Appendix A

Treasury Management Report Q1 2023/24

Introduction

The Council has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires it to approve, as a minimum, treasury management semi-annual and annual outturn reports.

This quarterly report provides an additional update and incorporates the new requirement in the 2021 Code, mandatory from 1 April 2023, of quarterly reporting of the treasury management prudential indicators. The non-treasury management prudential indicators are incorporated in the Council's Quarter 1 Financial Forecast.

The Council's Treasury Management Strategy for 2023/24 was approved at a meeting on 21 February 2023. The Council 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 Council's Treasury Management Strategy.

External Context

Economic background: From the start of the quarter until May it looked like peak global monetary policy rates were in sight as inflation continued to ease and central banks turned more dovish in tone. Only a few weeks later, stronger and more persistent inflation data, particularly in the UK, changed the picture.

The UK situation was not welcome news for the Bank of England. GDP growth was weak, confirmed at 0.1% in Q1, although more recent monthly GDP data has been somewhat better. The housing market has stalled, consumer demand is weak but seemingly recovering despite higher interest rates, and labour demand remained strong, with repercussions for wage growth which is accelerating.

April data showed the unemployment rate increased to 3.8% (3mth/year) while the employment rate rose to 76.0%. Pay growth was 6.5% for total pay (including bonuses) and 7.2% for regular pay, the largest growth rate of the latter outside of the Covid pandemic. Once adjusted for inflation, however, growth in total pay and regular pay remained negative.

Inflation fell from its peak of 11.1% reached in October 2022, but annual headline CPI in May 2023 was higher than the consensus forecast at 8.7% (8.4% expected), largely driven by services inflation, while the annual measure of underlying core inflation rose to 7.1% from 6.8%.

After a sharp rise in interest rate expectations, with clearly serious implications for mortgage markets due to higher inflation and wage data, the Bank of England's Monetary Policy Committee reaccelerated monetary policy tightening over the period with a 0.25% rise in Bank Rate in May and a 0.5% rise in June, taking Bank Rate to 5.0%. At both meetings the vote was 7-2 in favour of increasing rates, with the two dissenters preferring to keep rates on hold.

Interest rate expectations priced in further hikes in policy rates. Arlingclose, the Council's treasury adviser, revised its forecast to forecast a further 0.5% of monetary tightening to take Bank Rate to

5.5%. The risks, however, are that rates could be higher; financial markets are forecasting policy interest rates above 6%.

With many mortgages at low fixed rates now systematically being re-set over the next 12-24 months at higher rates at the end of their fixed rate period, there has been a lagged effect of the feed through of monetary policy on households' disposable income. The economic slowdown is expected to develop over time and therefore, despite the GfK measure of consumer confidence rising to -24 in June, it is likely confidence will be negatively affected at some point. The manufacturing sector contracted during the quarter according to survey data, which will eventually feed into services, whose expansion is slowing.

Despite the US Federal Reserve increasing its key interest rate to 5.00-5.25% over the period, activity in the region continued to defy monetary tightening, particularly in labour markets which have so far appeared robust, supporting the Fed's assertations of two more rate hikes after it paused in June. Annual US inflation continued to ease, falling from 4.9% in April to 4.0% in May, the lowest level since March 2021. US GDP growth at 2% annualised in the first calendar quarter of 2023 was also significantly stronger than expected against the initial estimate of 1.3%.

In the Euro zone, the picture was somewhat different. The European Central Bank maintained its hawkish tone and increased its key deposit, main refinancing, and marginal lending interest rates to 3.50%, 4.00% and 4.25% respectively. There were signs of weakening activity, particularly in Germany whose manufacturing sector has taken a hit from high energy prices and weaker global demand. However, inflation remained sticky, annual headline CPI fell to 5.5% in June while annual core inflation rose to 5.4% from 5.3%, which means the ECB is unlikely to stop monetary tightening.

Financial markets: Financial market sentiment and bond yields remained volatile, the latter continuing their general upward trend as uncertainty and concern over higher inflation and higher interest rates continued to dominate.

Gilt yields rose over the period. The 5-year UK benchmark gilt yield rose from 3.30% to 4.67%, the 10-year gilt yield from 3.43% to 4.39%, and the 20-year yield from 3.75% to 4.51%. The Sterling Overnight Rate (SONIA) averaged 4.37% over the quarter.

