	Audit and Standards Advisory Committee 6th December 2023
	Report from the Corporate Director of Finance and Resources
	Lead Cabinet Member - Deputy Leader and Cabinet Member for Finance, Resources & Reform

Mid – Year Treasury Management Report 2023/24

Wards Affected:	All
Key or Non-Key Decision:	Non-key
Open or Part/Fully Exempt: (If exempt, please highlight relevant paragraph of Part 1, Schedule 12A of 1972 Local Government Act)	Open
No. of Appendices:	One: Mid – Year Treasury Management Report 2023/24
Background Papers:	None
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1.0 Executive Summary

1.1 This report updates Members on Treasury activity for the first half of the financial year 2023-24.

2.0 Recommendation(s)

2.1 The Committee is asked to note the 2023-24 Mid-Year Treasury report for reference on to Cabinet and Council, along with noting the fact that the Council has been fully compliant with the Treasury Management indicators.

3.0 Detail

3.1 Contribution to Borough Plan Priorities & Strategic Context

3.2 Treasury Management underpins all aspects of financial management within the Council which enables the delivery of the priorities and objectives within the Borough Plan. The Council's Treasury Management Strategy is underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's Code of Practice (the CIPFA Code) on Treasury Management 2021. This requires the Council to approve Treasury Management mid-year and annual reports. The update report is presented here in-line with CIPFA's recommendations.

3.3 CIPFA published its revised Treasury Management Code of Practice (the TM Code) back in December 2021. The key changes in the two codes were around permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments. The principles within the Code took immediate effect although local authorities were able to defer the revised reporting requirements until the 2023/24 financial year. In line with this, the Council has fully adopted the revised reporting requirements in the current financial year.

Background

3.4 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."

3.5 The Council's Treasury Management Strategy for 2023/24 was approved by Full Council on 23rd February 2023.

3.6 In addition to reporting on risk management, the Code requires the Council to report on any financial instruments entered into to manage treasury risks.

Economic Background

3.7 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. CPI inflation has subsequently fallen to 4.6% in October 2023, raising hopes that the impact of higher interest rates is reducing demand and inflationary pressures in the wider economy.

3.8 Economic growth in the UK remained relatively weak over the period. In calendar Q2 2023, the economy expanded by 0.4%, beating expectations of a 0.2% increase. 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.

3.9 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.

3.10 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%.

3.11 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.

3.12 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.

3.13 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.

Financial Markets

3.14 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.

3.15 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.

Local Context

3.16 On 31st March 2023, the Council had external borrowing of £781.0m 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

	31.03.23 Actual £m	**31.03.24 Forecast £m**
General Fund CFR	851.4	1,021.0
HRA CFR	295.0	348.4
Total CFR	**1,146.4**	**1,369.4**
*Other debt liabilities	36.2	32.5
Borrowing CFR	**1,182.6**	**1,401.9**
Less: External borrowing	(781.0)	(707.6)
Internal borrowing	401.6	694.4
Less: Balance sheet resources		
Usable Reserves	(491.2)	(491.2)
Working Capital	(26.6)	(26.6)
(Investments) / New Borrowing	**(116.2)**	**176.6**

* Finance leases, PFI liabilities and transferred debt that form part of the Council's total debt

Table 2: Borrowing and Investment Portfolio

	31.03.23 Balance £m	Movement £m	30.09.23 Balance £m	30.09.23 Rate %
Long-term borrowing:				
PWLB	529.8	(4.7)	525.1	3.92%
LOBO’s	70.5	-	70.5	4.64%
Other	95.0	-	95.0	2.37%
Short-term borrowing:				
PWLB	13.2	(3.8)	9.4	2.19%
Local Authorities	70.0	(20.0)	50.0	4.48%
Other	2.5	-	2.5	-
Total borrowing	**781.0**	**(28.5)**	**752.5**	**3.80%**
Short-term investments	116.2	2.3	118.5	5.27%
Total investments	**116.2**	**2.3**	**118.5**	**5.27%**
Net Borrowing	**664.8**	**(30.8)**	**634.0**	

Debt Management

3.17 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.

3.18 The Council 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

3.19 As outlined in the treasury strategy, the Council’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 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.

3.20 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.

3.21 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.

3.22 A new PWLB HRA rate which is 0.4% below the certainty rate was made available from 15th 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. The HRA concessionary rate has had a limited impact so far as the significantly higher market rates still make the overall cost of borrowing relatively high which makes viability challenging. The availability of the HRA concessionary rate was extended in the 2023 Autumn statement and will now continue until 15th June 2024.

