Council	
22 January 2024	

Subject: Recommendation from Corporate Policy and Resources Committee – 9 November 2023 - Mid-Year Treasury Management Report 2023-24

Report by:	Director of Corporate Services (S151 Officer)
Contact Officer:	Peter Davy Financial Services Manager peter.davy@west-lindsey.gov.uk
Purpose / Summary:	This report provides the Mid-Year update for Treasury Management Indicators in accordance with the Local Government Act 2003 and stands recommended from the Corporate Policy and Reosurces Committee

RECOMMENDATION(S):

That Council accept the recommendation from the Corporate Policy and Committee and in doing so note the report, the treasury activity and approve the revised prudential indicators at sections 5.2, 6.1 and 6.2.

IMPLICATIONS

Legal: This report complies with the requirement of the Local Government Act 2003

Financial : FIN/93/24/PD

There are no financial implications as a direct result of this report

Staffing : None arising as a result of this report

(N.B.) Where there are staffing implications the report MUST have a HR Ref

Equality and Diversity including Human Rights : None arising as a result of this report

Data Protection Implications : None arising as a result of this report

Climate Related Risks and Opportunities: This is a monitoring report only

Section 17 Crime and Disorder Considerations: This is a monitoring report only

Health Implications: This is a monitoring report only

Title and Location of any Background Papers used in the preparation of this report :

CIPFA Code of Treasury Management Practice 2017

CIPFA The Prudential Code

Local Government Act 2003

Located in the Finance Department

Risk Assessment :

The Mid Year Treasury Management Report reviews our assessment of Treasury Risks

Call in and Urgency:

Is the decision one which Rule 14.7 of the Scrutiny Procedure Rules apply?

i.e. is the report exempt from being called in due to urgency (in consultation with C&I chairman)	**Yes**		**No**	**x**

Key Decision:

A matter which affects two or more wards, or has significant financial implications	**Yes**		**No**	**x**

1. Executive Summary

1.1 This mid-year report has been prepared in compliance with the Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice on Treasury Management, and covers the following:

- An economic update for the first part 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 compliance with Treasury and Prudential Limits for 2023/24.

1.2 The Bank of England Base rate has increased during 2023/24, with the potential for further rises. The current rate is 5.25%.

1.3 There have been no changes to the Treasury Management Strategy Statement and Annual Investment Strategy.

1.4 The forecast out-turn for Capital Expenditure is £18.441m against the approved original budget of £20.888m. The budget will be revised to £18.441m at Corporate Policy and Resources committee on 9th November 2023 with a request of £9.262m to be re-phased over future financial years.

1.5 The Council is projected to have circa £13m invested at the year end and have generated £0.732m in investment Interest. The return on investments is increasing with the increase in interest rates compared to when rates were much lower when the original budget was set combined with higher investment balances than anticipated. The Council's budgeted investment return for 2023/24 is £0.577m, and performance for the year is forecast to be £0.155m above budget at £0.732m.

1.6 When investing consideration is given to environmental, social and governance (ESG) issues to ensure the Council is an ethical investor. As at 30th September 2023 the Council had 31% of its funds in these investments.

1.7 It is anticipated that total external borrowing will stay the same at £21.5m for the rest of the year due to underspends in the capital programme meaning the Council's cash balances remain higher than anticipated.

2 Background

2.1 Capital Strategy

In December 2017, CIPFA issued revised Prudential and Treasury Management Codes. These require all local authorities to prepare a Capital Strategy which is to provide the following:

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- an overview of how the associated risk is managed;
- the implications for future financial sustainability.

2.2 **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 returns.

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 aspirations. 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 the 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."

2.3 **Key Changes to the Treasury and Capital Strategies**

There are no changes to report to this committee.

3 Economics and Interest Rates (provided by Link Asset Services)

3.1 In its latest monetary policy meeting on 20 September, the Bank of England left interest rates unchanged at 5.25%. The weak August CPI inflation release, the recent loosening in the labour market and the downbeat activity surveys appear to have convinced the Bank of England that it has already raised rates far enough. The minutes show the decision was "finely balanced". Five MPC members voted for no change and the other four voted for a 25bps hike.