Credit review: Having completed a review of its credit advice on unsecured deposits at UK and non-UK banks following concerns of a wider financial crisis after the collapse of Silicon Valley Bank, purchase of Credit Suisse by UBS, as well as other well-publicised banking sector issues, in March Arlingclose reduced the advised maximum duration limit for all banks on its recommended counterparty list to 35 days.

Over the period S&P upgraded NatWest Group and related entities to A+ (except NatWest Markets which was upgraded to A), revised the UK sovereign outlook to stable from negative, and upgraded both Barclays Bank Plc and Barclays Bank UK Plc to A+.

Fitch put the US sovereign rating on Rating Watch Negative following increased political partisanship which at the time was hindering the latest resolution to raise the debt ceiling. It also upgraded the outlook on United Overseas Bank to stable, the outlook on Clydesdale to positive, and the outlook on Bank of Montreal to stable.

Moody's withdrew Guildford BC's rating (who chose not to continue being rated) and affirmed the Aaa rating of the European Investment Bank.

Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress but made no changes to the counterparty list or recommended durations over the quarter.

Nevertheless, heightened market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Council's counterparty list recommended by Arlingclose remain under constant review.

Local Context

On 31 March 2023, the Council had net borrowing of £286.8 million 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 balance sheet resources 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	31.3.24 Forecast £m
General Fund CFR	16.7	18.5
HRA CFR	80.9	80.9
Investments CFR	238.5	245.5
Total CFR	**336.1**	**344.9**
Less: Other debt liabilities *	(4.0)	(3.8)
Borrowing CFR	**332.1**	**341.1**
Less: Usable reserves	(34.0)	(29.5)
Less: Working capital	(11.3)	(11.3)
Net borrowing	**286.8**	**300.3**

* PFI liabilities that forms part of the Authority's total debt

The treasury management position at 30 June 2023 and the change over the quarter is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.23 Balance £m	Net Movement £m	30.6.23 Balance £m	30.6.23 Weighted Average Rate %
Long-term borrowing	190.6	0.0	190.6	3.61
Short-term borrowing	108.8	(6.0)	102.8	3.36
Total borrowing	**299.4**	**(6.0)**	**293.4**	**3.52**
Short-term investments	12.1	(1.3)	10.8	5.05
Cash and cash equivalents	0.5	0.1	0.6	2.09
Total investments	**12.6**	**(1.2)**	**11.4**	**4.89**
Net borrowing	**286.8**	**(4.8)**	**282.0**	

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.

However, where an authority already holds a commercial property portfolio, as in the case of this Council, the Prudential Code does permit further capital expenditure on the prudent active management and rebalancing of the portfolio and maximising the value of existing property assets.

Before undertaking further additional borrowing the Council will review the options for exiting these investments, in line with the requirements of the Prudential Code.

Borrowing strategy and activity

As outlined in the Treasury Management Strategy, the Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective. The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

There has been a substantial rise in the cost of both short- and long-term borrowing over the last 18 months. In this quarter, Bank Rate rose from 4.25% at the beginning of April to 5.00% at the end of the quarter and was also significantly higher than its level of 1.25% at the end of June 2022.

Gilt yields faced upward pressure since early April following signs that UK growth has been more resilient and inflation stickier than expected. Consequently, PWLB borrowing rates continued to rise over the quarter. On 30 June 2023, the PWLB certainty rates for maturity loans were 5.25% for 10-year loans, 5.36% for 20-year loans and 4.95% for 50-year loans. Their equivalents on 31 March 2023 were 4.33%, 4.70% and 4.41% respectively.

A new PWLB HRA rate which is 0.4% below the certainty rate has been made available from 15 June 2023. Initially available for a period of one year, this discounted rate is to support local authorities borrowing for the Housing Revenue Account and for refinancing existing HRA loans, providing a window of opportunity for HRA-related borrowing and to replace the Council's £3m loans relating to the HRA maturing during this time frame.

At 30 June 2023 the Council held £293.4 million of loans, (a decrease of £6.0 million from 31 March 2023), as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30 June 2023 are summarised in Table 3A below.

