BROMSGROVE DISTRICT COUNCIL

Cabinet

22nd November 2023

TREASURY MANAGEMENT STRATEGY HALF YEARLY REPORT

Relevant Portfolio Holder	Councillor Charlie Hotham, Finance and Enabling Portfolio Holder
Portfolio Holder Consulted	Yes
Relevant Head of Service	Michelle Howell
Report Author	Job Title: Head of Finance & Customer Services email:michelle.howell@bromsgroveandredditch.gov.uk Contact Tel: 0152764252
Wards Affected	N/A
Ward Councillor(s) consulted	N/A
Relevant Strategic Purpose(s)	All
Non-Key Decision	
If you have any questions about this report, please contact the report author in advance of the meeting.	

1. SUMMARY OF PROPOSALS

1.1 This report for 2023/24 presents a half yearly update on the Council's Capital and Treasury Management Strategies, including all prudential indicators. There is the requirement for progress to reported through Cabinet to Council at the half year pointy.

2. RECOMMENDATIONS

Cabinet are asked to Recommend to Council that:

1 That Cabinet note the position in relation to the Councils Prudential indicators.

3. Background

Introduction

3.1 The Authority 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 the Authority to approve, as a minimum, treasury management semi-annual and annual outturn reports.

3.2 This report includes the new requirement in the 2021 Code, mandatory from 1st April 2023, of quarterly reporting of the treasury management prudential indicators.

3.3 The Authority's treasury management strategy for 2023/24 was approved at a meeting on the 22nd February 2023. The Authority has 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 Authority's treasury management strategy.

External Context

3.4 **Economic background:** UK inflation remained stubbornly high over much the period compared to the US and euro zone, keeping expectations elevated of how much further the Bank of England (BoE) would hike rates compared to the regions. However, inflation data published in the latter part of the period undershot expectations, causing financial markets to reassess the peak in BoE Bank Rate. This was followed very soon after by the BoE deciding to keep Bank Rate on hold at 5.25% in September, against expectation for another 0.25% rise.

3.5 Economic growth in the UK remained relatively weak over the period. In calendar Q2 2023, the economy expanded by 0.2%. However, monthly GDP data showed a 0.5% contraction in July, the largest fall to date in 2023 and worse than the 0.2% decline predicted which could be an indication the monetary tightening cycle is starting to cause recessionary or at the very least stagnating economic conditions.

3.6 July data showed the unemployment rate increased to 4.3% (3mth/year) while the employment rate rose to 75.5%. Pay growth was 8.5% for total pay (including bonuses) and 7.8% for regular pay, which for the latter was the highest recorded annual growth rate. Adjusting for inflation, pay growth in real terms were positive at 1.2% and 0.6% for total pay and regular pay respectively.

3.7 Inflation continued to fall from its peak as annual headline CPI declined to 6.7% in July 2023 from 6.8% in the previous month against expectations for a tick back up to 7.0%. The largest downward contribution came from food prices. The core rate also surprised on the downside, falling to 6.2% from 6.9% compared to predictions for it to only edge down to 6.8%.

3.8 The Bank of England's Monetary Policy Committee continued tightening monetary policy over most of the period, taking Bank Rate to 5.25% in August. Against expectations of a further hike in September, the Committee voted 5-4 to maintain Bank Rate at 5.25%. Each of the four dissenters were in favour of another 0.25% increase.

3.9 Financial market Bank Rate expectations moderated over the period as falling inflation and weakening data gave some indication that higher interest rates were working. Expectations fell from predicting a peak of over 6% in June to 5.5% just ahead of the September MPC meeting, and to then expecting 5.25% to be the peak by the end of the period.

3.10 Following the September MPC meeting, Arlingclose, the authority's treasury adviser, modestly revised its interest forecast to reflect the central view that 5.25% will now be the peak in Bank Rate. In the short term the risks are to the upside if inflation increases again, but over the remaining part of the time horizon the risks are to the downside from economic activity weakening more than expected.

3.11 The lagged effect of monetary policy together with the staggered fixed term mortgage maturities over the next 12-24 months means the full impact from Bank Rate rises are still yet to be felt by households. As such, while consumer confidence continued to improve over the period, the GfK measure hit -21 in September, it is likely this will reverse at some point. Higher rates will also impact business and according to S&P/CIPS survey data, the UK manufacturing and services sector contracted during the quarter with all measures scoring under 50, indicating contraction in the sectors.

