

MEETING:	GOVERNANCE AND AUDIT COMMITTEE
DATE:	5 SEPTEMBER 2024
TITLE:	TREASURY MANAGEMENT 2023/24
PURPOSE:	CIPFA's Code of Practice requires that a report on the results of the Council's actual treasury management is produced.
RECOMMENDATION:	RECEIVE THE REPORT FOR INFORMATION
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Executive Summary

During the 2023/24 financial year the Council's treasury management activity remained within the limits originally set and total interest received on deposits was £3.5m which was above the budgeted level of £3.2m. There were no defaults by institutions in which the Council had deposited money.

1. Introduction

The Council's Treasury Management Strategy for 2023/24 was approved at Full Council on 2nd March 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 are therefore central to the Council's Treasury Management Strategy.

This report compares the actual performance against the strategy for the financial year 2023/24 and fulfils the Council's legal obligation under the Local Government Act 2003 to have regard for both the CIPFA Code and the Welsh Government's Investment Guidance.

2. External Context

Economic Background: UK inflation continued to decline from the 8.7% rate seen at the start of 2023/24. By the last quarter of the financial year headline consumer price inflation (CPI) had fallen to 3.4% in February, but was still above the Bank of England's 2% target at the end of the period. The core measure of CPI, i.e. excluding food and energy, also slowed in February to 4.5% from 5.1% in January, a rate that had stubbornly persisted for three consecutive months.

The UK economy entered a technical recession in the second half of 2023, as growth rates of -0.1% and -0.3% respectively were recorded for Q3 and Q4. Over the 2023 calendar year GDP growth only expanded by 0.1% compared to 2022. Of the recent monthly data, the Office for National Statistics reported a rebound in activity with economy expanding 0.2% in January 2024. While the economy may somewhat recover in Q1 2024, the data suggests that prior increases in interest rates and higher

price levels are depressing growth, which will continue to bear down on inflation throughout 2024.

Labour market data provided a mixed message for policymakers. Employment and vacancies declined, and unemployment rose to 4.3% (3mth/year) in July 2023. The same month saw the highest annual growth rate of 8.5% for total pay (i.e. including bonuses) and 7.8% for regular pay growth (i.e. excluding bonuses). Thereafter, unemployment began to decline, falling to 3.9% (3mth/year) in January and pay growth also edged lower to 5.6% for total pay and 6.1% for regular pay, but remained above the Bank of England's forecast.

Having begun the financial year at 4.25%, the Bank of England's Monetary Policy Committee (MPC) increased the Bank Rate to 5.25% in August 2023 with a 3-way split in the Committee's voting as the UK economy appeared resilient in the face of the dual headwinds of higher inflation and interest rates. The Bank Rate was maintained at 5.25% through to March 2024. The vote in March was 8-1 in favour of maintaining rates at this level, with the single dissenter preferring to cut rates immediately by 0.25%. Although financial markets shifted their interest rate expectations downwards with expectations of a cut in June, the MPC's focus remained on assessing how long interest rates would need to be restrictive in order to control inflation over the medium term.

In the Bank's quarterly Monetary Policy Report (MPR) released in August 2023 the near-term projection for services price inflation was revised upwards, goods price inflation widespread across products, indicating stronger domestic inflationary pressure with second-round effects in domestic prices and wages likely taking longer to unwind than they did to emerge. In the February 2024 MPR the Bank's expectations for the UK economy were positive for the first half of 2024, with a recovery from the mild recession in calendar H2 2023 being gradual. Headline CPI was forecast to dip below the 2% target quicker than previously thought due to declining energy prices. These effects would hold inflation slightly above target for much of the forecast horizon.

Following this MPC meeting, Arlingclose, the authority's treasury adviser, maintained its central view that 5.25% remains the peak in Bank Rate and that interest rates will most likely start to be cut later in H2 2024. The risks in the short term are deemed to be to the downside as a rate cut may come sooner than expected, but then more broadly balanced over the medium term.

The US Federal Reserve also pushed up rates over the period, reaching a peak range of between 5.25-5.50% in August 2023, where it has stayed since. US policymakers have maintained the relatively dovish stance from the December meeting and at the meeting in March, economic projections pointed to interest rates being cut by a total of 0.75% in 2024.

Following a similarly sharp upward trajectory, the European Central Bank hiked rates to historically high levels over the period, pushing its main refinancing rate to 4.5% in September 2023, where it has remained. Economic growth in the region remains weak, with a potential recession on the cards, but inflation remains sticky and above the ECB's target, putting pressure on policymakers on how to balance these factors.

Financial Markets: Sentiment in financial markets remained uncertain and bond yields continued to be volatile over the year. During the first half of the year, yields rose as interest rates continued to be pushed up in response to rising inflation. From October they started declining again before falling sharply in December as falling

inflation and dovish central bank attitudes caused financial markets to expect cuts in interest rates in 2024.