3.2 Like the US Federal reserve, the Bank of England wants the markets to believe in the higher for longer narrative. The statement did not say 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 Andrew 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".

3.3 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. A rebound in services inflation, another surge in wage growth and/or a further leap in oil prices could conceivably force it to raise rates at the next meeting on 2nd November, or even pause in November and raise rates in December.

3.4 The yield on 10-year Gilts fell from a peak of 4.74% on 17th August to 4.44% on 29th September, mainly on the back of investors revising down their interest rate expectations. But even after their recent pullback, the rise in Gilt yields has exceeded the rise in most other Developed Market government yields since the start of the year. Looking forward, once inflation falls back, Gilt yields are set to reduce further. A (mild) recession over the next couple of quarters will support this outlook if it helps to loosen the labour market (higher unemployment/lower wage increases).

3.5 The pound weakened from its cycle high of $1.30 in the middle of July to $1.21 in late September. In the first half of the year, the pound bounced back strongly from government instability last autumn. That rebound was in large part driven by the substantial shift up in UK interest rate expectations. However, over the past couple of months, interest rate expectations have dropped sharply as inflation started to come down, growth faltered, and the Bank of England called an end to its hiking cycle.

3.6 The FTSE 100 has gained more than 2% since the end of August, from around 7,440 on 31st August to 7,608 on 29th September. The rebound has been primarily driven by higher energy prices which boosted the valuations of energy companies. The FTSE 100's relatively high concentration of energy companies helps to explain why UK equities outperformed both US and Euro-zone equities in September. Nonetheless, as recently as 21st April the FTSE 100 stood at 7,914.

4. Interest Rate Forecasts

4.1 The Council's treasury advisor, Link Group, have provided the following forecasts on 25th September 2023. The latest forecast sets out a view that both short and long-dated interest rates will be elevated for some little while, as the Bank of England seeks to reduce inflation in the economy.

4.2 The current and previous 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.

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

Additional notes by Link on this forecast table: -

- LIBOR and LIBID rates ceased at the end of 2021. In a continuation of the previous forecasts, the money market yield forecasts are based on expected average earnings by local authorities for 3 to 12 months.

- The forecasts for average earnings are averages i.e., rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short-term cash at any one point in time.

4.3 **PWLB Rates (provided by Link Asset Services)**

4.4 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%.

4.5 July saw short-dated rates peak at their most expensive. The 1-year rate spiked to 6.36% and the 5-year rate to 5.93%. Although, in due course, short-dated rate expectations fell, the medium dates shifted higher through August and the 10-year rate pushed higher to 5.51% and the 25-year rate to 5.73%. The 50-year rate was 4.27% on 5th April but rose to 5.45% on 28th September.

4.6 Rates are forecast to fall back over the next two to three years as inflation dampens. The CPI measure of inflation is expected to fall below 2% in the second half of 2024, and we forecast 50-year rates to stand at 3.90% by the end of September 2025. However, there is considerable gilt issuance to be digested by the market over the next couple of years, as a minimum, so there is a high degree of uncertainty as to whether rates will fall that far.

5. Treasury Management Strategy Statement and Annual Investment Strategy update

5.1 The Treasury Management Strategy Statement (TMSS) for 2023/24, which includes the Annual Investment Strategy, was approved by the Council on 6 March 2023.

5.2 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:

Prudential Indicator 2023/24	Original £'000	Revised Prudential Indicator £'000
Authorised Limit	43,000	43,000
Operational Boundary	38,321	37,768
External Debt	26,500	21,500
Investments	(13,000)	(13,000)
Net Borrowing	**13,500**	**8,500**
Capital Financing Requirement	38,321	37,768

6 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;
- Compliance with the limits in place for borrowing activity.

