 31/08/23 £000
Capital Receipts	14	1,835
Capital Grants and Contributions	18,256	15,624
Revenue/Reserves	150	569
Total	**18,420**	**18,028**

5.4.2.2 Whilst the above table shows that the capital programme is fully funded and there is no immediate additional financing need, some of the capital grants and contributions are reliant on the council having initially incurred expenditure which is then reclaimed. Whilst the council has sufficient cash balances, this borrowing is sourced internally, however, should anything change, there may be the requirement to undertake borrowing in the short-term to bridge any funding gaps. Just under 87% of planned expenditure is funded by grants and contributions; with around 13% being funded from a combination of cpaital receipts and revenue contributions / utilisation of reserves.

5.4.3 Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary

5.4.3.1 The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary.

Prudential Indicator	2023/24 Original Estimate £000	2023/24 Revised Estimate £000
Capital Financing Requirment (CFR)	10,780	10,780
Total CFR	**10,780**	**10,780**
Operational Boundary:		
External Debt	13,452	15,925
Other Long Term Liabilities	50	50
Total Operational Boundary	**13,502**	**15,975**

5.4.3.2 The CFR requirement represents historical capital expenditure which has yet to be financed; there have been no changes to this.

5.4.3.3 There has been a change to the prudential indicator setting out the operational boundary for external debt. The council currently operates well below this operational level and in reality it currently has no external borrowing. The external debt level factors in the council's CFR, as well as current and future year capital schemes for which funding has been approved but is on 'credit'; in these instances the council incurs expenditure and then claims the funding from a third party. Presently when this occurs the council internally borrows from other cash that it is holding to fund this expenditure in the short term; the amendment to the Prudential Indicator is a worst case scenario, should external borrowing be required in the short term to bridge the gap instead.

5.4.3.4 The Operational Boundary is not a limit but it acts as an early warning indicator to ensure that the Authorised Limit is not breached. If external debt levels are close to the operational boundary, they will be monitored closely to ensure that the Authorised Limit, which is the maximum level of external borrowing that the council can incur, is not exceeded. However, the council currently has no external borrowing.

5.4.4 Limits to Borrowing Activity

5.4.4.1 The first key control over treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2023/24 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

5.4.4.2 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Council. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

5.4.4.3 The approved Authorised Limit for 2023/24 is set at £20.1m; this limit is still sufficient for the council.

5.5 Borrowing

5.5.1 The council's CFR for 2023/24 is £10.780m. The CFR denotes the council's underlying need to borrow for capital purposes. If the CFR is positive the council may borrow from the PWLB or the market (external borrowing), or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.

5.5.2 The 2023/24 budget assumed no long-term borrowing with capital schemes funded by grants and contributions, capital receipts, revenue or reserves. It is anticipated that further borrowing will not be undertaken during this financial year.

5.6 Compliance with Treasury and Prudential Limits

5.6.1 It is a statutory duty for the council to determine and keep under review the affordable borrowing limits. During the half year ended 30 September 2023, the council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2023/24. The Corporate Director Resources reports that no difficulties are envisaged for the current or future years in complying with these indicators, subject to any changes to the Medium Term Financial Plan (MTFP) which would worsen the current forecast budget gap or significantly increase the draw-down on reserves. Beyond the current MTFP period, this position could change if the budget pressures are not addressed in the interim.

5.6.2 All treasury management operations have also been conducted in full compliance with the Council's TMPs.

5.7 Annual Investment Strategy

5.7.1 The Treasury Management Strategy Statement (TMSS), for 2023/24 was approved by this Council on 20 April 2023.

5.7.2 In accordance with the CIPFA's Treasury Management Code of Practice, it sets out the council's investment priorities as being:

1. Security of capital;
2. Liquidity;
3. Yield.

5.7.3 The council will aim to achieve the optimum return (yield) 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, but also to seek out value available in periods up to 12 months with high credit quality financial institutions, using the Link suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

5.8 Creditworthiness

5.8.1 Following the Government's fiscal event on 23 September 2022, both S&P and Fitch placed the UK sovereign debt rating on Negative Outlook, reflecting a downside bias to the current ratings in light of expectations of weaker finances and a challenging economic outlook. Nothing further has evolved in the first half of 2023/24.

5.9 Investment Counterparty Criteria

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

5.9.2 Interest receivable on investments for the first half of the year was £1,084,524 compared to an annual budget of £537,610. The level of interest received is expected to increase through the second part of the year and the budget has been updated in line with expectations and reported to Cabinet on 18 October 2023. The driving factor is an increase in the level of interest rates available. As a result, the MTFP forecast has been adjusted upwards to reflect a more realistic target.

5.9.3 The equated investments for the first half of 2023/24 are detailed in the following table:

Counterparty	Equated Investment Principal	Interest Due	Annualised Rate of Return %	Benchmark Return %	No. of days invested
Santander 35 Day Corp Notice	£219,178	£7,847	3.58	4.71	183
Handelsbanken 35 Day Notice Account	£1,989,042	£26,630	5.40	4.71	183
Qatar 3 month	£6,671,232	£162,247	5.38	4.71	183
Qatar 6 month	£361,644	£15,201	4.11	4.71	183
Handelsbanken I.A Account	£123,288	£2,359	4.10	4.71	183
Bank of Scotland (Call Acc.)	£5,977,126	£139,329	4.91	4.71	183
Nat West - Liquid Select	£4,221,024	£35,498	1.05	4.71	183
LGIM	£8,021,918	£188,658	5.02	4.71	183
Insight	£7,561,645	£167,969	5.01	4.71	183
Deutsche	£6,717,807	£149,704	4.92	4.71	183
Prime Rate	£8,021,918	£189,080	5.03	4.71	183
TOTAL	**£49,885,822**	**£1,084,524**	**4.34**		

5.9.4 The investments earned an average return of 4.34% which means that we have underperformed against the benchmark SONIA (Sterling Overnight Interbank Average) 7-day average of 4.71%. and this is the best comparator available at present. However, for noting at outturn, more specific benchmark returns will be utilised depending upon the term of investment. The volatility in the markets has seen the average rate as low as 4.18% up to highs of 5.19%. In line with our investment priorities, at times we have deposited funds in low interest earning accounts in order to maintain security and liquidity of funds and this will be monitored going forward.

6. Alternative options considered and rejected

6.1 No alternative options have been considered.

Financial, Legal and Climate Change implications	
Finance	Considered in detail in the report above.
Legal	The noting and approval of the recommendations will ensure that the CIPFA Code of Practice on Treasury Management and statutory requirements have been complied with.
Climate Change	There are no direct implications on climate change arising from this report.

Other risks/implications: checklist

If there are significant implications arising from this report on any issues marked with a ✓ below, the report author will have consulted with the appropriate specialist officers on those implications and addressed them in the body of the report. There are no significant implications arising directly from this report, for those issues marked with a x.

risks/implications	✓ / x
community safety	x
equality and diversity	x
health and safety	x

risks/implications	✓ / x
asset management	x
ICT	x
data protection	x

Processing Personal Data

In addition to considering data protection along with the other risks/ implications, the report author will need to decide if a 'privacy impact assessment (PIA)' is also required. If the decision(s) recommended in this report will result in the collection and processing of personal data for the first time (i.e. purchase of a new system, a new working arrangement with a third party) a PIA will need to have been completed and signed off by Data Protection Officer before the decision is taken in compliance with the Data Protection Act 2018.

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List of background papers:		
name of document	date	where available for inspection
None		

List of appendices

Appendix 1 – Prudential Indicators 2023/24 onwards