Appendix 8

Treasury Management Strategy Statement and Prudential Indicators Mid-Year Monitoring Report 2023/24

1 Background

1.1 Treasury Management

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 optimising investment return.

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 and on occasion, any debt previously drawn, may be restructured to meet Council risk or cost objectives.

Accordingly, treasury management is defined as:

> *"The management of local authority's borrowing, 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. Introduction

This report has been written in accordance with the requirements of the CIPFA Prudential and Treasury Management (revised 2021).

The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the way the Council will seek to achieve those policies and objectives.
- Receipt by the full council of an annual Treasury Management Strategy Statement – including the Annual Investment Strategy and Minimum

Revenue Provision Policy – for the year ahead, a Mid-Year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specified named body. For this Council the delegated body is the Budget and Corporate Scrutiny Management Board.

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management and covers the following:

- An economic update for the first half of the 2023/24 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of the Council's investment portfolio for 2023/24;
- A review of the Council's borrowing strategy for 2023/24;
- A review of any debt rescheduling undertaken during 2023/24;
- A review of compliance with Treasury and Prudential Limits for 2023/24.

3. Economics and Interest Rates

3.1 Full Economic Update

- 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).

- The 0.5% m/m fall in GDP in July suggests that underlying growth has lost momentum since earlier in the year. Some of the weakness in July was due to there being almost twice as many working days lost to strikes in July (281,000) than in June (160,000). But with output falling in 10 out of the 17 sectors, there is an air of underlying weakness.
- The 0.4% m/m rebound in retail sales volumes in August is not as good as it looks as it partly reflected a pickup in sales after the unusually wet weather in July. Sales volumes in August were 0.2% below their level in May, suggesting much of the resilience in retail activity in the first half of the year has faded.
- As the growing drag from higher interest rates intensifies over the next six months, we think the economy will continue to lose momentum and soon fall into a mild recession. Strong labour demand, fast wage growth and government handouts have all supported household incomes over the past year. And with CPI inflation past its peak and expected to decline further, the economy has got through the cost-of- living crisis without recession. But even though the worst of the falls in real household disposable incomes are behind us, the phasing out of financial support packages provided by the government during the energy crisis means real incomes are unlikely to grow strongly. Higher interest rates will soon bite harder too. We expect the Bank of England to keep interest rates at the probable peak of 5.25% until the second half of 2024. Mortgage rates are likely to stay above 5.0% for around a year.
- The tightness of the labour market continued to ease, with employment in the three months to July falling by 207,000. The further decline in the number of job vacancies from 1.017m in July to 0.989m in August suggests that the labour market has loosened a bit further since July. That is the first time it has fallen below 1m since July 2021. At 3.0% in July, and likely to have fallen to 2.9% in August, the job vacancy rate is getting closer to 2.5%, which would be consistent with slower wage growth. Meanwhile, the 48,000 decline in the supply of workers in the three months to July offset some of the loosening in the tightness of the labour market. That was due to a 63,000 increase in inactivity in the three months to July as more people left the labour market due to long term sickness or to enter education. The supply of labour is still 0.3% below its pre-pandemic February 2020 level.
- But the cooling in labour market conditions still has not fed through to an easing in wage growth. While the monthly rate of earnings growth eased sharply from an upwardly revised +2.2% in June to -0.9% in July, a lot of that was due to the one-off bonus payments for NHS staff in June not being repeated in July. The headline 3myy rate rose from 8.4% (revised up from 8.2%) to 8.5%, which meant UK wage growth remains much faster than in the US and in the Euro-zone. Moreover, while the Bank of England's closely watched measure of regular private sector wage growth eased a touch in

July, from 8.2% 3myy in June to 8.1% 3myy, it is still well above the Bank of England's prediction for it to fall to 6.9% in September.