6.1 Prudential Indicator for Capital Expenditure

This Table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed in March. It draws together the main strategy elements of the capital expenditure plans, highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying 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 (the Minimum Revenue Provision). This direct borrowing may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure by Cluster £'000	2023/24 Original Estimate £'000	2023/24 Revised Estimate £'000
Our People	1,302	7,277
Our Place	15,358	6,949
Our Council	1,228	1,215

Investment	3,000	3,000
Total capital expenditure	**20,888**	**18,441**
Financed by:		
Capital receipts	3,350	3,614
Capital grants	13,248	11,810
Earmarked Reserves	3,943	1,893
S106	204	1,694
Total Financing	**20,745**	**19,011**
Borrowing need	**143**	**(570)**

6.2 **Changes to the Prudential Indicators for the Capital Financing Requirement (CFR)**

The table below 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 the Operational Boundary.

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. The Director of Corporate Services (S151) reports that no difficulties are envisaged for the current or future years in complying with prudential indicators.

	2023/24 Original Estimate £’000	2023/24 Revised Estimate £’000
Prudential Indicators		
Capital Expenditure	20,888	18,441
Capital Financing Requirement (CFR)	**39,091**	**37,768**
Of Which Commercial Property	19,837	19,837
Annual Change in CFR	**-0,770**	**-1,669**
In year Borrowing Requirement	**26,500**	**21,500**
Under/(Over) Borrowing	**11,821**	**16,268**
Ratio of financing costs to net revenue stream	**10.04%**	**10.35%**
Incremental impact of capital investment decisions		
Increase/ Reduction(-) in Council Tax (band change per annum)	**0**	**£7.26**

Please note the above prudential indicators assume a revenue provision will be made for the repayment of debts in 2023/24 of £0.906m.

6.3 **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 CFR in the preceding year plus the estimates of any additional CFR for 2023/24 and 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.

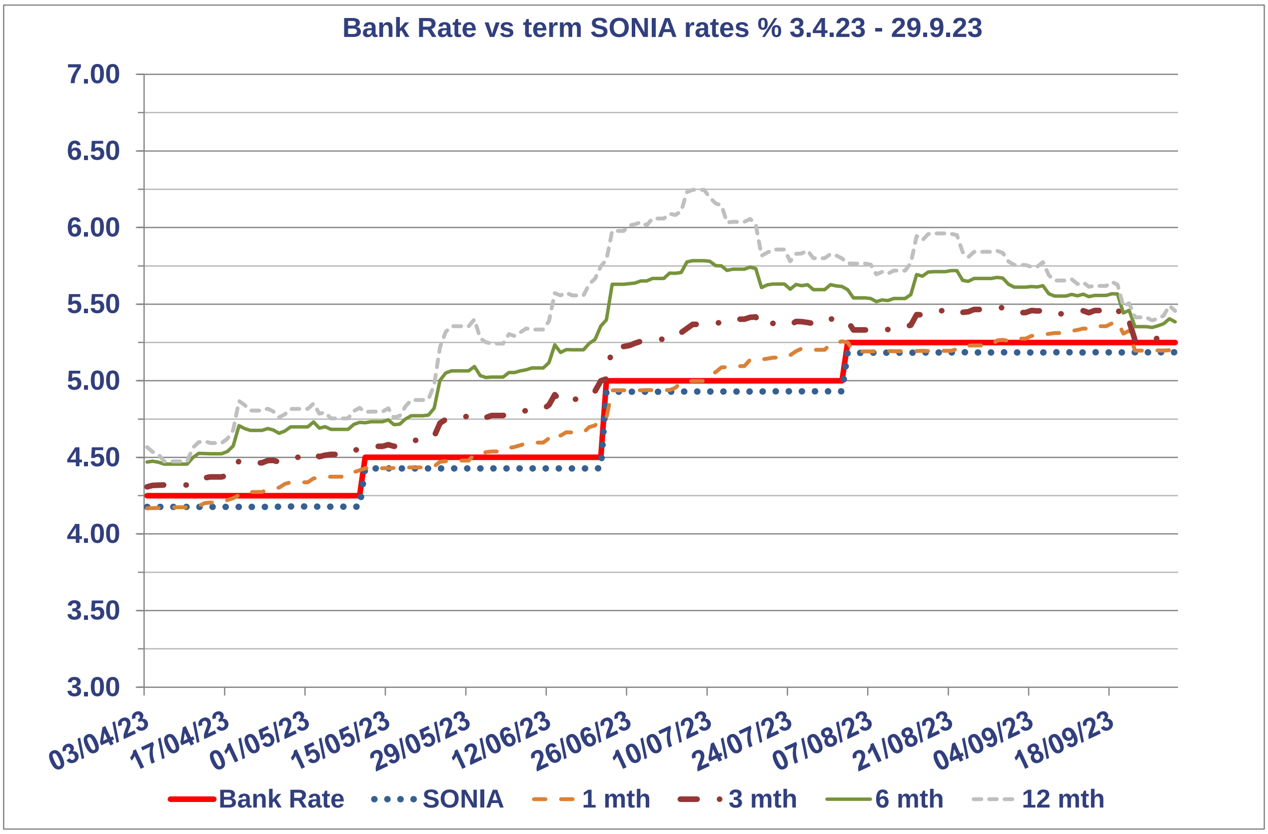
A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short 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.