3.23 The UK Infrastructure Bank (UKIB) which is wholly owned and backed by HM Treasury has earmarked £4bn for lending to local authorities. Eligible projects must meet the Bank's investment principals: driving economic growth, developing infrastructure, delivering a positive financial return and crowding in private capital. The Treasury has provided £22bn in funding to the Bank over its first 5 years.

3.24 The Bank invested £1.1bn in 2022/23; although all of this was to the private sector (2021/22: £193m private, £117m public). Investments have included subsidy-free solar farms, gigabit broadband infrastructure and green buses. Loans are now available for qualifying projects at gilt yields plus 0.4%, which is 0.4% lower than the PWLB certainty rate. This was a recent reduction from the original offering of gilt yields plus 0.6%, in light of budgetary pressures arising from higher interest rates and gilt yields.

3.25 UKIB borrowing proposals must meet a strict set of criteria to be eligible. These include alignment with the government's net zero objectives and the project being an infrastructure asset or network. The UKIB does not support predominantly social infrastructure projects.

3.26 There may be an opportunity to borrow at lower rates from PWLB or UKIB in relation to the South Kilburn heat network. The GLA is providing low rate finance through the Mayor's Energy Efficiency Fund (MEEF) and the Mayor's Green Finance Fund, which was launched during London Climate Action Week 2023. The forecast development timetable of the heat network is likely to lead us to apply to the latter scheme when it opens for a second round of expressions of interest; expected in late 2023. Whilst the exact finance rates have not been confirmed, preliminary discussions have been held and funding is likely to be at lower rates those offered by the PWLB or the UKIB.

3.27 A summary of the Council's borrowing in the first half of 2023/24 is provided below:

Table 3 - Borrowing Position

	31.03.23 Balance £m	**Movement £m**	**30.09.23 Balance £m**	**30.09.23 Weighted Average Rate %**	**30.09.23 Weighted Average Maturity (Years)**
PWLB	543.0	(8.5)	534.5	3.89%	29.3
LOBO's	70.5	-	70.5	4.64%	41.0
Local Authority	70.0	(20.0)	50.0	4.48%	0.2
Other	97.5	-	97.5	2.31%	22.2
Total borrowing	**781.0**	**(28.5)**	**752.5**		

3.28 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^{th} September 2023 of £50.0m was 4.48%, this compares with 3.01% on £70m of loans 6 months ago.

3.29 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 flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

3.30 In the first half of the year, new external long-term borrowing did not take place due to sufficient cash levels and high market rates making forward borrowing unattractive. Short-term borrowing continued to meet cash flow requirements. The Council continues to monitor borrowing rates with the objective to re-introduce the little and often approach for new long-term borrowing to support providing certainty on affordability for projects within the capital programme.

3.31 Borrowing costs on have increased significantly in recent months alongside increased market rates (see 3.7). The highest borrowing rate that has been agreed YTD was at 5.8% for a short-term 11 month borrowing period.

3.32 The Council has an increasing Capital Financing Requirement due to the elements of the capital programme funded by borrowing. An estimated borrowing requirement is determined by the liability benchmark, which takes into account the Council's usable reserves, planned capital expenditure and minimum revenue provision. Borrowing is also determined through detailed cashflow forecasting. This has shown that further borrowing in excess of £176.6m will be required in 2023/24.

3.33 The cost of PWLB and alternate borrowing options has continued to increase substantially in 2023/24, although rates have started to reduce very marginally in recent weeks. For our borrowing requirement, the PWLB remains the cheapest form of financing.

3.34 The Council has considered and will continue to monitor the possibility of agreeing forward funded deals if these are at advantageous rates. The Council will continue to monitor alternative sources of funding and pursue the lower cost solutions and opportunities as they arise. To date, no such opportunities have emerged, given the relatively high interest rate environment and expectation that rates will fall, making forward funding deals relatively unattractive.

3.35 Higher interest rates mean that it would be uneconomic to restructure existing PWLB debt. The majority of our existing long-term PWLB borrowing was secured at interest rates significantly lower than those which would be incurred on new borrowing arrangements. However this will be kept under review should interest rates be reduced in future.

3.36 The Council continues to hold £70.5m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. No lender exercised their option in the first half of the year. However, due to higher market rates, there is now a significant risk that existing LOBO's may require refinancing at higher rates or repayment. £16m of LOBO's have break points in the second half of 2023/24 and may require repayment and refinancing at higher rates. One LOBO, outlined below, had a break point in Q1. However, the break clause was not exercised.

