Treasury Management

Borrowing and Investments

1. Table 1 below shows the year's opening balance of borrowing and investments, current levels, and the year-end forecast. Forecast borrowing is based on the forecast capital programme and will be subject to review during the year.

The Authority maintained its strategy of keeping borrowing and investments below their underlying levels to reduce risk and make a net saving.

2. **Table 1 - Borrowing and Investments**

	31-Mar-23 Actual £M	31-Mar-23 Average Yield / Rate %	31-Dec-23 Actual £M	31-Dec-23 Average Yield / Rate %	31-Mar-24 Forecast £M	31-Mar-24 Forecast Average %
Long Term Borrowing						
Public Works Loan	289.19	3.52	283.40	3.45	350.70	3.03
LOBO Loans from Banks	9.00	4.86	4.00	4.86	4.00	4.85
	298.19	**3.63**	**287.40**	**3.56**	**354.70**	**3.07**
Short Term Borrowing						
Other Local Authorities	5.00	3.36	20.00	5.79	20.00	5.79
Total External Borrowing	**303.19**	**2.96**	**307.40**	**2.96**	**374.70**	**3.17**
Other Long Term Liabilities						
PFI Schemes	44.37	9.56	43.55	9.56	41.08	9.82
Deferred Debt Charges (HCC)	12.73	3.27	12.73	3.27	12.37	4.98
Total Gross External Debt	**360.29**	**4.08**	**363.68**	**4.08**	**428.15**	**4.00**
Investments:						
Managed In-House						
Government & Local Authority	(11.06)	4.05	0.00	0.00		
Cash (Instant access)	(15.49)	4.08	(23.75)	5.32	(20.00)	5.40
Cash (Notice Account)	0.00	0.00	0.00	0.00	0.00	0.00
Long Term Bonds	(1.01)	5.27	(1.03)	5.27	(1.00)	5.27
Managed Externally						
Pooled Funds (CCLA) & Shares	(27.00)	4.04	(27.00)	4.56	(27.00)	3.00
Total Investments	**(54.56)**	**4.08**	**(51.78)**	**4.59**	**(48.00)**	**4.05**
Net Debt	**305.73**		**311.90**		**380.15**	

3. After taking into account maturing and new debt requirements in year and a forecast reduction in investment balances, net borrowing is expected to increase by £74.42M, to £380.15M, a reduction of £7.1M from the last reported position of £387.25M, due to a reduction in proposed draw on balances.

This forecast remains subject to change; most notably regarding the increased use of balances, (which increase borrowing need as use of internal borrowing will reduce) and changes to the capital programme, which due to the current financial environment is subject to ongoing review against the backdrop of rising inflation (which is significantly increasing construction costs) and rising interest rates which has seen the cost of borrowing increase dramatically in the last year.

4. The interest cost of financing the council's long and short term loan debt is charged to the general fund revenue account and is detailed below together with a summary of performance to date.

	Borrowing
5.	As of December 2023, the forecast cost of financing the council's loan debt is £20.45M of which £5.88M relates to the HRA, however this will be subject to movement as the need for further borrowing for the remainder of the year becomes more certain.
6.	As outlined in the treasury strategy, the Authority's primary objective when borrowing is 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 Authority's long-term plans change being a secondary objective. The Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.
7.	Interest rates have seen substantial rises over the last two years, although these rises began to plateau in the later months of 2023. Rates over the last 3 quarters were at the peak between June and October, since then they have fallen back to lows last seen in April 2023. Gilt yields have remained volatile, facing upward pressure following signs that UK growth had been more resilient and inflation stickier than expected. However more recent signs of slowing inflation and the perception of an increasingly struggling economy have now begun to change this sentiment, resulting in falling gilt yields and, consequently, PWLB rates. On 31st December, the PWLB certainty rates for maturity loans were 4.19% for 10-year loans, 4.90% for 20-year loans and 4.67% for 50-year loans. Their equivalents on 31st March 2023 were 4.33%, 4.70% and 4.41% respectively
8.	A new PWLB HRA rate which is 0.4% below the certainty rate has been made available from 15th September 2023. This rate will now be available until to June 2025. The discounted rate is to support local authorities borrowing for the Housing Revenue Account and for refinancing existing HRA loans, providing a window of opportunity for HRA-related borrowing and to replace the Authority's £10.3M loans relating to the HRA maturing during this time frame.
9.	The Authority has previously raised the majority of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Authority does not intend to do this and will therefore retain its access to PWLB loans.
10.	**Loans restructuring**: The sharp rise in gilt yields over the past 18 months has now resulted in some of the Authority's loans being in or close to a discount position if repaid early. However, as the prepaid loans would need to be replaced by new loans at higher interest rates, this isn't a cost-effective option for the Authority.
11.	**LOBO loans**: LOBO (Lender's Option Borrower's Option) loans are where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate and terms or to repay the loan at no additional cost. As reported previously with market interest rates having risen, the probability of LOBOs being called increased and in September one lender exercised their option to increase the rate. The proposed increase from 4.94% to 6.11% was not deemed acceptable, given lower market rates, so in consultation with our treasury management advisors Arlingclose, the £5M loan was repaid and is currently being financed by temporary borrowing from other local authorities.