3.12 The US Federal Reserve increased its key interest rate to 5.25-5.50% over the period, pausing in September following a 0.25% rise the month before, and indicating that it may have not quite completed its monetary tightening cycle.

3.13 Having fallen throughout 2023, annual US inflation started to pick up again in July 2023, rising from 3% in June, which represented the lowest level since March 2021, to 3.2% in July and then jumping again to 3.7% in August, beating expectations for a rise to 3.6%. Rising oil prices were the main cause of the increase. US GDP growth registered 2.1% annualised in the second calendar quarter of 2023, down from the initial estimate of 2.4% but above the 2% expansion seen in the first quarter.

3.14 The European Central Bank increased its key deposit, main refinancing, and marginal lending interest rates to 4.00%, 4.50% and 4.75% respectively in September, and hinted these levels may represent the peak in rates but also emphasising rates would stay high for as long as required to bring inflation down to target.

3.15 Although continuing to decline steadily, inflation has been sticky, Eurozone annual headline CPI fell to 5.2% in August while annual core inflation eased to 5.3% having stuck at 5.5% in the previous two months. GDP growth remains weak, with recent data showing the region expanded by only 0.1% in the three months to June 2023, the rate as the previous quarter.

Financial markets:

3.16 Financial market sentiment and bond yields remained volatile, with the latter generally trending downwards as there were signs inflation, while still high, was moderating and interest rates were at a peak.

3.17 Gilt yields fell towards the end of the period. The 5-year UK benchmark gilt yield rose from 3.30% to peak at 4.91% in July before trending downwards to 4.29%, the 10-year gilt yield rose from 3.43% to 4.75% in August before declining to 4.45%, and the 20-year yield from 3.75% to 4.97% in August and then fell back to 4.84%. The Sterling Overnight Rate (SONIA) averaged 4.73% over the period.

Credit review:

3.18 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. This stance continued to be maintained at the end of the period.

3.19 During the second quarter of the period, Moody's revised the outlook on Svenska Handelsbanken to negative from stable, citing concerns around the Swedish real estate sector.

3.20 Having put the US sovereign rating on Rating Watch Negative earlier in the period, Fitch took further action in August, downgrading the long-term rating to AA+, partly around ongoing debt ceiling concerns but also an expected fiscal deterioration over the next couple of years.

3.21 Following the issue of a Section 114 notice, in September Arlingclose advised against undertaking new lending to Birmingham City Council, and later in the month cut its recommended duration on Warrington Borough Council to a maximum of 100 days.

3.22 Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress and although no changes were made to recommended durations over the period, Northern Trust Corporation was added to the counterparty list.

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

Local Context

3.24 On 31st March 2023, the Authority had net investments of £6.52m 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 Forecast £m	**31.3.24 Forecast £m**
General Fund CFR	16.49	16.59
Investments CFR	13.75	9.47
Total CFR	**30.24**	**26.06**
Less: External borrowing**	8.28	18.28
Internal (over) borrowing	21.96	7.78
Less: Balance sheet resources		
Usable Reserves	-13.40	-11.20
Working Capital	-3.10	-3.10
Net New borrowing / (investments)	**5.46**	**-6.52**

* finance leases, PFI liabilities and transferred debt that form part of the Authority's total debt
** shows only loans to which the Authority is committed and excludes optional refinancing

3.25 The treasury management position at 31 March 2023 and the change over the six months' is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.23 Balance £m	Movement £m	30.9.23 Balance £m	30.9.23 Rate %
Long-term borrowing - PWLB - Other Short-term borrowing	3.75	-3.75	0	
Total borrowing	3.75	-3.75	0.00	
Long-term investments Short-term investments Cash and cash equivalents	1.0	4.70	5.70	5.00%
Total investments	1.00	4.70	5.70	
Net borrowing / (investments)	2.75	-8.45	-5.70	

Borrowing

3.26 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.

3.27 The Authority has not invested in assets primarily for financial return or that are not primarily related to the functions of the Authority. It has no plans to do so in future.

Borrowing strategy and activity

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

3.29 There was a substantial rise in the cost of both short- and long-term borrowing over the last 18 months. Bank Rate rose by 1% from 4.25% at the beginning of

April to 5.25% at the end of September. Bank Rate was 2% higher than at the end of September 2022.

3.30 UK gilt yields were volatile, mainly facing upward pressure since early April following signs that UK growth had been more resilient, inflation stickier than expected, and that the Bank of England saw persistently higher rates through 2023/24 as key to dampening domestic demand. Gilt yields, and consequently PWLB borrowing rates, rose and broadly remained at elevated levels. On 30th September, the PWLB certainty rates for maturity loans were 5.26% for 10-year loans, 5.64% for 20-year loans and 5.43% for 50-year loans. Their equivalents on 31st March 2023 were 4.33%, 4.70% and 4.41% respectively.