Over the financial year, the 10-year UK benchmark gilt yield rose from 3.44% to peak at 4.75% in August, before then dropping to 3.44% in late December 2023 and rising again to 3.92% (28th March 2024). The Sterling Overnight Rate (SONIA) averaged 4.96% over the period to 31st March.

Credit review: In response to an improving outlook for credit markets, in January 2024 Arlingclose moved away from its previous temporary stance of a 35-day maximum duration and increased its advised recommended maximum unsecured duration limit on all banks on its counterparty list to 100 days.

Earlier in the period, S&P revised the UK sovereign outlook to stable and upgraded Barclays Bank to A+. Moody's also revised the UK outlook to stable, Handelsbanken's outlook to negative, downgraded five local authorities, and affirmed HSBC's outlook at stable while upgrading its Baseline Credit Assessment. Fitch revised UOB's and BMO's outlooks to stable.

In the final quarter of the financial year, Fitch revised the outlook on the UK sovereign rating to stable from negative based on their assessment that the risks to the UK's public finances had decreased since its previous review in October 2022, the time of the mini- budget.

Moody's, meanwhile, upgraded the long-term ratings of German lenders Helaba, Bayern LB and LBBW on better solvency and capital positions, despite challenges from a slowing German economy and exposure to the commercial real estate sector. Moody's also upgraded or placed on review for an upgrade, Australian banks including ANZ, CBA NAB and Westpac on the back of the introduction of a new bank resolution regime.

Credit default swap prices began the financial year at elevated levels following the fallout from Silicon Valley Bank and collapse/takeover of other lenders. From then the general trend was one of falling prices and UK lenders' CDS ended the period at similar levels to those seen in early 2023. Earlier in the year some Canadian lenders saw their CDS prices rise due to concerns over a slowing domestic economy and housing market, while some German lenders were impacted by similar economic concerns and exposure to commercial real estate towards the end of the period, with LBBW remaining the most elevated.

Heightened market volatility is expected to remain a feature, at least in the near term and, credit default swap levels will be monitored for signs of ongoing credit stress. As ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remain under constant review.

3. Year End Position

Balance Sheet Summary

At 31 March 2024 the Council had net investments of £41m arising from its revenue and capital activities. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The movements are summarised in the following table:

	31.3.23 Actual £m	2023/24 Movement £m	31.3.24 Actual £m
CFR	171	3	174
Less: Other debt liabilities	(1)	0	(1)
Borrowing CFR	170	3	173
Less: Usable reserves	(134)	6	(128)
Less: Working capital	(86)	0	(86)
Net borrowing/ (investment)	(50)	9	(41)

The Council pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

Treasury Management Summary

	31.3.23 Balance £m	Movement £m	31.3.24 Balance £m
Long- term borrowing	100.9	(6.9)	94.0
Short-term borrowing	1.1	4.5	5.6
PFI	1.2	(0.2)	1.0
Total borrowing	103.2	(2.6)	100.6
Short-term investments	(89.9)	(7.7)	(97.6)
Cash and cash equivalents	(62.8)	18.9	(43.9)
Total investments	(152.7)	11.2	(141.5)
Net borrowing/ (investment)	(49.5)	8.6	(40.9)

4. Borrowing Activity

At 31st March 2024, the Council held £99.6m of loans, a decrease of £2.4m on the previous year, as part of its strategy for funding previous years' capital programmes.

The debt interest paid in 2023/24 was £5.4 million on an average debt portfolio of £100.2 million at an average interest rate of 5.44%.

The year-end borrowing position and the year-on-year change is summarised in the following table:

	31.3.23 Balance £m	2023/24 Movement £m	31.3.24 Balance £m	31.3.24 Rate %	31.3.24 WAM* years
PWLB	84.3	(2.2)	82.1	5.7	16.9
Bank (Fixed term)	16.2	0.0	16.2	4.2	54.4
Other	1.5	(0.2)	1.3	0.0	3.0
Total borrowing	102.0	(2.4)	99.6		

*Weighted average maturity

The Council's main 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 a secondary objective of flexibility to renegotiate loans should the Council's long-term plans change. The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio and, where practicable, to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

Interest rates have seen substantial rises over the last two years, although these rises have now begun to plateau. Gilt yields fell in late 2023, reaching April 2023 lows in December 2023 before rebounding to an extent in the first three months of 2024. Gilt yields have remained volatile, seeing upward pressure from inflation at times and downward pressure from falling inflation and a struggling economy at other times.

On 31st December, the PWLB certainty rates for maturity loans were 4.74% for 10-year loans, 5.18% for 20-year loans and 5.01% for 50-year loans. Their equivalents on 31st March 2023 were 4.33%, 4.70% and 4.41% respectively.