We currently have £4M remaining in LOBO loans and all have call dates within the next 12 months, we will continue to monitor and liaise with Arlingclose over the likelihood of the options being exercised and take appropriate action.

12. **Short-term borrowing:** cost increased with the rise in Bank Rate in July and August, and we took out £20M (5.79%) of short term debt during this period and anticipate further borrowing before year end.

Rates have fallen slightly since the bank of England maintained the base rate at its meeting on 20th September and is currently around 5.65% for a 1 year loan.

Any borrowing will be done in consultation with our advisors as although short term borrowing is currently higher than 25 year maturity debt at 5.27%, long term debt is expected to fall in the medium term and the overall cost needs to be considered.

13. The Authority has an increasing CFR due to the capital programme, and after future debt maturities currently has an estimated borrowing requirement of £72.10M for the year, as determined by the Liability Benchmark, which considers capital spend, maturing debt, usable reserves and working capital and is summarised in Table 2 below.

Table 2 – Estimated Borrowing Requirement

	2023/24 £M	**Previous £M**	**Movement £M**
New Capital Expenditure	35.92	35.92	(0.00)
Repayment of Principle (MRP)	(8.69)	(8.69)	(0.00)
Maturing Debt	20.60	20.60	(0.00)
Movement in Resources	44.27	51.39	(7.12)
	92.10	**99.22**	**(7.12)**
New Borrowing Taken in Year	(20.00)	(20.00)	(0.00)
Cumulative Borrowing Need	**72.10**	**79.22**	**(7.12)**

Investment

14. Both the CIPFA Code and government guidance require the Authority 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 Authority'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.

As demonstrated in table 2 above, the Authority expects to be a long-term borrower and new treasury investments are therefore primarily made to manage day-to-day cash flows using short-term low risk instruments. The existing portfolio of strategic pooled funds will be maintained to diversify risk into different sectors and boost investment income.

15. The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves. During the year investment balances have ranged between £94.52M and £48.08M and are currently £51.78M and expected to reduce to £48M by year end.

16. Bank Rate increased by 1%, from 4.25% at the beginning of April to 5.25% in August. Short-dated cash rates rose commensurately, with 3-month rates rising to around 5.6% and 12-month rates to nearly 6.6%, although these rates subsequently began to reduce towards the end of the period. The rates on DMADF deposits also rose, ranging between 4.8% and 5.4% by the end of September and Money Market Rates between 4.2% and 5.35%, they have since fallen