3.31 At 30th September the Authority held no loans, a decrease of £3.75m from 31st March 2023, as part of its strategy for funding previous and current years' capital programmes. There are no outstanding loans on 30th September are summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.23 Balance £m	Net Movement £m	30.9.23 Balance £m	30.9.23 Weighted Average Rate %	30.9.23 Weighted Average Maturity (years)
Public Works Loan Board					
Banks (LOBO)					
Banks (fixed-term)					
Local authorities (long-term)					
Local authorities (short-term)	3.75	-3.75	0.00		
Total borrowing	3.75	-3.75	0.00		

3.32 The Authority's short-term borrowing cost has increased with the rise in Bank Rate and short-dated market rates. It has no short term debt at the moment

Treasury Investment Activity

3.33 The CIPFA Treasury Management Code now defines treasury management investments as those investments which arise from the Authority's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

3.34 The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the half year, the Authority's investment balances ranged between £0.5million and 11 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 £'000	Net Movement £'000	30.9.23 Balance £'000	30.9.23 Income Return %	30.9.23 Weighted Average Maturity days
Banks & building societies (unsecured)					
Banks & building societies (secured deposits)					
Covered bonds (secured)					
Government	1.00	4.70	5.70	5.00%	6
Local authorities and other govt entities					
Corporate bonds and loans					
Money Market Funds					
Total investments	**1.00**	**4.70**	**5.70**		

3.35 Both the CIPFA Code and government guidance require the Authority 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 Authority'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.

3.36 As demonstrated by the liability benchmark in this report, the Authority 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. The existing portfolio of strategic pooled funds will be maintained to diversify risk into different asset classes and boost investment income.

3.37 Bank Rate increased by 1%, from 4.25% at the beginning of April to 5.25% by the end of September. Short-dated cash rates rose commensurately, with 3-month rates rising to around 5.25% and 12-month rates to nearly 6%. The rates on DMADF deposits also rose, ranging between 5.17% and 5.26% by the end of September

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3.38 £5m that is available for longer-term/ short-term investment is invested with DMADF.

Non-Treasury Investments

3.39 The definition of investments in the Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority 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).

3.40 Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) and Welsh Government also includes within the definition of investments all such assets held partially or wholly for financial return.

3.41 The Authority does not hold these types of investments presently, although the setting up of the new Housing Company will include a shareholding in a subsidiary and a loan to that Subsidiary.

Treasury Performance

3.42 The Authority measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 5 below

Table 5: Performance

	Actual £m	Budget £m	Over/ under	Actual %	Benchmark %	Over/ under
Total borrowing	**0**	**0**	**0**			
PFI and Finance leases	0	0	0			
Total debt	0	0	0			
Total treasury investments	**5.70**	**5.00**	**0.70**			
				n/a	n/a	n/a

Compliance

3.43 The Interim Director of Finance reports that all treasury management activities undertaken during the quarter complied fully with the principles in the Treasury Management Code and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 6 below.

Table 6: Investment Limits

	2023/24 Maximum	30.9.23 Actual	2023/24 Limit	Complied? Yes/No
Any single organisation, except the UK Government				
UK Central Government	Unlimited	£5.7m		Yes
Any group of organisations under the same ownership				
Any group of pooled funds under the same management				
Negotiable instruments held in a broker's nominee account				
Limit per non-UK country				
Registered providers and registered social landlords				
Unsecured investments with banks and building societies				
Loans to unrated corporates				
Money Market Funds				
Strategic pooled funds				
Real Estate Investment Trusts				

3.44 Compliance with the Authorised Limit and Operational Boundary for external debt is demonstrated in table 7 below.

Table 7: Debt and the Authorised Limit and Operational Boundary

	H1 2023/24 Maximum £'000	30.9.23 Actual £'000	2023/24 Operational Boundary £'000	2023/24 Authorised Limit £'000	Complied? Yes/No
Borrowing	5,500	0	45,000	55,000	Yes
PFI and Finance Leases			**1,000**	**1,000**	Yes
Total debt	**5,500**	**0**	**46,000**	**56,000**	Yes

3.45 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

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

1. Liability Benchmark:

3.47 This new indicator compares the Authority'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 £2m required to manage day-to-day cash flow.

