

Report to: **Audit and Governance Committee**

Date: **14th December 2023**

Title: **Treasury Management Mid-Year Review**

Portfolio Area: **Cllr Brazil - Finance**

Wards Affected: **All**

Urgent Decision: **N** Approval and clearance obtained: **Y**

Date next steps can be taken: **N/A**

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RECOMMENDATION:

It is RECOMMENDED that the Audit Committee resolves to endorse the contents of the report.

1. Executive summary

1.1 To date, the Council has outperformed against the industry benchmark by 0.12%. The Council has achieved a rate of return of 4.83%, against the Sterling Overnight Interbank Average (SONIA) rate of 4.71%. The Council's budget for investment interest of £800,000 for 2023/24. The current forecast is £1,575,000 which will exceed the budget by £775,000.

2. Background

2.1 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return.

2.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans or using longer term cash flow surpluses.

2.3 Treasury management is defined as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2.4 The Council's Finance Procedure Rules require that a report be taken to the Audit Committee three times a year on Treasury Management. The specific reporting requirements are:

- An annual treasury strategy in advance of the year (Council 30/03/2023 – 73/22)
- A mid-year (minimum) treasury update report (This report)
- An annual review following the end of the year describing the activity compared to the strategy.

2.5 The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that Members be updated on treasury management activities regularly (i.e. Treasury Management Strategy Statement (TMSS), annual and midyear reports). This report therefore ensures this Council is implementing best practice in accordance with the Code.

3. Economics and Interest Rates

Economics Update

3.1 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).

Interest Rate Forecast

3.2 The Council's treasury advisor, Link Group, has provided the following forecast.

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

3.3 The latest forecast shown above sets out a view that short, medium and long-dated interest rates will be elevated for some little while, as the Bank of England seeks to squeeze inflation out of the economy.

4. Treasury Management Strategy Statement

4.1 The Treasury Management Strategy Statement (TMSS) for 2023/24, was approved by the Council on 30/03/23 – 73/22. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield.

4.2 The Council will also aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with highly credit rated financial institutions, using our suggested creditworthiness approach, including a minimum sovereign credit rating, and Credit Default Swap (CDS) overlay information.

4.3 There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

5. Investment Portfolio 2023/24

5.1 The Council held £34.736m of investments as at 30 September 2023 (£56.52m at 31 March 2023) and the investment portfolio yield for the first six months of the year is 4.83% against a benchmark (SONIA rate) of 4.71%. The £34.736m of investments is made up of Money Market Funds, Fixed Term Deposits and Property Funds.

A full list of investments held as at 30 September 2023 is shown below:

Money Market Funds

Amount £	Investment	Average Interest rate
4,900,000	BlackRock ICS-Inst GBP	4.73%
6,000,000	LGIM Sterling Liquidity Fund	4.65%
10,900,000	Total Money Market Funds	

The Council currently has three Money Market Funds. The money market funds allow immediate access to the Council's funds and spreads risk as it is pooled with investments by other organisations and invested across a wide range of financial institutions.

Fixed Term Deposits – Current

Counterparty	Fixed to	£	Interest Rate
Standard Chartered	05/01/2024	6,000,000	5.89%
Lloyds NRFB	28/03/2024	6,000,000	5.66%
Natwest NRFB	24/11/23	4,200,000	5.12%
Debt Management Office	19/10/2023	1,000,000	5.24%
Debt Management Office	19/10/2023	1,300,000	5.26%
Debt Management Office	19/10/2023	4,500,000	5.25%
Debt Management Office	19/10/2023	1,000,000	5.26%
Total Fixed Term Deposits		24,000,000	

5.2 The Council's Investments mid-way through the year are always higher than at the end of the year (at 31st March) due to the cash flow advantage that the Council benefits from part way through the year.