Table 3A: Borrowing Position

	31.3.23 Balance £m	Net Movement £m	30.6.23 Balance £m	30.6.23 Weighted Average Rate %	30.6.23 Weighted Average Maturity Years
Public Works Loan Board	158.3	0.0	158.3	3.76	13.6
Phoenix Life Ltd	36.1	0.0	36.1	2.86	19.8
Government (incl. local authorities)	100.0	(1.0)	99.0	3.36	0.3
Building Societies	5.0	(5.0)	0.0	0.00	0.0
Total borrowing	**299.4**	**(6.0)**	**293.4**	**3.52**	**9.9**

The Council's short-term borrowing cost has continued to increase with the rise in Bank Rate and short-dated market rates. The average rate on the Council's short-term loans at 30 June 2023 on £293.4 million was 3.52%, this compares with 3.27% on £299.4 million loans 3 months ago.

Table 3B: Long-dated loans outstanding

	30.6.23 Balance £m	Rate %	Period Remaining (Years)
PWLB Maturity Loan	3.0	2.82%	1.7
PWLB Maturity Loan	2.0	4.03%	1.7
PWLB Maturity Loan	3.0	2.92%	2.7
PWLB Maturity Loan	3.0	3.01%	3.7
PWLB Maturity Loan	3.0	3.08%	4.7
PWLB Maturity Loan	3.0	3.15%	5.7
PWLB Maturity Loan	4.0	3.21%	6.7
PWLB Maturity Loan	50.0	4.16%	7.2
PWLB Maturity Loan	4.0	3.26%	7.7
PWLB Maturity Loan	4.0	3.30%	8.7
PWLB Maturity Loan	4.0	3.34%	9.7
PWLB Maturity Loan	4.0	3.37%	10.7
PWLB Maturity Loan	4.0	3.40%	11.7
PWLB Maturity Loan	4.0	3.42%	12.7
PWLB Maturity Loan	5.0	3.44%	13.7
PWLB Maturity Loan	5.0	3.46%	14.7
PWLB Maturity Loan	5.0	3.47%	15.7
PWLB Maturity Loan	5.0	3.48%	16.7
PWLB Maturity Loan	5.0	3.49%	17.7
PWLB Maturity Loan	5.4	3.50%	18.7
Phoenix Annuity Loan	14.6	2.86%	34.0
Phoenix Annuity Loan	11.7	2.86%	34.0
Phoenix Annuity Loan	9.8	2.86%	34.0
PWLB Annuity Loan	29.9	4.28%	48.2

The Council'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.

Treasury Investment Activity

The CIPFA Code defines treasury management investments as investments that arise from the organisation's cash flows or treasury risk management activity that ultimately represent balances that need to be invested until the cash is required for use in the course of business.

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the quarter, the Council's investment balances ranged between £9.4 and £15.3 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.23 Balance £m	Net Movement £m	30.6.23 Balance £m	30.6.23 Weighted Average Rate %	30.6.23 Weighted Average Maturity years
Government (incl. local authorities)	12.1	(1.3)	10.8	5.05	0.3
Banks (unsecured)	0.5	0.1	0.6	2.09	0.0
Total investments	**12.6**	**(1.2)**	**11.4**	**4.89**	**0.3**

Both the CIPFA Code and government guidance require the Council 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 Council'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 Council expects to be a long-term borrower and new treasury investments are therefore primarily made to manage day-to-day cash flows using short-term low risk instruments.

Bank Rate increased by 0.75%, from 4.25% at the beginning of April to 5.00% by the end of June, with the prospect of further increases to come. Short-dated cash rates rose commensurately, with 3-month rates rising to around 5.25% and 12-month rates to nearly 6.00%. The rates on DMADF deposits also rose, ranging between 4.80% and 5.40% by the end of June.

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	4.65	A+	5	71	3.89
30.06.2023	4.25	AA-	6	119	4.89
Similar LA's	4.66	A+	65	45	4.26
All LA's	4.65	A+	63	11	4.32

Non-Treasury Investments

The definition of investments in the Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council 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 the Department for Levelling Up, Housing and Communities (DLUHC) also includes within the definition of investments all such assets held partially or wholly for financial return.

The Council has invested the following total principal sums in directly owned property:

Table 6: Directly Owned Property

	31.03.23 Actual £m	30.06.23 Actual £m
Skyway House, Parsonage Road, Takeley - Offices	21.3	21.3
Deer Park Road, Livingston, Scotland - Vet Practice	5.2	5.2
Stane Retail Park, Colchester - Retail Park	27.2	27.2
Chorley - Regional Distribution Centre	58.3	58.3
Gloucester - Distribution Centre	43.3	43.3
Tewkesbury - Offices and Warehouse	29.1	29.4
TOTAL	**184.4**	**184.7**

These investments are forecast to generate £9.6 million of investment income for the Council in 2023/24 after taking account of direct costs.