	back in anticipation of an interest rate reduction during 2024. DMADF rates are currently 5.18% for a 3 month deposit. Due to shortage of cash availability in the LA to LA market rates have remained higher at 5.50% for a 3 month loan / deposit. Forecast income is now £2.99M, £1.15M higher than originally budgeted which helps to partly mitigate the increase in borrowing costs.
	Investment Performance
17.	The council's advisors undertake quarterly investment benchmarking across its client base. We previously had a more diversified portfolio and at higher interest rates than the average as a result of moving into the bond programme earlier than most clients, but there is now more competition for bonds from both government bodies and other local authorities, so opportunities to replace maturing bonds are limited and we have seen a fall in suitable instruments. With this in mind, and the changes to Prudential code to only borrow when cash flows dictate, our investments primarily now consist of a previous long-term investment in property funds and short term investments for cash flow purposes.
18.	Our current investment in bonds remains at £1M and we maintained the pooled property fund at £27M, with all other cash being placed in short term deposits as shown in table 1.
19.	As detailed in paragraph 15 our cash balances have continued to fall in line with yearend forecast and at £51.78M have reduced by £42.74M since highest point, when we held £94.52M. Our target is to reduce this to a £20M working balance to reduce borrowing and therefore net interest costs but this will be dependent on actual capital spend and movement in balances.
20.	Investments managed internally are currently averaging a return of 5.32% which is slightly higher than the average unitary authority at 5.13%, whilst maintaining a high credit rating at AAA compared to A+. Average LA returned 5.08% against a credit rating of A+. Total income returns at 5.03% is in line other unitary (5.06%) and the average for LA's (5.04%). As we are now operating on a cash flow basis for investm5nts to avoid higher borrowing costs we maintain a lower cash balances, £49.7M as opposed to £76.7M for other Unitaries and £72.8M for other Local Authority. Cash is performing well in the current financial environment. We hold 40% of our investments in strategic funds which offer higher return over the long term, as detailed in paragraphs 21 to 26, which is higher than the average but not unexpected as our cash flows have reduced. The capital value of our external strategic funds has fallen by a further £0.5M in the last quarter, which is consistent across all local authorities that hold funds in pooled property funds. The income return over the longer term was and remains the driver to invest, although this is kept under review.
	External Managed Investments
21.	The council has invested £27M in pooled property funds as an alternative to buying property directly. As previously reported these funds offer the potential for enhanced returns over the longer term but may be more volatile in the shorter term. They are managed by professional fund managers which allows the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments.
22.	Because these funds have no defined maturity date but are usually available for withdrawal after a notice period (180 days), their performance and continued suitability in meeting the Authority's investment objectives is regularly reviewed.
23.	Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three to five-year period total returns will exceed cash interest rates.

	Considering their performance over the long-term and the Authority's latest cash flow forecasts, investment in these funds has been maintained but will be monitored carefully especially as the statutory override on accounting for gains and losses on pooled investment funds ends on 31st March 2025, when any difference between initial investment and the current value will be a cost/gain to the Authority. Tables 3 and 4 below shows current value and income due in year together with the performance of the fund since we invested and how it has performed against cash. We have ongoing discussions with Arlingclose about the implications for the investment strategy and what action may need to be taken, current advice is to give notice on part of the fund once we have seen two consecutive increases in the value of fund.
24.	Investor sentiment for UK commercial property remained subdued with caution showed by buyers and sellers. With interest rates and bond yields remaining relatively high and investors demanding higher yields, property prices remained under pressure. The outlook for offices remains challenging from changing working practices. This was evident in the capital value of the CCLA fund which were below those in March and September. The change in the funds' capital values and income earned over the 9-month period is shown in Table 3 below. The dividend for this quarter is forecast to be slightly lower than previous quarter which included one off activity. Based on this the forecast dividend for the year is £1.29M. **Table 3 - Pooled Fund Performance (Year to Date)**

Quarter Ending	Valuation £M	Movement since Reported in SOA	Dividends £M
1st April	25.80		
30th June	25.77	(0.04)	0.30
30th September	25.46	(0.34)	0.34
31st December	24.96	(0.84)	0.33 E
Total			0.97

25.	As mentioned in paragraph 23 above investments in the CCLA were made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three to five-year period total returns will exceed cash interest rates.

26. Table below shows that although the investment currently shows an unrealised capital loss of £2.04M at 31st December 2023, since investing we have earned dividends of £8.76M, a net return of £6.72M which equates to an annualised income return of 3.87% compared to the average bank rate of 0.97% for the same period. This also compares favourably to the investments that were made directly in property, which returned a net return of 2.13% after financing costs (excluding unrealised loss/gain).