This is, in part, due to the timing differences between the Council collecting council tax income and paying this over to major precepting authorities such as Devon County Council, the Police and the Fire Authority

The Council's current counterparty limit is £6 million (£7 million for Lloyds plc).

Property Funds

Amount* £	Investment	Dividend Yield
1,298,526	CCLA – Property Fund (original investment of £1.5million)	4.66%
1,823,277	CCLA – Diversified Income Fund (original investment of £2million)	3.39%
3,121,803	Total Property Funds	

*Investment value as at 30 September 2023

5.3 The CCLA Investments experienced a downward revaluation in 2022/23. The outlook for global economic growth continues to be weaker. Inflation is likely to remain above target rates for some time, interest rates in most areas will still be negative in real terms. This backdrop placed some downward pressure on investments during 2022. CCLA will maintain the portfolio's emphasis on real assets such as good quality equities and alternatives, adding selectively to fixed income as attractive opportunities are identified to support continues performance for this long term investment.

5.4 These investments have yielded returns of 4.66% and 3.39% as shown above. Due to the nature of these investments they are long term strategic investments (the Council does not currently intend to sell them) and the Council elected to designate them as fair value through other comprehensive income. This election means that there is no impact on the revenue budget of changes in their valuation. Any gains or losses on the valuation of the CCLA investments are transferred to a Financial Instruments Revaluation Reserve. This is classed as an unusable reserve.

5.5 The Chief Financial Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2023/24. The Council's budgeted investment return for 2023/24 is £800,000 and based on performance for the year to date, this is expected to be exceeded by £1,575,000.

Investment Counterparty Criteria

5.5 The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

Borrowing Position

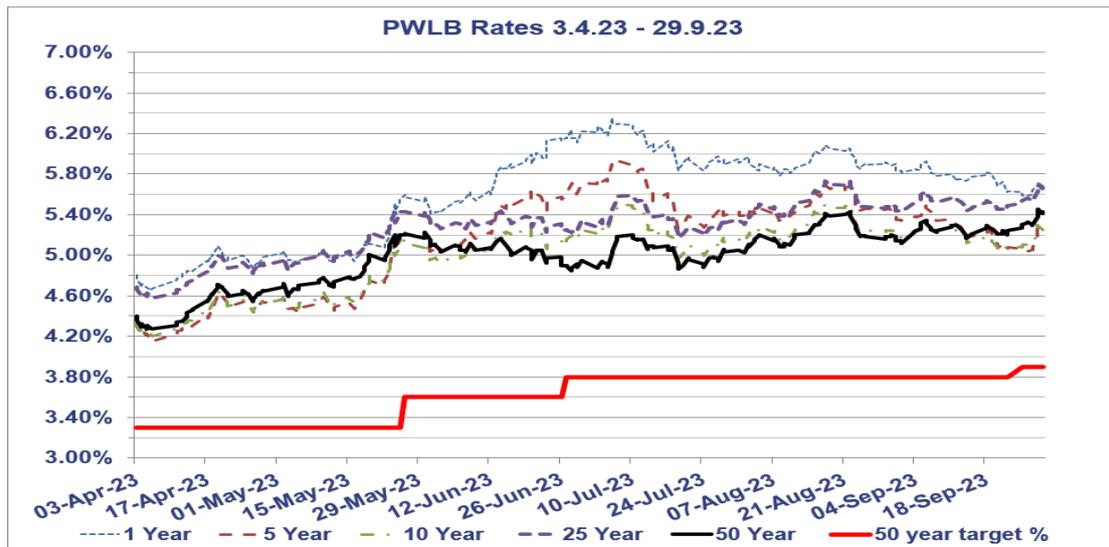
5.6 The Council's capital financing requirement (CFR) for 2023/24 is £21.5million. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.