In addition, as at 30 June 2023 the Council had invested principal amounts of £59.6 million in loans to its subsidiary, Aspire (CRP) Ltd, which holds a 50% share in investment property at Chesterford Research Park. These loans are forecast to generate investment income of £2.4 million during the year.

All non-treasury investments are acquired and managed in line with the Commercial Strategy approved each year by Full Council, and available on the Council's website. This sets out in more detail the risks to the Council of holding such investments, mitigating actions taken, and governance and oversight arrangements.

The principle risks of tenant defaults, void periods, and unexpected refurbishment costs are managed by setting aside sums in a commercial asset reserve. As at 31 March 2023 this reserve stood at £4 million, and there is provision in the Medium Term Financial Strategy to increase this amount by £1 million in each of the following 5 years.

The total contribution generated by commercial investments in 2023/24 (net of associated borrowing costs and repayment of principal) is forecast at £0.8 million, representing 4% of the Council's forecast net direct service expenditure. This contribution has decreased in recent years due to increased borrowing costs, but nevertheless is forecast to remain positive for the foreseeable future.

Compliance

All treasury management activities undertaken during the quarter complied fully with the principles in the Treasury Management Code and the Council's approved Treasury Management Strategy. Compliance with specific treasury management limits is demonstrated in the tables below.

Table 7: Investment Limits

	2023/24 Maximum £m	30.06.23 Actual £m	2023/24 Limit £m	Complied?
UK Central Government	7.3	5.8	Unlimited	✓
UK Local Authorities including Police and Fire per authority	3.0	3.0	5.0	✓
Secured Investments	0.0	0.0	5.0	✓
Banks (unsecured)	1.1	0.6	3.0	✓
UK Building Societies without credit ratings	0.0	0.0	3.0	✓
Registered Providers (unsecured)	0.0	0.0	3.0	✓
Money Market Funds per fund	0.0	0.0	5.0	✓
Strategic Pooled Funds	0.0	0.0	3.0	✓
Real Estate Investment Trusts	0.0	0.0	3.0	✓
Saffron Building Society	0.0	0.0	0.5	✓
Other Investments	0.0	0.0	3.0	✓

Compliance with the Authorised Limit and Operational Boundary for external debt is demonstrated in table 8 below.

Table 8: Debt Limits

	2023/24 Maximum £m	30.06.23 Actual £m	2023/24 Operational Boundary £m	2023/24 Authorised Limit £m	Complied?
Borrowing	299.4	293.4	395.0	415.0	✓
PFI	4.0	4.0	5.0	5.0	✓
TOTAL	**303.4**	**297.4**	**400.0**	**420.0**	✓