7. Investment Portfolio 2023/24

7.1 In accordance with the CIPFA Treasury Management Code of Practice, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent 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.

7.2 As shown by the interest rate forecasts in section 3.2, rates are starting to return to levels not seen since before the financial crash of 2008 and the austerity measures which followed. This means investment returns are on an upward trajectory and indeed this is shown in the quarter two forecasting which shows increased investment income in 2023/24. If rates continue to remain at or near current levels then the Council's MTFS for 2024/25 onwards will benefit.

7.3 The Council held £23.9m of investments as at 30 September 2023 (£18.515m at 31 March 2023). The annualised investment rate for the first six months of the year is 4.853% against the Sterling Overnight Indexed Average (SONIA) average rate of 4.74%. The weighted average interest rate is 4.809%.



7.4 The Council's budgeted investment return for 2023/24 is £0.577m, and performance for the year is forecast to be £0.155m above budget at £0.732m, this is due to increasing interest rates and higher balances than expected.

7.5 The Director of Corporate Services (S151) confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2023/24.

8 Investment Counterparty criteria

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

8.2 Treasury Officers continue to mitigate investment risk in accordance with Treasury Management Practices.

9. Borrowing

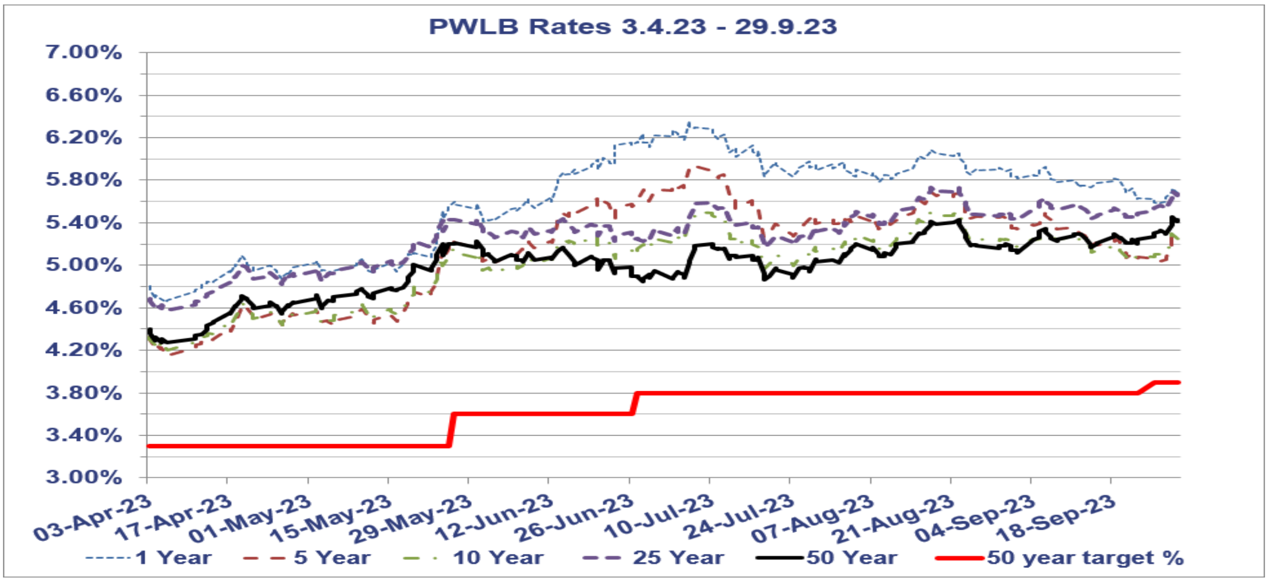
9.1 The Council's capital financing requirement (CFR) for 2023/24 was originally forecast to be £38.321m which has now changed to £37.768m after the Council closed its accounts for 2022/23. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council 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.