A summary of the Council's debt position at 30 September 2023 compared with 31 March 2023 is shown in the table below:

Lender	Maturity	Interest Rate %	Principal held at 31 March 2023 £'000	Principal held at 30 Sept 2023 £'000
PWLB – Maturity Borrowed in May 2018 (23 maturity loans)	5-19 Years	2.41*	5,490	5,130
PWLB – Annuity Borrowed in September 2019	50 Years	1.97	3,829	3,778
PWLB – Annuity Borrowed in December 2019	50 Years	3.09	4,965	4,917
Total			14,284	13,825

*Average interest rate

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



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	4.65%	4.14%	4.20%	4.58%	4.27%
Date	06/04/2023	06/04/2023	06/04/2023	06/04/2023	05/04/2023
High	6.36%	5.93%	5.51%	5.73%	5.45%
Date	06/07/2023	07/07/2023	22/08/2023	17/08/2023	28/09/2023
Average	5.62%	5.16%	5.01%	5.29%	5.00%
Spread	1.71%	1.79%	1.31%	1.15%	1.18%

Local Authorities are required to submit a summary of their planned capital spending and PWLB borrowing for the following three years. This is updated on at least an annual basis. In March of each year, Council approves its Capital Strategy, Investment Strategy and Treasury Management Strategy. PWLB borrowing is permitted in the future for the four categories of regeneration, service delivery, housing and refinancing.

Debt Rescheduling

5.8 Debt rescheduling opportunities have increased over the course of the past six months and will be considered if giving rise to long-term savings. However, no debt rescheduling has been undertaken to date in the current financial year.

6. Outcomes/outputs

6.1 The Council's budget for investment interest of £800,000 for 2023/24 is expected to be exceeded. A forecast of £1,575,000 will exceed this budget by £775,000.

6.2 Industry performance is judged and monitored by reference to a standard benchmark; this is the Sterling Overnight Interbank Average rate (SONIA). The average SONIA rate at the end of September was 4.71% which is 0.12% higher than our average return of 4.83% as at 30 September 2023.

7. Options available and consideration of risk

7.1 The Treasury Management Strategy is risk averse with no investments allowed for a period of more than a year and very high credit rating is required, together with a limit of £6m per counterparty. This has resulted in only a small number of institutions in which the Council can invest (see Appendix A).

7.2 The Council's treasury management activities and interest rates are reviewed daily to ensure cash flow is adequately planned with surplus funds being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

7.3 The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy will be brought to Members' attention in treasury management update reports.

8. Proposed Way Forward

8.1 The Council's treasury activities and interest rates will continue to be monitored daily and appropriate action taken to mitigate risk whilst optimising investment return where possible.

9. Compliance with Treasury Limits and Prudential Indicators

9.1 During the financial year the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement and annual Treasury Strategy Statement. The Council's Prudential Indicators for 2023/24 are detailed and shown in Appendix B.

10. Implications

Implications	Relevant to proposals Y/N	Details and proposed measures to address
Legal/Governance	Y	The Statutory Powers that apply to this report are the Local Government Act 1972 Section 151 and the Local Government Act 2003.
Financial implications to include reference to value for money	Y	To date, the Council has underperformed the industry benchmark by 0.12%. The Council has achieved a rate of return of 4.83%, against the Sterling Overnight Interbank Average rate (SONIA) of 4.71%. The Council's investment income target of £800,000 for 2023/24 is expected to be exceeded by £775,000.

Risk		<p>The security risk is the risk of failure of a counterparty. The liquidity risk is that there are liquidity constraints that affect the interest rate performance. The yield risk is regarding the volatility of interest rates/inflation.</p> <p>The Council has adopted the CIPFA Code of Practice for Treasury Management and produces an Annual Treasury Management Strategy and Investment Strategy in accordance with CIPFA guidelines.</p> <p>The Council engages a Treasury Management advisor and a prudent view is always taken regarding future interest rate movements. Investment interest income is reported quarterly to SLT and the Executive through the quarterly budget monitoring reports.</p>
Supporting Corporate Strategy		The treasury management function supports all of the Thematic Delivery Plans within 'Better Lives for all'.
Climate Change – Carbon/Biodiversity Impact		No direct carbon/biodiversity impact arising from the recommendations.
<i>Comprehensive Impact Assessment Implications</i>		
Equality and Diversity		None directly arising from this report.
Safeguarding		None directly arising from this report.
Community Safety, Crime and Disorder		None directly arising from this report.
Health, Safety and Wellbeing		None directly arising from this report.
Other implications		None directly arising from this report.