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 Prudential Indicators

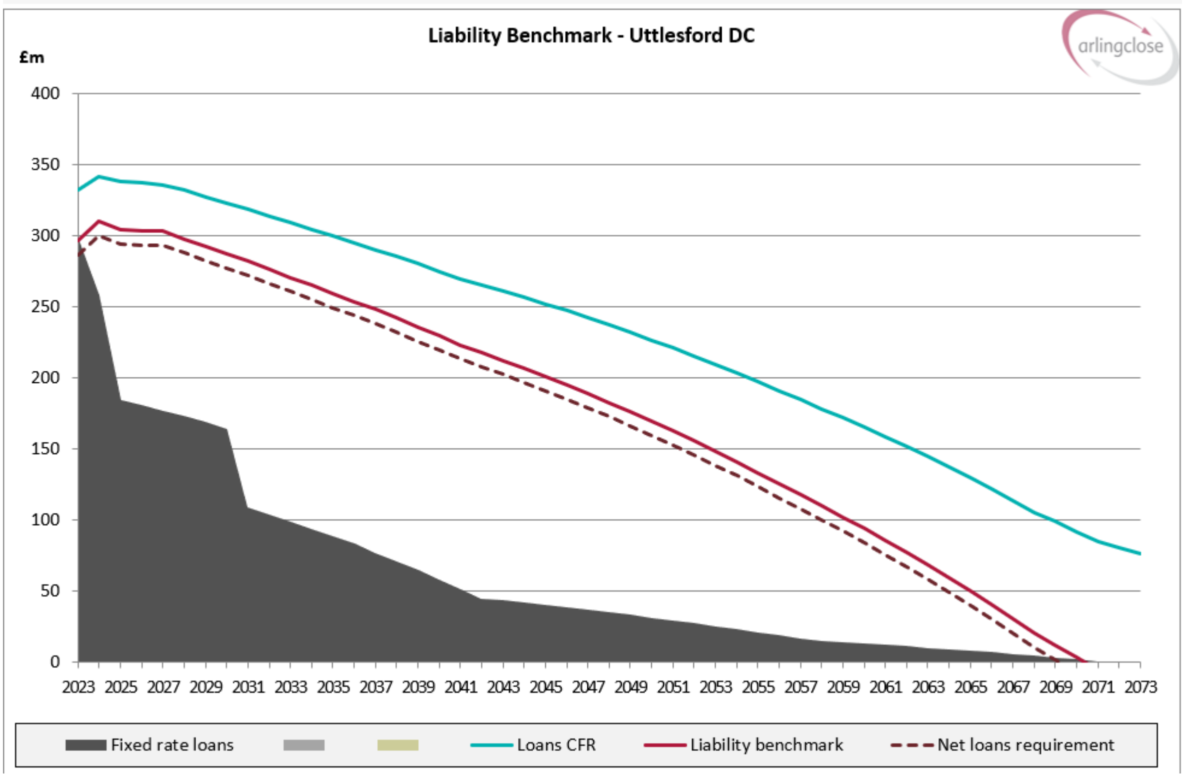
As required by the 2021 CIPFA Treasury Management Code, the Council monitors and measures the following treasury management prudential indicators.

1. Liability Benchmark

This new indicator compares the Council'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 £10 million required to manage day-to-day cash flow.

	31.3.23 Actual £m	31.3.24 Forecast £m	31.3.25 Forecast £m	31.3.26 Forecast £m
Loans CFR	332.1	341.1	337.9	337.2
Less: Usable reserves	(34.0)	(29.5)	(32.7)	(32.5)
Less: Working capital	(11.3)	(11.3)	(11.3)	(11.3)
Add: Minimum investments	10.0	10.0	10.0	10.0
Liability Benchmark	**296.8**	**310.3**	**303.9**	**303.4**

Following on from the medium-term forecast above, the long-term liability benchmark has been calculated assuming approved levels of capital expenditure funded by borrowing until 2027/28, minimum revenue provision on new capital expenditure based on the Council's approved MRP policy, and expenditure and reserves all increasing by inflation of 2% per annum after the end of the current 5-year MTFS period. This is shown in the chart below together with the maturity profile of the Council's existing borrowing.



Whilst borrowing may be above the liability benchmark, strategies involving borrowing which is significantly above the liability benchmark carry higher risk. The gap between the actual agreed fixed rate loans (in grey) and the liability benchmark (solid red line) provides an indication of the level of borrowing which the Council will need to refinance in future years (assuming no further capital expenditure beyond that already forecast).

2. <u>Maturity Structure of Borrowing</u>

This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	30.6.23 Actual %	Upper Limit %	Complied?
Under 12 months	30.61	50	✓
12 months and within 24 months	6.42	50	✓
24 months and within 5 years	3.98	50	✓
5 years and within 10 years	25.25	80	✓
10 years and within 20 years	18.89	80	✓
20 years and above	14.84	100	✓

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 Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury management investments are:

	30.06.23 Actual £m	2023/24 Limit £m	Complied?
Limit on principal invested beyond year end	3.0	10.0	✓

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.

4. Security

The Council 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.

	30.06.23 Actual	2023/24 Target	Complied?
Portfolio average credit rating	AA-	A	✓

5. Liquidity

The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

	30.06.23 Actual £m	2023/24 Target £m	Complied?
Total cash available within 3 months	6.4	2.0	✓

6. Interest Rate Exposures

This indicator is set to control the Council's exposure to interest rate risk. It shows the annual revenue impact that a 1% rise or fall in interest rates would have in respect of borrowing and investments due to expire in the next 12 months. 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.

	30.06.23 Actual £m	2023/24 Target £m	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	0.7	1.5	✓
Upper limit on one-year revenue impact of a 1% fall in interest rates	0.7	1.5	✓