9.2 Due to the overall financial position and the underlying need to borrow for capital purposes (the capital financing requirement - CFR), no new external borrowing was undertaken in the first six months of the financial year. External borrowing remains at £21.5m. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

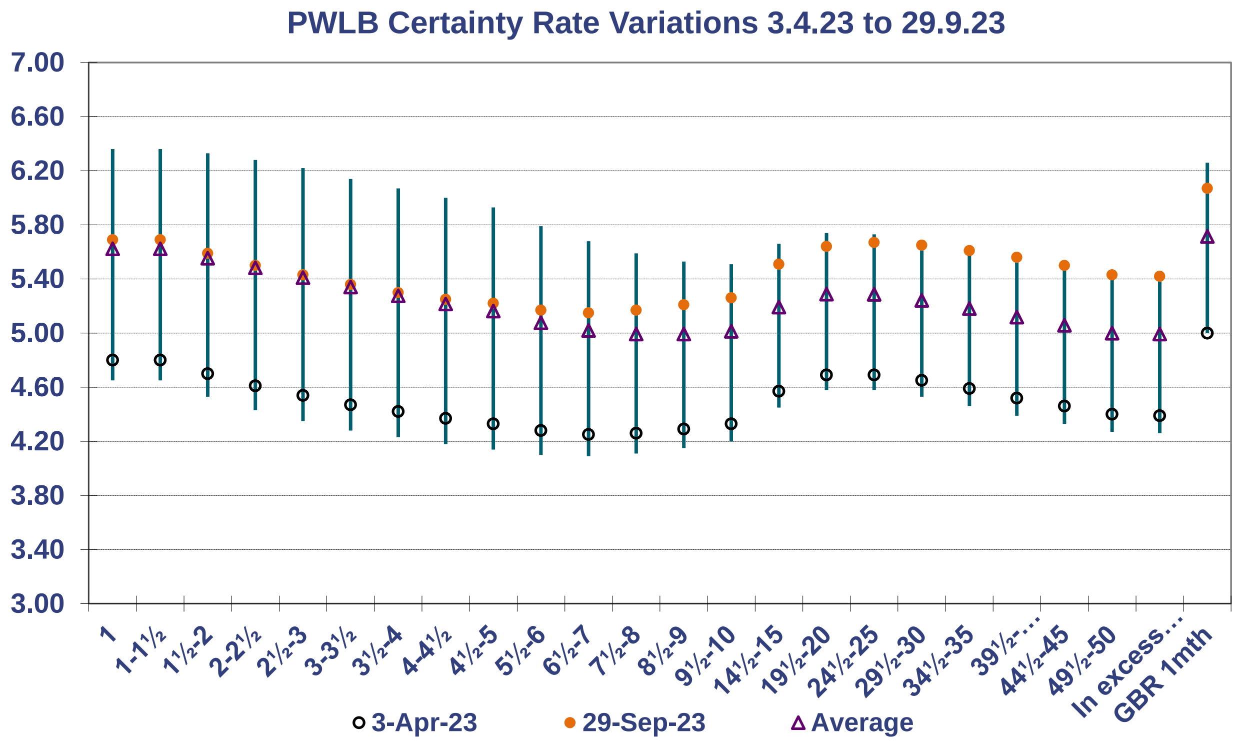
9.3 **INTERNAL BORROWING**: The Council forecasts that by the end of the financial year it will have cumulatively £16.268m of internal borrowing

9.4 It is anticipated that further short term external borrowing may be undertaken early next year to smooth peaks and troughs in cashflow.