Supporting Information
Appendices:

Appendix A – Lending list as at 30th September 2023
Appendix B – Prudential and Treasury Indicators 2023/24

APPENDIX A

Counterparty as at 29th Sept 2023		Fitch Rating				Moody's Ratings			S&P Ratings		Suggested Duration		
		Long Term	Short Term	Viability	Support	Long Term	Short Term	Long Term	Short Term				
United Kingdom													
AAA Rated and Government Backed Securities	Collateralised LA Deposit*										Y - 60 mths		
	Debt Management Office										Y - 60 mths		
	Multilateral Development Banks										Y - 60 mths		
	Supranationals										Y - 60 mths		
	UK Gilts										Y - 60 mths		
Building Societies	AI Rayan Bank PLC	SB				NO	A1	P-1			P - 6 mths		
	Bank of Scotland PLC (RFB)	SB	A+	F1	a	WD	SB	A1	P-1	SB	A+	A-1	P - 6 mths
	Barclays Bank PLC (NRFB)	SB	A+	F1	a	WD	SB	A1	P-1	SB	A+	A-1	P - 6 mths
	Barclays Bank UK PLC (RFB)	SB	A+	F1	a	WD	SB	A1	P-1	SB	A+	A-1	P - 6 mths
	Close Brothers Ltd	NO	A-	F2	a-	WD	SB	Aa3	P-1				P - 6 mths
	Clydesdale Bank PLC	PO	A-	F2	bbb+	WD	SB	A3	P-2	SB	A-	A-2	G - 100 days
	Co-operative Bank PLC (The)	SB	BB	B	bb-	WD	PO	Ba1	NP				N/C - O mths
	Goldman Sachs International Bank	SB	A+	F1		WD	SB	A1	P-1	SB	A+	A-1	P - 6 mths
	Handelsbanken Plc	SB	AA	F1+		WD				SB	AA-	A-1+	O - 12 mths
	HSBC Bank PLC (NRFB)	SB	AA-	F1+	a	WD	SB	A1	P-1	SB	A+	A-1	O - 12 mths
	HSBC UK Bank Plc (RFB)	SB	AA-	F1+	a	WD	SB	A1	P-1	SB	A+	A-1	O - 12 mths
	Lloyds Bank Corporate Markets Plc (NRFB)	SB	A+	F1		WD	SB	A1	P-1	SB	A	A-1	P - 6 mths
	Lloyds Bank Plc (RFB)	SB	A+	F1	a	WD	SB	A1	P-1	SB	A+	A-1	P - 6 mths
	National Bank of Kuwait (International) PLC	SB	A+	F1		WD				SB	A	A-1	P - 6 mths
	NatWest Markets Plc (NRFB)	SB	A+	F1	WD	WD	SB	A1	P-1	SB	A	A-1	P - 6 mths
	Santander Financial Services Plc (NRFB)	SB	A+	F1		WD	NO	A1	P-1	SB	A-	A-2	P - 6 mths
	Santander UK PLC	SB	A+	F1	a	WD	NO	A1	P-1	SB	A	A-1	P - 6 mths
	SMBC Bank International PLC	SB	A-	F1		WD	SB	A1	P-1	SB	A	A-1	P - 6 mths
Standard Chartered Bank	SB	A+	F1	a	WD	SB	A1	P-1	SB	A+	A-1	P - 6 mths	
Building Societies	Coventry Building Society	SB	A-	F1	a-	WD	SB	A2	P-1				P - 6 mths
	Leeds Building Society	SB	A-	F1	a-	WD	SB	A3	P-2				G - 100 days
	Nationwide Building Society	SB	A	F1	a	WD	SB	A1	P-1	SB	A+	A-1	P - 6 mths
	Principality Building Society	SB	BBB+	F2	bbb+	WD	SB	Baa1	P-2				N/C - O mths
	Skipton Building Society	SB	A-	F1	a-	WD	SB	A2	P-1				P - 6 mths
	West Bromwich Building Society						SB	Ba3	NP				N/C - O mths
Yorkshire Building Society	SB	A-	F1	a-	WD	PO	A3	P-2				G - 100 days	
Nationalised and Part Nationalised Banks	National Westminster Bank PLC (RFB)	SB	A+	F1	a	WD	SB	A1	P-1	SB	A+	A-1	B - 12 mths
	Royal Bank of Scotland Group Plc (RFB)	SB	A+	F1	a	WD	SB	A1	P-1	SB	A+	A-1	B - 12 mths