- CPI inflation declined from 6.8% in July to 6.7% in August, the lowest rate since February 2022. The biggest positive surprise was the drop in core CPI inflation, which declined from 6.9% to 6.2%. That reverses all the rise since March and means the gap between the UK and elsewhere has shrunk (US core inflation is 4.4% and in the Euro-zone it is 5.3%). Core goods inflation fell from 5.9% to 5.2% and the further easing in core goods producer price inflation, from 2.2% in July to a 29-month low of 1.5% in August, suggests it will eventually fall close to zero. But the really positive development was the fall in services inflation from 7.4% to 6.8%. That also reverses most of the rise since March and takes it below the forecast of 7.2% the Bank of England published in early August.
- The Bank of England wants the markets to believe in the higher for longer narrative. Statements from the Bank of England have not said that rates have peaked and once again said if there was evidence of more persistent inflation pressures "further tightening in policy would be required". Governor Bailey stated, "we'll be watching closely to see if further increases are needed". The Bank also retained the hawkish guidance that rates will stay "sufficiently restrictive for sufficiently long".
- This narrative makes sense as the Bank of England does not want the markets to decide that a peak in rates will be soon followed by rate cuts, which would loosen financial conditions and undermine its attempts to quash inflation. The language also gives the Bank of England the flexibility to respond to new developments.

3.2 Interest Rate Movements and Expectations

The Council has appointed Link Group as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. The PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1st November 2012.

The latest forecast on 25th September 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.

The PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps, calculated as gilts plus 80bps) which has been accessible to most authorities since 1st November 2012.

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

4. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy Statement (TMSS) for 2023/24 was approved by this Council on 21 February 2023.

The underlying TMSS approved previously requires revision in the light of economic and operational movements during the year. The proposed changes and supporting detail for the changes are set out below:

	2023/24	
	Original Estimate £'m	Revised Prudential Indicator £'m
Authorised Limit	913.142	891.638
Operational Boundary	544.113	573.252
Capital Financing Requirement	896.581	876.638

5. The Council's Capital Position (Prudential Indicators)

This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity

5.1. Prudential Indicator for Capital Expenditure

This table shows the projected outturn for capital expenditure based on projections at period 6, along with the expected financing arrangements against the original indicators set at the time the capital programme was agreed in February 2023.

	2023/24	
	Original Estimate £'m	Projected Outturn £'m
Capital Expenditure		
General Fund	109.596	75.289
HRA	91.949	75.700
Total	**201.545**	**150.989**
Resourced by:		
Capital Receipts	22.993	21.212
Capital Grants & Contributions	81.934	50.783
Revenue	35.349	28.044
Capital Expenditure Financed from Borrowing	**61.269**	**50.950**

There has been a forecast decrease in the projected level of expenditure since the original estimate. This is mostly due to re-profiling of expenditure into 2024/25 (including £27m Towns Fund Regeneration schemes, £8m DFG, £7m transport and £17m HRA projects)

The borrowing need underlines the indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt known as the Minimum Revenue Provision (MRP). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

5.2. Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary

The table shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed as the Operational Boundary.

	2023/24					
	Original Estimate			Projected Outturn		
	HRA	General Fund	Total	HRA	General Fund	Total
	£'m	£'m	£'m	£'m	£'m	£'m
Opening Capital Financing Requirement	**526.722**	**319.641**	**846.363**	**517.908**	**318.711**	**836.619**
add: Capital Expenditure funded from Borrowing	57.653	3.616	61.269	46.063	4.887	50.950
less: MRP	0.000	-6.829	-6.829	0.000	-6.709	-6.709
add: Movement on Other Long Term Liabilities	-1.389	-2.833	-4.222	-1.389	-2.833	-4.222
Closing Capital Financing Requirement	**582.986**	**313.595**	**896.581**	**562.582**	**314.056**	**876.638**
External Debt						
Borrowing			530.653			512.310
Other Long Term Liabilities*			60.942			60.942
Total Debt at 31 March			**591.595**			**573.252**

* - Represents the estimated finance lease creditors liability as at 31 March 2024 in relation to ‘on balance sheet’ PFI schemes.

5.3. Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2023/24 and the next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

	2023/24	
	Original Estimate £'m	**Projected Outturn £'m**
Gross Borrowing	530.653	512.310
add: Other Long Term Liabilities*	60.942	60.942
Total Debt	**591.595**	**573.252**
CFR (Year end position)	**896.581**	**876.638**

* Includes on balance sheet PFI schemes and finance leases etc.