<u>Non – Treasury Investments</u>

27. The definition of investments in CIPFA's revised 2021 Treasury Management Code covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e., management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) and Welsh Government also broadens the definition of investments to include all such assets held partially or wholly for financial return.

Between 2016 and 2017, SCC implemented a strategy to invest in commercial properties with the expected return on investment being used to fund council services, known as the Property investment fund (PIF). To date the authority has purchased 3 properties.

The rate of return on investment in 2022/23 before borrowing costs and other on-costs was 5.74%. Borrowing costs of 3.90% were incurred giving a net rate of return of 2.13% before any realised gains or losses.

All of the properties remain fully let and the tenants are meeting their financial obligations under the leases (although one tenant has vacated the premises but continues to honour the lease).

A full review of all the authority assets is underway and may result in the disposal of some or all of these assets. Further details will be included in the TM Strategy report for 24/25.

Details of the properties purchased are shown in table 4 below.

28. **<u>Table 4 – Property Investment Fund</u>**

Property	Actual	31.03.2022 Actual		31.03.2023 Actual		Outstanding Debt 31.03.2023	Outstanding Debt 31.03.2024
	Purchase Cost £M	Value in Accounts	Gain or (Loss) in Year	Value in Accounts	Gain or (Loss) in Year	£M	£M
Property 1	6.47	4.88	(0.33)	4.79	(0.09)	5.81	5.75
Property 2	14.69	11.64	1.32	10.61	(1.03)	13.18	13.05
Property 3	8.53	9.16	0.43	8.42	(0.74)	7.65	7.57
	29.69	**25.68**	**1.42**	**23.82**	**(1.86)**	**26.64**	**26.37**

Financial Review and Outlook

29. A summary of the external factors, which sets the background for Treasury, as provided by the council's treasury advisors, Arlingclose Ltd, is summarised below:

Table 5 - Arlingclose's Economic Outlook (December 2023 interest rate forecast)

	Current	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00
Central Case	5.25	5.25	5.25	5.25	5.00	4.75	4.25	4.00	3.75	3.50	3.25	3.00	3.00
Downside risk	0.00	0.00	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00

30. The economic interest rate outlook provided by the Council's treasury advisor, Arlingclose Ltd, for December 2023 is based on the following underlying assumptions:

- The MPC held Bank Rate at 5.25% in December. We believe this is the peak for Bank Rate.
- The MPC will cut rates in the medium term to stimulate the UK economy but will be reluctant to do so until it is sure there will be no lingering second-round effects. We see rate cuts from Q3 2024 to a low of around 3% by early-mid 2026.
- The immediate risks around Bank Rate have become more balanced, due to the weakening UK economy and dampening effects on inflation. This shifts to the downside in the short term as the economy weakens.
- Long-term gilt yields are now substantially lower. Arlingclose expects yields to be flat from here over the short-term reflecting medium term Bank Rate forecasts. Periodic volatility is likely.

Economic background

31. UK inflation rates finally started to decline, mirroring the sharp but earlier drop seen in the Eurozone and US. Despite the fall, the Consumer Price Index (CPI) remained substantially in excess in the Bank of England's (BoE) 2% target, at 3.9% for November 2023. Market expectations for further rises in Bank Rate fell from October through to year end, indicating that the 5.25% level reached in August 2023 was indeed the peak for Bank Rate.

Economic growth in the UK remained weak over the period, edging into recessionary territory. In calendar Q3 2023, the economy contracted by 0.1%, following no change in Q2. Monthly GDP data showed a 0.3% contraction in October, following a 0.2% rise in September. While other indicators have suggested a pickup in activity in the subsequent months, Q4 GDP growth is likely to continue the weak trend.

July data showed the unemployment rate increased to 4.2% (3mth/year) while the employment rate rose to 75.7%. Pay growth edged lower as the previous strong pay rates waned; total pay (including bonuses) growth was 7.2% over the three months to October 2023, while regular pay growth was 7.3%. Adjusting for inflation, pay growth in real terms were positive at 1.3% and 1.4% for total pay and regular pay respectively.