	31.3.23 Actual	31.3.24 Forecast	31.3.25 Forecast	31.3.26 Forecast
Loans CFR	30.2	26.1	27.3	27.7
Less: Balance sheet resources				
Usable reserves	-13.4	-11.2	-10.8	-10.2
Working Capital	-3.1	-3.1	-3.1	-3.1
Net loans requirement	13.7	11.8	13.4	14.4
Plus: Liquidity allowance	0.2	0.2	0.2	0.2
Liability benchmark	**13.9**	**12.0**	**13.6**	**14.6**
Existing borrowing	**3.7**	**18.28**	**18.28**	**18.28**

3.48 Following on from the medium-term forecast above, the long-term liability benchmark assumes capital expenditure funded by borrowing of £18m, minimum revenue provision on new capital expenditure based on a 40 year asset life and income, expenditure and reserves all increasing by inflation of 7% in 2024/5 reducing to 2% ongoing. This is shown in the chart below together with the maturity profile of the Authority's existing borrowing. Presently borrowing has been delivered through the use of internal resources and the Council has no long term borrowing.

3.49 Whilst borrowing may be above the liability benchmark, strategies involving borrowing which Is significantly above the liability benchmark carry higher risk.

2. ***Maturity Structure of Borrowing*:**

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

	Upper Limit	Lower Limit	30.9.23 Actual	Complied?
Under 12 months	50%	0%	0%	Yes
12 months and within 24 months	50%	0%	0%	Yes
24 months and within 5 years	50%	0%	0%	Yes
5 years and within 10 years	50%	0%	0%	Yes
10 years and above	100%	0%	0%	Yes

3.51 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:***

3.52 The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury management limits are:

	2023/24	2024/25
Limit on principal invested beyond year end	£1.0m	£0.5m
Actual principal invested beyond year end	Nil	Nil
Complied?	Yes	Yes

3.53 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.

Additional indicators

Security:

3.54 The Authority 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.

	2023/24 Target	30.9.23 Actual	Complied?
Portfolio average credit rating	A	UK Govt	Yes

Liquidity:

3.55 The Authority 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.

	30.9.23 Actual	2023/24 Target	Complied?
Total cash available within [3] months	£5.7m	£2.5m	Yes
Total sum borrowed in past [3] months without prior notice	0	0	Yes

Interest Rate Exposures:

3.56 This indicator is set to control the Authority's exposure to interest rate risk. Bank Rate rose by 1.25% from 4.25% on 1st April to 5.25% by 30th September.

Interest rate risk indicator	2023/24 Target	30.9.23 Actual	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	500,000	0	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	500,000	0	Yes

3.57 For context, the changes in interest rates during the quarter were:

	31/3/23	30/9/23
Bank Rate	4.25%	5.25%
1-year PWLB certainty rate, maturity loans	4.78%	5.69%
5-year PWLB certainty rate, maturity loans	4.31%	5.22%
10-year PWLB certainty rate, maturity loans	4.33%	5.26%
20-year PWLB certainty rate, maturity loans	4.70%	5.64%
50-year PWLB certainty rate, maturity loans	4.41%	5.43%

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.

4. IMPLICATIONS

Financial Implications

4.1 Financial implications are set out in Section 3.

Legal Implications

4.2 A number of statutes governing the provision of services covered by this report contain express powers or duties to charge for services. Where an express power to charge does not exist the Council has the power under Section 111 of the Local Government Act 1972 to charge where the activity is incidental or conducive to or calculated to facilitate the Council's statutory function.

Service / Operational Implications

4.3 Monitoring is undertaken to ensure that income targets are achieved, with Treasury Management activities taking place on a daily basis.

Customer / Equalities and Diversity Implications

4.4 The only impact of treasury transaction is in respect of ethical investment linked to the Council's investment counterparties. Presently, the Council has a limited counterparty list based on financial risk to the authority.

5. RISK MANAGEMENT

5.1 There is always significant risk in relation to treasury transactions, this is why Councils appoint Treasury Advisors, which in the case of Bromsgrove is Arlingclose. In addition, there is the requirement in this area to provide a yearly Strategy report containing indicators/limits that must be met, a half yearly update and closure report all of which must be reported to full Council.

6. APPENDICES

None

7. BACKGROUND PAPERS

MTFP 2023/4 – February 2023 which contains this year's Asset Strategy, Treasury Management Strategy and MRP Policy.

Choose agenda document pack - Council 22 February 2023 (bromsgrove.gov.uk)

8. KEY

None