Report for: **Cabinet**

Date of Meeting:	14 November 2023
Subject:	**Treasury Management Strategy Mid-Year Review Report 2023/24**
Cabinet Member:	Cllr James Buczkowski, Cabinet Member for Finance
Responsible Officer:	Andrew Jarrett, Deputy Chief Executive (S151)
Exempt:	N/A
Wards Affected:	All
Enclosures:	Appendix A – Economic Commentary from our Treasury Advisors (Link Group)

Section 1 – Summary and Recommendation(s)

To inform the Cabinet of the treasury performance during the first six months of 2023/24, to agree the ongoing deposit strategy for the remainder of 2023/24 and a review of compliance with Treasury and Prudential Limits for 2023/24.

Recommendation(s):

1. The Cabinet are asked to recommend to Council approval of:
   - **a) a continuation of the current policy outlined at paragraphs 4.0 – 4.5 be agreed; and**
   - **b) the changes to the Capital Financing Requirement, Operational Boundaries and Authorised Limits for the current year at paragraphs 5.4 – 5.5.**

Section 2 – Report

1.0 Introduction

1.1 CIPFA's Code of Practice for Treasury Management recommends the annual setting of a Treasury Management Strategy and best practice dictates a half yearly update on treasury performance. This report will not only update Members on the treasury performance over the first six months of 2023/24, but will also seek approval for the ongoing deposit strategy.

2.0 Treasury Performance 01/04/2023 to 30/09/2023

2.1 The table below shows the Council's overall treasury management position for the first six months of 2023/24.

Treasury Position	Average Interest	Total Interest as at 30/09/2023	Forecast Year-End Position
Temporary Investments and Deposits	4.90%	£510k	£1,183k
CCLA Dividends	4.63%	£116k	£216k
Loans to Subsidiary Company	5.96%	£601k	£1,200k
Loans to Redlands Primary Care*	3.51%	£37k	£73k
Total		**£1,264k**	**£2,672k**
Split Between:			
General Fund		£1,009k	£2,081k
Housing Revenue Account		£255k	£591k

**The Council made two loans in 2021 totalling £2.175m towards the construction of a new GP surgery in Crediton.*

2.2 The General Fund 2022/23 budget for all investment activity is £1,073k and for the Housing Revenue Account is £400k.

3.0 Economic Update

3.1 The Council's treasury advisor, Link Group, provided the following forecasts on 25 September 2023 (PWLB rates are certainty rates, gilt yields plus 80bps):

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

3.2 Bank Rate now appears to have peaked at 5.25%, as weaker August CPI inflation, 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. It is expected that Bank Rate will remain at 5.25% until the second half of 2024.

3.3 Please refer to Appendix 1 for the economic commentary provided by the Council's treasury advisors (Link Group).

4.0 Investment Portfolio

4.1 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite (SLY Principle). Increases to Bank Rate throughout the last two years led to large increases in rates offered by banks and building societies, with current rates far exceeding levels seen over recent years. These increases appear to have levelled off, with the full benefit of the higher interest rates to be seen in the second half of 2023/24.

4.2 The Council's investment portfolio as at 30 September 2023 was made up of short term investments/deposits to the value of £25.26m, comprising of £25.00m in fixed term investments and £0.26m in NatWest call accounts. In addition to this, the Council also holds £5.00m in the CCLA commercial property fund.

4.3 Short term investments/deposits held as at 30 September 2023 are as follows:

Institution	Principal (£)	Rate	Start Date	Maturity Date
Thurrock Council	2,000,000	3.55%	25/10/2022	24/10/2023
NBK International PLC	2,000,000	5.02%	02/05/2023	02/11/2023
NBK International PLC	1,000,000	4.97%	15/05/2023	15/11/2023
Lloyds Bank PLC	4,000,000	5.35%	01/08/2023	01/11/2023
NBK International PLC	2,000,000	5.87%	02/08/2023	02/02/2024
Santander	2,000,000	5.45%	15/08/2023	15/11/2023
Goldman Sachs International Bank	2,500,000	5.84%	29/08/2023	29/02/2024
Goldman Sachs International Bank	2,500,000	5.64%	01/09/2023	01/12/2023
DMO	5,000,000	5.17%	28/09/2023	02/10/2023
City of Liverpool	2,000,000	5.70%	29/09/2023	31/05/2024

4.4 The Council received an average return of 4.90% on investments during the first six months of 2023/24, up from 0.89% at the same point in the previous year. Returns during the early part of 2023/24 were slightly weakened by maturing investments made before Bank Rate hit its current high of 5.25%, and so this rate isn't representative of the interest rates on offer during that time. Performance is expected to improve slightly in the second half of 2023/24 following increases to interest rates throughout the first half of the year.