Inflation continued to fall from its peak as annual headline CPI declined to 3.9% (down from 4.6%) in November 2023. The largest downward contribution came from energy and food prices. The core rate also surprised on the downside, falling to 5.1% from 5.7%.

The BoE's Monetary Policy Committee held Bank Rate at 5.25% throughout the period, although a substantial minority continued to vote for a 25 basis point rate rise. The Bank continues to tighten monetary policy through asset sales, as it reduces the size of its balance sheet. Financial market Bank Rate expectations moderated over the period as falling inflation

	and weakening data showed that higher interest rates were working in the UK, US, and Eurozone. Following the December MPC meeting, Arlingclose, the authority's treasury adviser, maintained its central view that 5.25% is the peak in Bank Rate. Short term risks are broadly balanced, but over the remaining part of the time horizon the risks are to the downside from economic activity weakening more than expected. 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, it is likely this will reverse at some point and spending will struggle. Higher rates will also impact exposed businesses; according to S&P/CIPS survey data, the UK manufacturing and construction sectors contracted during the quarter. The services sector recovered, however, with the PMI rising strongly in December, possibly due to improving consumer confidence. The US Federal Reserve held its key interest rate at 5.25-5.50% over the period. While policymakers continued to talk up the risks to inflation and therefore interest rates, this stance ebbed over the quarter culminating in a relatively dovish outcome from the December FOMC meeting. The European Central Bank continues to resist market policy loosening expectations, but the Eurozone CPI rate has fallen sharply as GDP growth as markedly slowed, hitting 2.4% in November (although rising to 2.9% on energy-related base effects).
	Financial Markets
32.	Financial market sentiment and bond yields remained volatile, but the latter rapidly trended downwards towards the end of 2023 on signs of sharply moderating inflation and economic growth. Gilt yields fell towards the end of the period. The 10-year UK benchmark gilt yield rose from 4.57% to peak at 4.67% in October before dropping to 3.54% by the end of December 2023. The Sterling Overnight Rate (SONIA) averaged 5.19% over the period.
	Credit Review
33.	Arlingclose maintained the advised maximum duration limit for all banks on its recommended counterparty list to 35 days over the period. In October, Moody's revised the outlook on the UK's Aa3 sovereign rating to stable from negative. This led to similar rating actions on entities that include an element of government support in their own credit ratings, including banks and housing associations. Local authorities were, however, downgraded on expectations of lower government funding. Following the issue of a Section 114 notice, in November Arlingclose advised against undertaking new lending to Nottingham City Council. After reducing its recommended duration on Warrington Borough Council to a maximum of 100 days in September, the local authority was subsequently suspended from the Arlingclose recommended list following a credit rating downgrade by Moody's to Baa1. Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress, but no changes were made to recommended durations over the period. Heightened market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remains under constant review.

	Consultations
34.	The Department for Levelling Up, Housing and Communities (DLUHC) issued two consultations in December. a “final” consultation on proposed changes to regulations and statutory guidance on MRP closing on 16th February and a “call for views” on capital measures to improve sector stability and efficiency closing on 31st January. Draft regulations and draft statutory guidance are included in the MRP consultation. The proposals remain broadly the same as those in June 2022 – to limit the scope for authorities to (a) make no MRP on parts of the capital financing requirement (CFR) and (b) to use capital receipts in lieu of a revenue charge for MRP. In its call for views on capital measures, Government wishes to engage with councils to identify and develop options for the use of capital resources and borrowing to support and encourage ‘invest-to-save’ activity and to manage budget pressures without seeking exceptional financial support. Whilst Government has identified some options including allowing authorities to capitalise general cost pressures and meet these with capital receipts, there is no commitment to take any of the options forward. We are currently reviewing these consultations and will report back any action or changes required to our practices and procedures.
	Prudential Indicators
35.	As required by the 2021 CIPFA Treasury Management Code, the Authority monitors and measures the following treasury management prudential indicators, which together with Capital Prudential Indicators can be seen in Appendix 4 (6 – 11): • Liability Benchmark • Maturity Structure of Borrowing • Long-term Treasury Management Investments • Security • Liquidity • Interest Rate Risk Indicator