<u>LOBO's with break point in first half of 23/24</u>

	Amount £m	**Rate %**	**Final maturity**	**New rate proposed**	**Action taken by the Council**
Loan 1	10.0	4.1	19/05/2055	None	None

<u>LOBO's with break points in the remainder of 23/24</u>

	Amount £m	**Rate %**	**Final maturity**
Loan 1	5.0	4.72%	18/11/2077
Loan 2	11.0	4.99%	12/02/2067

Treasury Investment Activity

3.37 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Council's investment balances ranged between £56.1m and £122.0m due to timing differences between income and expenditure.

3.38 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.

3.39 The Council's investment position is shown in the table below.

	Balance b/f 01/04/23 £m	Investments Repaid £m	New Investments £m	Balance c/f 30/09/23 £m
Debt Management Account Deposit Facility	-	(147.5)	164.8	17.3
Money Market Funds	116.2	(348.2)	333.2	101.2
Total Investments	**116.2**	**(495.7)**	**498.0**	**118.5**

Average rate of investments	Return %
Debt Management Account Deposit Facility	4.68%
Money Market Funds	4.53%

3.40 The Council holds most of its cash in Money Market Funds. The return on Money Market Funds has increased reflecting the higher interest rate environment. As at 30th September our Funds were paying rates between 5.20% - 5.35%. The Council also uses the Debt Management Agency's Deposit Facility (DMADF) for short-term cash deposits, which pays comparable rates.

3.41 The inter-local authority market has also seen higher interest rates. However, as at 30th September the Council did not hold any short-term deposits with other local authorities, as the liquidity offered by the money market funds was of greater benefit.

3.42 There was a modest increase of £2.3m in short term investments in the first half of the year. Investment balances are expected to reduce in the second half of the year in-line with the Council's cashflow requirements. The Council is reviewing its borrowing options which include short-term local authority borrowing, longer-term PWLB borrowing and forward borrowing (agreement to borrow at an agreed future date and rate in the future).

3.43 Security of capital has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2023/24. In accordance with the policy, new investments can be made with the following classes of institutions:

- A+ or above rated banks;

- AAA rated Money Market Funds;
- Other Local Authorities;
- Housing Associations;
- UK Debt Management Office;
- Corporate Bonds
- Collective Investment Schemes (Pooled Funds)
- Real Estate Investment Trusts

3.44 A short summary of the investment products available to the council along with an indication of the main driver behind their financial return and an indication of relative risk is provided below:

Asset Classes (approx. return)	**Cash (1.4%)**	**Bonds (-4.6%)**	**Equities (-0.9%)**	**Property (-19.7%)**
Income driven by	Short term interest rates	Medium term interest rates	Dividends/ share prices	Rental income/ vacancies
Key Risk(s)	Bank defaults	Company defaults	Company performance and perception of future performance	Property prices, least liquid asset class

3.45 Investments in Equities, Property and Bonds tend to be considered over a longer time frame, which are not currently suitable for the Council given its significant capital spending plans.

Risks

3.46 Regardless of the approach taken, the Council will be required to manage significant risks in relation to its treasury investment portfolio. Some key risks are:

- Credit risk - the risk that a bank or other institution will not be able to pay back the money invested with it. For longer term investments, the council is more exposed to credit risk. Should a counterparty's credit worthiness change, the council may not be able to get all their money back or may face heavy penalties if it can do so.

Mitigation – see Prudential Indicator 1 (Security) – Appendix 1

- Liquidity risk - that is the council having funds tied up in long-term investments when it needs to use that money. Increasing the duration of fixed cash deposits increases liquidity risk, however this can be mitigated through good cash flow management.