4.5 The Council currently has £5m deposited with the CCLA (Churches, Charities and Local Authorities) Local Authorities' Property Fund, which pays dividends quarterly. For the first two quarters of 2023/24, dividends of £116k (4.63%) were received, up from £92k (3.68%) for the same period in 2022/23. The dividend payout has risen in the first two quarters of 2023/24, having remained consistent since early 2021, and there has been a small decrease in fund value of £61k during the first half of 2023/24. The Council's share in the fund is now valued at £4.578m.

5.0 Borrowing Requirements and Prudential Indicators

5.1 The Council has no short-term borrowing but has existing PWLB loans of £32.349m as at 30 September 2023, in addition to £1.981m in finance leases.

5.2 The Council's revised capital financing requirement (CFR) for 2023/24 is £49.475m. 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. Table 5.6 shows the Council has forecast borrowings at 31 March 2024 of £33.450m, and so will have utilised £16.025m of cash flow funds in lieu of borrowing to finance the CFR of £49.475m shown in table 5.5.

5.3 There has so far been no new borrowing in 2023/24, and it is expected that there will not be a need for new borrowing before the end of the financial year. This is a reduction in the level of borrowing forecast at the start of the year, which originally stood at £12.500m, and is mainly due to slippage in the Capital Programme.

5.4 The Treasury Management Strategy Statement (TMSS) for 2023/24 was approved by Cabinet on 07 February 2023. The underlying TMSS approved previously requires revision in light of a revised deliverable Capital Programme for 2023/24. The proposed changes are set out below:

Prudential Indicator 2023/24	Original £000	Q1 Updated Forecast £000	Revised Prudential Indicator £000
Authorised Limit	107,000	67,000	60,000
Operational Boundary	98,000	58,000	51,000
Capital Financing Requirement	96,793	56,147	49,475

5.5 The table below shows a breakdown of the revised CFR.

Prudential Indicator – Capital Financing Requirement	2023/24 Original Estimate £000	Q1 Updated Forecast £000	2023/24 Revised Estimate £000
CFR – Non Housing	14,223	9,832	9,508
CFR – Housing	51,934	43,791	39,967
CFR – Loans to Subsidiary Company**	30,636	2,523	0
Total CFR	**96,793**	**56,147**	**49,475**
Net movement in CFR*	**25,814**	**(8,446)**	**(15,117)**

**In-year movement calculated against 2022/23 CFR (estimated at £70,979k when the original 2023/24 estimate was calculated, now known to be £64,592k – 2022/23 Treasury Outturn).*
***Following the decision to soft close 3 Rivers Developments Limited (Full Council 06 September 2023), all future financing assumptions have been removed from the CFR.*

5.6 The table below shows the expected debt position at 31 March 2024, which determines the Operational Boundary and Authorised Limit shown in 5.4 above.

Prudential Indicator – External Debt	**2023/24 Original Estimate £000**	**2023/24 Revised Estimate £000**
Borrowing	43,873	31,373
Other Long Term Liabilities*	2,037	2,077
Total Debt (Year End Position)	**45,910**	**33,450**

** Includes finance leases*

6.0 Annual Investment Strategy

6.1 Any fixed term investments in the market place (except Debt Management Office [DMO]) are restricted to a maximum term of two years (previously one year). The Council's substantial commitments (particularly the monthly precepts to Devon County Council, the Police and Fire Authority) constrain the term of investments. The Cabinet of 7 February 2019 resolved to diversify the investment portfolio to include non-UK banks with a minimum Sovereign Fitch rating of AAA (highest possible rating).

6.2 The Council will continue to have regard to the MHCLG's Guidance on Local Government Investments ("the Guidance") issued in April 2018 (3rd Edition) and CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectorial Guidance Notes ("the CIPFA Treasury Management Code").