Key	
Watches and Outlooks	Duration
SB Stable Outlook	Yellow - Y 60 Months
NO Negative Outlook	Blue - B 12 Months
NW Negative Watch	Orange - O 12 Months
PO Positive Outlook	Pink - P 6 Months
PW Positive Watch	Green - G 100 Days
EO Evolving Outlook	
EW Evolving Watch	

APPENDIX B

PRUDENTIAL AND TREASURY INDICATORS 2023/24

The Council's capital expenditure plans are the key driver of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members to overview and confirm capital expenditure plans.

Capital Expenditure

This prudential Indicator is a summary of the Council's capital expenditure.

	2022/23 Actual £000	2023/24 Budget £000	2023/24 Estimate £000
General Fund services	9,379	12,312	10,468
TOTAL	9,379	12,312	10,468

The table below summarises the financing of the Council's capital programme.

	2022/23 Actual £000	2023/24 Budget £000	2023/24 Estimate £000
External sources	2,596	1,604	4,241
Own resources	1,312	3,478	2,751
Debt	5,471	7,230	3,476
TOTAL	9,379	12,312	10,468

The Council's Borrowing Need (the Capital Financing Requirement)

The Council's cumulative outstanding amount of debt finance is measured by the Capital Financing Requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt.

	2022/23 Actual £000	2023/24 Budget £000	2023/24 Estimate £000
General Fund services	18,520	26,253	21,507
TOTAL CFR	18,520	26,253	21,507

The Council's Gross Debt and the Capital Financing Requirement

Statutory guidance states that debt should remain below the capital financing requirement, except in the short-term. As can be seen from the indicator below, the debt is lower than the CFR by £7.68m in the forecast for 2023/24.

