EXECUTIVE OVERVIEW & SCRUTINY COMMITTEE:
9 November 2023

CABINET: 21 November 2023

COUNCIL: 13 December 2023

Report of: Head of Finance, Procurement and Commercial Services

Relevant Portfolio Holder: Cllr Rob Molloy

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SUBJECT: TREASURY MANAGEMENT AND PRUDENTIAL INDICATORS Q2 MONITORING 2023-24

Wards affected: Borough wide

1.0 PURPOSE OF THE REPORT

1.1 To set out details of Treasury Management operations for the first half of 2023/24 and to report on the Prudential Indicators, where available.

2.0 RECOMMENDATIONS TO EXECUTIVE OVERVIEW & SCRUTINY COMMITTEE

2.1 That the report be considered and any comments submitted to the Finance Portfolio Holder in advance of the Council meeting on 13 December 2023.

3.0 RECOMMENDATIONS TO CABINET

3.1 To note the Treasury Management activity and Prudential Indicator performance for the first quarter of 2023/24.

3.2 To note and endorse the changes to the Prudential Indicators highlighted in section 9.3 for approval by Council in December 2023.

4.0 RECOMMENDATIONS TO COUNCIL

4.1 To note the Treasury Management activity and Prudential Indicator performance for the first quarter of 2023/24.

4.2 To approve the changes to the Prudential Indicators highlighted in section 9.3.

5.0 BACKGROUND

5.1 The Council has adopted the CIPFA Treasury Management Code of Practice in Local Authorities. One condition of the Code is that a report must be made quarterly to the Council on the activities of the Treasury Management function including the exercise of Treasury Management powers delegated to the Head of Finance, Procurement and Commercial Services.

5.2 The CIPFA Prudential Code for Capital Finance sets out a range of prudential indicators to assess whether an authority's financial position is prudent, affordable and sustainable. It is best practice that performance on these indicators is reported to Members on a regular basis.

6.0 ECONOMICS UPDATE AND INTEREST RATE FORECAST

6.1 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. 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).

6.2 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.

6.3 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".

6.4 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.

6.5 The latest forecast from Link issued on 25th September sets out a view that the bank base rate will be elevated for some little while, as the Bank of England seeks to squeeze inflation out of the economy.

Link Group Interest Rate View	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-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**

6.6 Gilt yields and PWLB certainty rates were on a generally rising trend throughout the first half of 2023/24. At the beginning of April, the 5-year rate was the cheapest part of the curve and touched 4.14% whilst the 25-year rate was relatively expensive at 4.58%.

6.7 Link's view is that PWLB rates will fall back over the next two to three years as inflation dampens. The CPI measure of inflation is expected to fall below 2% in the second half of 2024, and we forecast 50-year rates to stand at 3.90% by the end of September 2025. However, there is considerable gilt issuance to be digested by the market over the next couple of years, as a minimum, so there is a high degree of uncertainty as to whether rates will fall that far.

6.8 Link's PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps, calculated as gilts plus 80bps) which has been accessible to most authorities since 1st November 2012.

Link Group Interest Rate View	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26
5yr 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**
10yr 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**
25yr 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**
50yr 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**

7.0 INVESTMENTS

7.1 The Treasury Management Strategy Statement (TMSS) for 2023/24, which includes the Annual Investment Strategy, was approved by the Council on 22nd 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 (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 rated financial institutions.

7.2 As a result of the SORP review, there were several changes to the criteria used for deciding upon counterparties for investment purposes as set out below.

Type of Counterparty	Maximum loan by Council	Maximum Period
Major British Based Banks and Subsidiaries with at least A- credit rating.	£5m	Up to £5m 364 days Up to £3m 3 years
British Based Building Societies. – Only those with at least A- credit rating as advised by Link.	£5m	Up to £5m 364 days Up to £3m 3 years
Other Local Authorities, where agreed.	£5m	Up to 5 years
Property Funds, Corporate Bonds, Infrastructure Investments	£3m	Up to 3 years for Corporate, and 5 years for Property and Infrastructure
Money Market Funds AAA rated	£3m	N/A Callable deposits

7.3 The following table provides details on investment activity during the first six months of this year and last year.

INVESTMENT PORTFOLIO	31.3.23 Actual £000	31.3.23 Actual %	30.9.23 Actual £000	30.9.23 Actual %
Treasury investments				
Banks	5,000	45%	10,000	77%
Building Societies - rated	1,000	9%		0%
Building Societies – unrated		0%		0%
Local authorities	5,000	45%	3,050	23%
DMADF (H M Treasury)	-	0%	-	0%
etc				
Total managed in house	11,000	100%	13,050	100%
Bond funds				
Property funds				
Cash fund managers				
Total managed externally	0	0%	0	0%
TOTAL TREASURY INVESTMENTS	11,000	100%	13,050	100%

Non Treasury investments				
Third party loans				
Subsidiaries	1,300	100%	1,300	100%
Companies				
Property				
etc				
TOTAL NON TREASURY INVESTMENTS	1,300	100%	1,300	100%

Treasury investments	11,000	89%	13,050	91%
Non Treasury investments	1,300	11%	1,300	9%
TOTAL OF ALL INVESTMENTS	12,300	100%	14,350	100%

The maturity structure of the investment portfolio was as follows:

	31.3.23 Actual £000	30.9.23 Actual £000
Investments		
Longer than 1 year		
Up to 1 year	12,300	14,350
Total	12,300	14,350

The gross interest earned was as follows:

	31.3.23 Actual £	30.9.23 Actual £
Gross interest earned	476,111	363,997

7.4 The 2023/24 gross investment income budget was agreed at £438.8k by Council in February 2023 which reflected the anticipated increase in interest rates during the year and resulting increase in investment returns.