7.0 Lending Criteria and Counterparty Limits

7.1 The current policy allows the lending of funds to be deposited with major UK banks and building societies with an investment period no longer than two years and where the counterparty is required to meet the following ratings requirements: Banks (Fitch F1, F1+) and for building societies based upon a minimum Fitch rating of F1 and an asset base level of at least £1bn. The maximum lending limit to any group counterparty is £5m. The policy includes investments with CCLA property fund and money market funds with a limit of £2m on this option. Note that delegation was provided to the S151 officer and Finance Portfolio Holder in 2011/12 to make reactive decisions when market conditions changed due to volatility in rating changes when our own bankers, NatWest, were downgraded, along with other part nationalised banks. We do not invest any term deposits with the Royal Bank of Scotland Group and only have our call accounts with them.

7.2 Officers would recommend a continuation of the existing policy for investments with banks and building societies, property funds and money market funds.

7.3 In addition to these fixed term deposits, the Council also uses an instant access liquidity account with NatWest (the Council's banker) to sweep any small surplus funds which cannot be placed by our brokers. Again, this account will be subject to the same £5m maximum deposit level, plus the balance of any grant fund.

7.4 The Council will also continue to lend to:

- Local Authorities, Police, Fire & Rescue, Parish Councils and other Public Bodies
- UK Government (including gilts, Treasury Bills and the DMADF)
- Other Bodies.

7.5 The investments that can be made to the organisations stated in paragraph 7.4 will not be constrained to a maximum deposit of £5m due to their lower level of risk. However, other bodies have a monetary limit of £3m.

8.0 Conclusion

8.1 The first half-year performance has seen a significant improvement on 2022/23, with slight increases expected through the second half of the year as interest rates on temporary investments and deposits reach their peak. Investment income continues to be bolstered by the interest received from 3 Rivers Developments Limited, which still outstrips interest rates available elsewhere. The Council's investment in the CCLA property fund has seen quarterly dividends exceed pre-pandemic levels, having declined at the start of the Covid-19 pandemic.

8.2 The positive Treasury performance reported above currently excludes any implications associated with the soft closure of 3Rivers. This will be formalised in the end of year outturn accounts.

Financial Implications: Good financial management and administration underpins the entire strategy. The Council's Treasury Management Strategy should attempt to maximise investment return commensurate with minimum risk to the principal sums invested**.**

Legal Implications: The Council is under a statutory duty to "have regard" to the 2011 CIPFA Treasury Management Code of Practice. The Council's own Financial Regulations include requirements as to the reporting of treasury management information.

Risk Assessment: The Council considers deposit security as the paramount function in any treasury dealings or activities. It should be noted that any investment decisions will always be subject to a degree of risk. However, in complying with an agreed Treasury Management Strategy, these risks would be kept to an acceptable level.

Impact on Climate Change: There are no Climate Change implications relating to the content of this report.

Equality Impact Assessment: It is considered that the impact of this report on equality related issues will be nil.

Relationship to Corporate Plan: Maximising investment return whilst minimising risk of credit default enables the Council to finance the delivery of its Corporate Plan objectives.

Section 3 – Statutory Officer sign-off/mandatory checks

Statutory Officer: Andrew Jarrett
Agreed by or on behalf of the Section 151
Date: 06/11/2023

Statutory Officer: Maria De Leiburne
Agreed on behalf of the Monitoring Officer
Date: 06/11/2023

Chief Officer: Stephen Walford
Agreed by or on behalf of the Chief Executive/Corporate Director
Date: 06/11/2023

Performance and risk: Dr Stephen Carr
Agreed on behalf of the Corporate Performance & Improvement Manager
Date: 06/11/2023

Cabinet member notified: Yes

Section 4 - Contact Details and Background Papers

Contact: Kieran Knowles, Principal Accountant & Procurement Manager
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Telephone: 01884 24(4624)

Background papers: Treasury Management Strategy Statement 2023/24 (Council 08/03/2023)

Appendix 1

1.0 Economic Commentary from our Treasury Advisors (Link Group)

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% 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).

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

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% 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.

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.

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 5.0% for around a year.

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.

1.7 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.

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. 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.

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.

1.10 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".

1.11 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.

1.12 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).

1.13 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.

1.14 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.