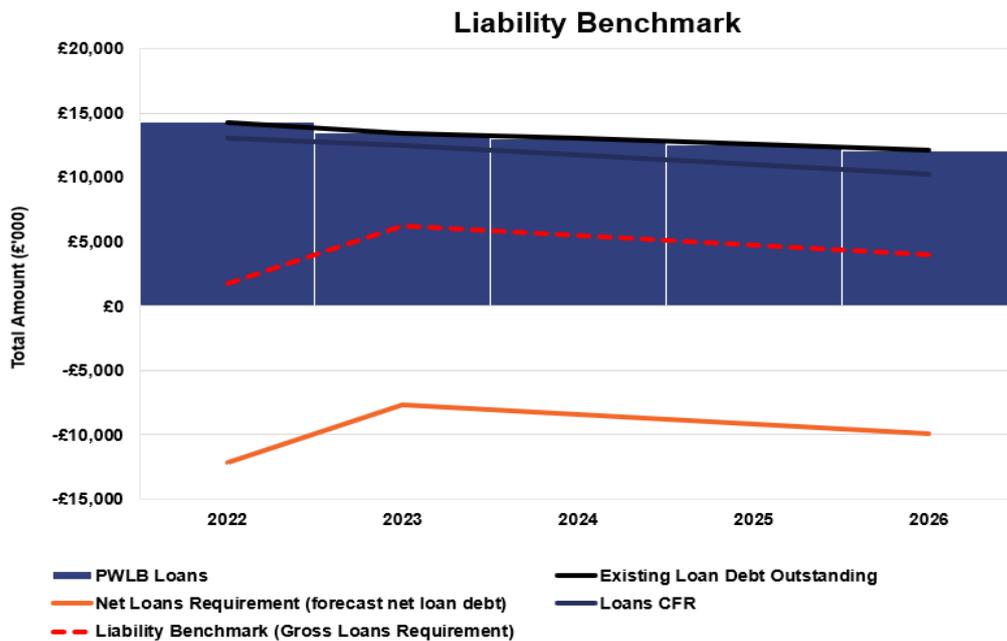
	2022/23 Actual £000	2023/24 Budget £000	2023/24 Estimate £000
Debt	14,284	18,465	13,825
Capital Financing Requirement	18,520	26,253	21,507

Liability Benchmark

A third and new prudential indicator for 2023/24 is the Liability Benchmark (LB). The Council is required to estimate and measure the LB for the forthcoming financial year and the following two financial years, as a minimum.

There are four components to the LB: -

- **Existing loan debt outstanding:** the Council's existing loans that are still outstanding in future years.
- **Loans CFR:** this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned MRP.
- **Net loans requirement:** this will show the Authority's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned MRP and any other major cash flows forecast.
- **Liability benchmark (or gross loans requirement):** this equals net loans requirement plus short-term liquidity allowance.



Borrowing is currently above the liability benchmark which will be utilised when future capital schemes in the Capital Strategy are delivered.

AFFORDABILITY PRUDENTIAL INDICATORS

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans.

These provide an indication of the impact of the capital investment plans on the Council's overall finances.

Ratio of financing costs to net revenue stream

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants.

	2022/23 Actual	2023/24 Budget	2023/24 Estimate
Financing costs (£m)	(296,783)	*98,845	** (731,498)
Proportion of net revenue stream	(2.8%)	0.8%	(6.2%)

* The budgets were prepared in January 2023. The forecast income from investments is £1,575,000 which is £775,000 higher than the budget of £800,000. This is due to successive increases in the bank base rate. As at September 2023 the Council is achieving 4.83% return from its treasury management investments. In addition to this the Council has taken out no external borrowing in 2023/24 and therefore financing costs are lower than previously estimated.

** This is made up of interest payments totalling £355k plus MRP totalling £489k less investment income of £1.575m

TREASURY INDICATORS: LIMITS TO BORROWING ACTIVITY

The Operational Boundary – This is the limit beyond which external debt is not normally expected to exceed. This is the maximum level of external debt for cash flow purposes.

Operational Boundary	2022/23	2023/24
	£	£
Borrowing	50,000,000	35,000,000
Other long term liabilities	-	-
Total	50,000,000	35,000,000

As part of the Treasury Management Strategy Statement for 2023/24, Members approved an Operational Boundary Limit of £35 million for 2023/24.

The Authorised Limit for External Debt – A further key prudential indicator represents a control on the overall level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by Full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

This provides headroom over and above the operational boundary for unusual cash movements. This is the maximum amount of money that the Council could afford to borrow.

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although no control has yet been exercised.

Authorised limit	2022/23	2023/24
	£	£
Borrowing	75,000,000	40,000,000
Other long term liabilities	-	-
Total	75,000,000	40,000,000

South Hams District Council's current level of borrowing as at 30 September 2023 was £14.28 million.

As part of the Treasury Management Strategy Statement for 2023/24, Members approved an overall Borrowing Limit of £40 million for 2023/24.