7.5 As part of the ongoing work to achieve best value in Treasury Management, we continually monitor our performance against a benchmark figure of the average 3-month SONIA interest rate. The average rate of interest earned at the end of September 2023 was 4.342% which was less than the benchmark average of 4.99%.

7.6 At the end of Q2, higher than anticipated base rate increases mean that it is projected that the overall surplus will be £238k, of which it is estimated to be a £240k surplus attributable to the GRA and a £1.6k shortfall attributable to the HRA.

The small HRA shortfall is due to the reduction in HRA balances upon which the item 8 calculation is made.

8.0 BORROWING

8.1 No long-term borrowing was undertaken during the first half of 2023/24, however, given the true balances held for investment by the Council as set out in 5.6 and the ongoing large scale capital investment it is likely that there will be a need to borrow during 2023/24. However, following advice from Link, the Council will look to borrow in the short-term if required to the point where long-term PLWB rates are expected to fall ie during the fourth quarter of 2023/24.

8.2 The Treasury Management function has managed cash flows in such a way as to avoid incurring borrowing costs despite the Council's GRA capital financing requirement (CFR), i.e. its underlying need to borrow to finance capital expenditure, being £23.1m at the end of 2022/23 as per the table in 7.3 below. Based on current 50-year PWLB rates 5.24% this would cost the Council £1.21m in interest per annum.

8.3 HM Treasury issued new guidance in November 2020 in relation to borrowing from the PWLB. It outlined permissible categories of local authority capital expenditure (service delivery, housing, regeneration, preventative action and treasury management). Any investment asset bought primarily for yield which was acquired after 26 November 2020 would result in the authority not being able to access the PWLB in that financial year or being able to use the PWLB to refinance this transaction at any point in the future.

8.4 The change in PWLB lending criteria is likely to impact the Commercial Property Strategy agreed at Council in July 2020 as part of the SORP process. It was agreed to invest up to £30m over three years for the purchase/construction of commercial properties. If the purchase is primarily for yield rather than for say regeneration, then PWLB borrowing to finance the Council capital programme would not be available. It is not anticipated that any large capital projects currently under consideration would be precluded from accessing PWLB funding.

9.0 PRUDENTIAL AND TREASURY INDICATORS

9.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the quarter ended 30th 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 Head of Finance, Procurement and Commercial Services reports that no difficulties are envisaged for the current or future years in complying with these indicators.

9.2 All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

9.3 The prudential and treasury indicators are shown below.

Treasury Indicators	31.03.23 Actual £'000	2023/24 Original Budget £'000	2023/24 Revised Budget £'000	2023/24 Forecast outturn £'000
Authorised limit for external debt	88,212	146,514	146,514	146,514
Operational boundary for external debt	88,212	136,014	136,014	136,014
Gross external debt	88,212	88,212	88,212	88,212

Prudential Indicators	31.03.23 Actual £'000	2023/24 Original Budget £'000	2023/24 Revised Budget £'000	2023/24 Forecast outturn £'000
Capital expenditure				
Non - HRA	7,709	2,987	6,826	6,296
HRA	13,097	21,955	17,906	12,534
Total	20,806	24,942	24,732	18,830
Capital Financing Requirement (CFR)				
Non - HRA	23,177	29,339	28,083	24,049
HRA	92,957	106,675	108,555	102,061
Total	116,134	136,014	136,638	126,110
Annual change in CFR				
Non - HRA	1,935	947	872	872
HRA	2,506	12,437	9,104	9,104
Total	4,441	13,384	9,976	9,976
In year borrowing requirement				
Non - HRA	2,249	1,347	1,272	1,272
HRA	2,868	12,812	9,479	9,479
Total	5,117	14,159	10,751	10,751
Ratio of financing costs to net revenue stream				
Non - HRA	-0.61%	0.47%	0.47%	0.47%
HRA	12.02%	11.29%	11.29%	11.29%

10.0 SUSTAINABILITY IMPLICATIONS

10.1 There are no significant sustainability impacts associated with this report and, in particular, no significant impact on crime and disorder. The report has no significant links with the Sustainable Community Strategy.

11.0 RISK ASSESSMENT

11.1 The formal reporting to Council of Prudential Indicators and Treasury Management performance is part of the overall framework set out in Codes of Practice to ensure that the risks associated with this area are effectively controlled. Given the Council's strict investment criteria the risk of loss of investment funds is low, the sums invested can be very large, so treasury management activities are included in the Council's Key Risk Register.

<u>Background Documents</u>

The following background documents (as defined in Section 100D (5) of the Local Government Act 1972) have been relied on to a material extent in preparing this Report.

Date	Document	File Ref
2021	CIPFA Updated Prudential Code for Capital Finance in Local Authorities	Accountancy Office
2017	CIPFA Updated Treasury Management Code of Practice	Accountancy Office

Equality Impact Assessment

The decision does not have any direct impact on members of the public, employees, elected members and / or stakeholders. Therefore, no Equality Impact Assessment is required.

Appendices

1 – Minute of Executive Overview & Scrutiny Committee (Cabinet & Council only)
2 – Minute of Cabinet (Council only)