The cost of short-term borrowing from other local authorities has generally risen with Base Rate over the year. Interest rates peaked at around 7% towards the later part of March 2024 as many authorities required cash at the same time. These rates are expected to fall back to more normal market levels in April 2024.

No new long-term borrowing was undertaken in 2023/24, with existing loans maturing without replacement. This strategy enabled the Council to reduce net borrowing costs (despite foregoing investment income) and reduce overall treasury risk.

5. Treasury Investment Activity

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.

The Council has held significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Council's investment balances have ranged between £139.5 million and £270.2

million.

Treasury Investment Position

	31.3.23 Balance £m	2023/24 Movement £m	31.3.24 Balance £m	31.3.24 Rate %	31.3.24 WAM* days
Banks & building societies (unsecured)	29.1	(23.2)	5.9	5.27	29.8
Local Authorities	20.1	60.9	81.0	5.84	134.2
Money Market Funds	60.8	(17.8)	43.0	5.27	1.0
Debt Management Office	34.0	(34.0)	0.0	0.0	0.0
Pooled Funds	8.7	2.9	11.6	5.78	365+
Total investments	152.7	(11.2)	141.5		

*Weighted average maturity

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 investments before seeking the highest 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.

The Bank Rate increased by 1% over the period, from 4.25% at the beginning of April 2023 to 5.25% by the end March 2024. Short- term rates peaked at 5.7% for 3-month rates and 6.7% for 12-month rates during the period, although these rates subsequently began to decline towards the end of the period. Money Market Rates also rose and were between 5.2% and 5.3% by the end of March 2024.

£11.6m of the Council's investments are held in externally managed strategic pooled equity, bond and property funds where short-term liquidity is a lesser consideration, and the objectives instead are regular revenue income and long- term price stability. These funds generated an income return of 5.8% which is used to support services in year, and an unrealised capital loss of £0.07m in this financial year. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued stability in meeting the Council's medium to long term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years but with the confidence that over a three-to five year period total returns will exceed cash interest.

Investment Benchmarking

	Credit Score	Credit Rating	Bail-in Exposure	WAM* (days)	Income Rate of Return
31.03.2023	4.63	A+	62%	33	4.04%
31.03.2024	5.30	A+	38%	36	5.59%
Similar LAs	4.06	AA-	21%	174	5.29%
All LAs	4.82	A+	61%	9	5.03%

*Weighted average maturity

6. Compliance Report

The section 151 officer reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in the following tables:

Debt Limits

	2023/24 Maximum	31.3.24 Actual	2023/24 Operational Boundary	2023/24 Authorised Limit	Complied
Borrowing	102.0m	99.6m	£190m	£200m	✓

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.

Investment Limits

	2023/24 Maximum	31.3.24 Actual	2023/24 Limit	Complied
The UK Government	£102m	£0m	Unlimited	✓
Local authorities & other government entities	£5m	£5m	£10m	✓
Secured investments	£0m	£0m	£10m	✓
Banks (unsecured)	£5m	£5m	£5m	✓
Building societies (unsecured)	£5m	£5m	£5m	✓
Registered providers (unsecured)	£5m	£0m	£5m	✓
Money Market Funds	£10m	£10m	£10m	✓
Strategic pooled funds	£5m	£5m	£10m	✓
Real estate investment trusts	£0m	£0m	£10m	✓
Other investments	£0m	£0m	£5m	✓

7. Treasury Management Indicators

The Council measures and manages its exposures to treasury management risks using the following indicators:

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the time-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment and taking the arithmetic average, weighted by the length of each investment. Unrated investments are assigned a score based on their perceived risk.

	31.3.24 Actual	2023/24 Target	Complied
Portfolio average credit score	5.3	A score of 6 or lower	✓

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.

	31.3.24 Actual	2023/24 Target	Complied
Total cash available within 3 months	£115.9m	£10m	✓

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates was:

	31.3.24 Actual	2023/24 Limit	Complied
Upper limit on one year revenue impact of a 1% rise in interest rates	£1,122,112	£1,039,420	x
Upper limit on one year revenue impact of a 1% fall in interest rates	£1,122,122	£1,039,420	x

This indicator has not been complied with because the indicator was set when interest rates were low, but interest levels have risen significantly in the year without warning and therefore it is reasonable that the amounts are above the limit.

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

	31.3.24 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	5.6%	25%	0%	✓
12 months and within 24 months	4.0%	25%	0%	✓
24 months and within 5 years	5.9%	50%	0%	✓
5 years and within 10 years	25.2%	75%	0%	✓
10 years and above	59.3%	100%	0%	✓

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.

Principal Sums Invested for Periods Longer than 364 days: 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 limits on the long-term principal sum invested to final maturities beyond the period end were:

	2023/24	2024/25	2025/26
Actual principal invested beyond year end	£13m	£0	£0
Limit on principal invested beyond year end	£20m	£20m	£20m
Complied	✓	✓	✓