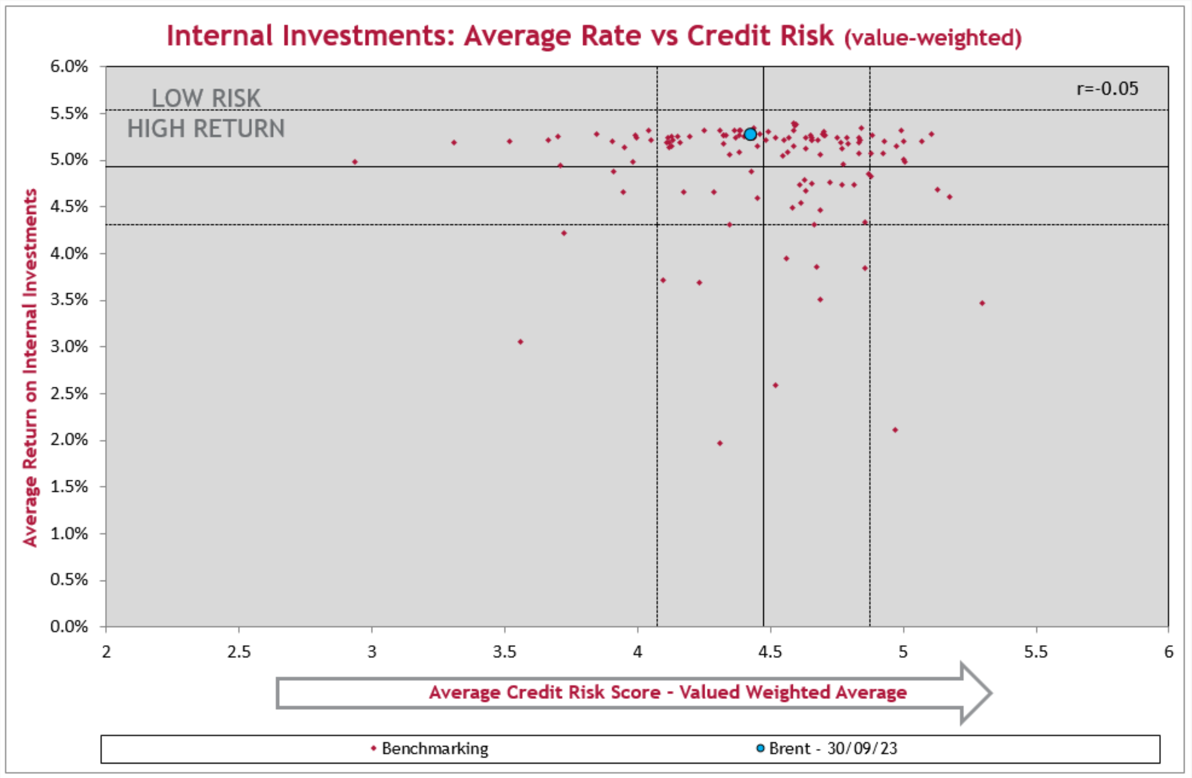
  Mitigation – see Prudential Indicator 2 (Liquidity) – Appendix 1

- Interest rate risk – the risk of the council's budget being affected by unforeseen changes in interest rates. Longer term cash deposits increase this risk and will negatively affect the council should interest rates rise. On the other hand, the council may benefit should interest rates fall.