9.5 The graph and table below show the movement in PWLB certainty rates for the first six months of the year:



	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%



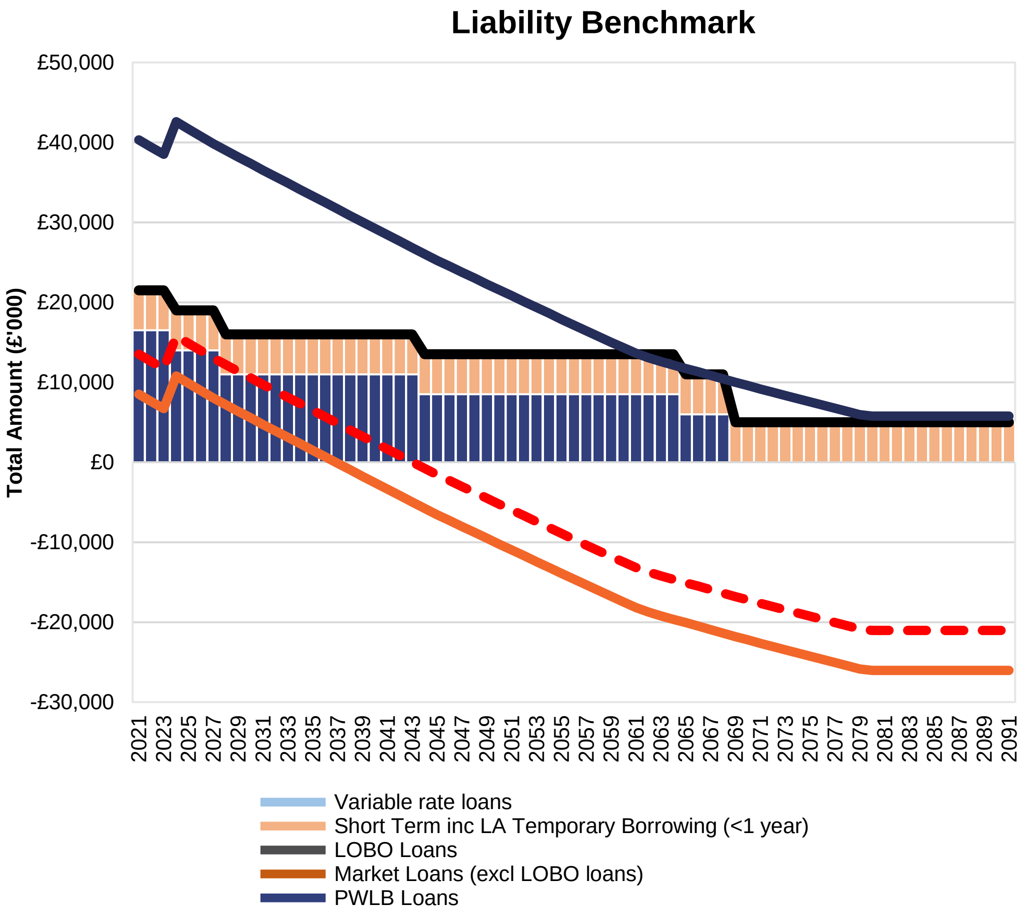
10.1 To Compare the Council's actual borrowing against an alternative strategy, a Liability Benchmark has been calculated showing the lowest risk level of borrowing. This prudential indicator is made up of four components:

- Existing loan debt outstanding: the Authority'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



Appendix A: Economics update (Supplied by Link Asset Services)

- 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 fall in the composite Purchasing Managers Index from 48.6 in August to 46.8 in September left it at its lowest level since COVID-19 lockdowns reduced activity in January 2021. At face value, it is consistent with the 0.2% q/q rise in real GDP in the period April to June, being followed by a contraction of up to 1% in the second half of 2023.
- 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.

APPENDIX B: Approved countries for investments as at 30 September 2023

Based on lowest available rating

AAA

- Australia
- Denmark
- Germany
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Canada
- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)

AA-

- Belgium
- France (downgraded by Fitch on 9th May 2023)
- Qatar
- **U.K.**