The Section 151 Officer can report that there are no difficulties envisaged for the current or future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

	2023/24	
	Original Estimate £'m	Projected Outturn £'m
Borrowing	475.588	512.310
add: Other Long Term Liabilities*	68.525	60.942
Total Operational Boundary	**544.113**	**573.252**
Total Authorised Limit	**913.142**	**891.638**

* Includes on balance sheet PFI schemes and finance leases etc.

6. Borrowing / Debt Activity during 2023/24

This table shows the Council's actual external debt and anticipated need against the underlying capital borrowing need (the CFR), highlighting any under or over borrowing.

	2023/24	
	Original Estimate £'m	Projected Outturn £'m
External Debt as at 1 April	471.016	464.310
Expected need to 31 March	59.637	48.000
Other Long Term Liabilities*	60.942	60.942
Estimated Debt as at 31 March	**591.595**	**573.252**
Capital Financing Requirement	**896.581**	**876.638**
(-)Under / (+)Borrowed	-304.986	-303.386
Investment as at 31 March	-25.000	-25.000
Net Debt Position as at 31 March	**566.595**	**548.252**

* Includes on balance sheet PFI schemes.

Due to the current economic situation and high interest rate environment, any new borrowing need will be taken for short periods pending a drop in borrowing rates when the debt can be refinanced for longer periods at more advantageous levels, thereby preventing long term high debt costs on the revenue accounts of the Council.

6.1. Debt Rescheduling

Debt rescheduling opportunities have been very limited in the current economic climate and following the various increases in the margins added to gilt yields which have impacted PWLB new borrowing rates since October 2010, no debt rescheduling has therefore been undertaken to date, in the current financial year. However, now that the whole of the yield curve has shifted higher there may be better opportunities in the future, although only prudent and affordable debt rescheduling will be considered.

7. Investment Strategy 2023/24

Key Objectives

The approved Treasury Management Strategy Statement (TMSS) for 2023/24, includes the Council's Annual Investment Strategy. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. 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 high credit rated financial institutions, using the Link suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

Current Investment Position

The Council held £115.750m of investments as at 30 September 2023 (£125.487m as at 30 September 2022) with the structure of the portfolio being detailed below.

	Portfolio as at 30 September 2023		Average Portfolio Performance 2023/24 (to end Sept 23)	
	Balance £'m	Yield £'m	Avg Balance £'m	Avg Yield £'m
Money Market Funds	110.168	5.29%	74.337	4.91%
Bank Current Account	0.582	1.45%	0.667	1.27%
Fixed Term Deposits (short term)	5.000	4.97%	5.191	4.88%
Total Investments	**115.750**	**5.26%**	**80.195**	**4.87%**

The section 151 Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the 6 months of 2023/24.

Risk Benchmarking

A regulatory development is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are new requirements to Member reporting, although the application of these is more subjective in nature.

The current position against the originally approved benchmarks is reported below;

% Benchmarks	SONIA (overnight)	1 Month	3 Month	6 Month	12 Month
Benchmark Return (average year to date)	4.74%	4.83%	5.03%	5.26%	5.45%

Liquidity

In respect of this area, the Council set liquidity facilities / benchmarks to maintain:

- Bank overdraft - £2m
- Liquid short-term deposits of at least £20m available within a week's notice.

The Section 151 Officer can report that liquidity arrangements have been adequate during the year to date.

Yield

Local measures of yield benchmarks are:

- Investments – Internal returns to be above the Overnight SONIA rate

The Section 151 Officer can report that the return to date has averaged 4.87%, against an average overnight SONIA rate at 30 September 2022 of 4.74%. The original Treasury Management Strategy Statement indicated that average yields for 2023/24 would be approximately 4.40%. The current interest rate environment remains higher than those original expectations and this has generated a higher return in investment income for the Council, which is reflected within the Q2 monitoring report.

8. Other

8.1 Compliant with Treasury and Prudential Limits

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the half year ended 30 September 2023, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2023/24. The Section 151 Officer reports that no difficulties are envisaged for the current or future years in complying with these indicators.

All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

8.2 Changes in Risk Appetite

There is no change to the Council Risk appetite.

8.3 Creditworthiness Policy

The current approved creditworthiness policy and counterparty limits for investment balances remain fit for purpose and no changes are proposed.