  Mitigation – see Prudential Indicator 3 (Interest Rate Exposure) – Appendix 1

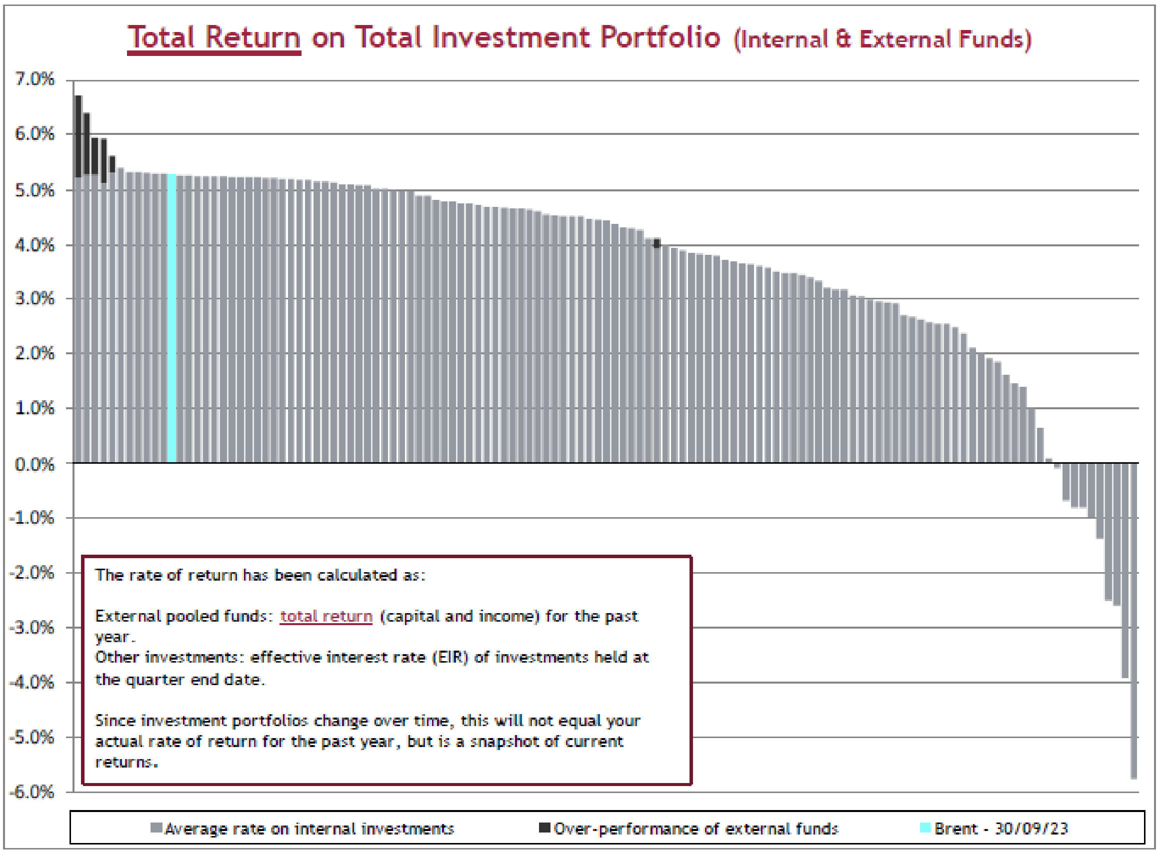
Benchmarking to other councils

3.47 The graph below shows a comparison in performance between Brent's investment portfolio and those of Arlingclose's (the Council's treasury advisor) other Local Authority clients. Brent's portfolio has an average risk profile compared with other authorities.



3.48 Our investment portfolio has a credit rating of AA- (equivalent to a Credit Risk Score of 4.42 in the table above). The credit rating achieved on our investments exceeds our target rating of A (which equates to a Credit Risk Score of 6 in the table above). The lower the Average Credit Risk score in the table above, the better the credit rating of the counterparties with which we hold investments.

3.49 A credit rating of 'A' per the Fitch agency indicates that an organisation has low default risk, but may be vulnerable to adverse economic conditions. A credit rating of 'AA' denotes that an organisation has very low default risk and is not significantly vulnerable to foreseeable events. The '+' and '-' are further delineations for each credit rating.



3.50 Our investment returns have been amongst the top 10 of our Treasury Adviser's clients. This is due to the short-term nature of our investment portfolio, enabling us to benefit promptly from the rising interest rate environment.

Budgeted Income And Outturn

3.51 The Council's external interest budget for the year is £21.8m, and for investment income is £11.3m. The average cash balances were £100.2m during the period to 30 September 2023. The Council expects to receive significantly higher income from its cash and short-dated money market investments than it did in 2022/23 and earlier years due to the higher interest rate environment and the immediate cash requirements, which only allow for short-term investments.

3.52 Reviewing the wider Capital Financing Budget, we are currently forecasting an overspend of £0.4m, with a forecast of £24.3m against a budget of £23.9m. This is driven by higher short-term interest payments which outweigh the benefit of increased interest income from our short-term investments.

Compliance

3.53 Officers confirm that they have complied with its Treasury Management Indicators for 2023/24, which were set in February 2023 as part of the Council's Treasury Management Strategy Statement (TMSS). Details can be found in Appendix 1.

Summary

3.54 In compliance with the requirements of the CIPFA Code of Practice, this report provides Members with a summary report of the treasury management activity during the first half of 2023/24. As indicated in this report, none of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

4.0 Financial Implications

4.1 These are covered throughout the report.

5.0 Legal Implications

5.1 There are no direct legal implications arising from this report.

6.0 Equality, Diversity & Inclusion (EDI) Considerations

6.1 There are no EDI considerations arising from this report.

7.0 Consultation with Ward Members and Stakeholders

7.1 There are no direct considerations arising from this report.

8.0 Human Resources/Property Implications

8.1 There are no HR or property considerations arising from this report.

9.0 Climate Change and Environmental Considerations

9.1 There are no climate change or environmental considerations arising from this report.

10.0 Communication Considerations

10.1 There are no direct communication considerations arising from this report.

Related Documents:

Treasury Management Strategy Report to Council – 24 February 2023

<u>Report sign off:</u>

Minesh Patel
Corporate Director of
Finance and Resources