	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-22 Actual £M	31-Mar-22 Average Yield / Rate %	31-Dec-22 Actual £M	31-Dec-22 Average Yield / Rate %	31-Mar-23 Forecast £M	31-Mar-23 Forecast Average %
Long Term Borrowing						
Public Works Loan	246.30	2.88	267.74	2.77	312.59	2.82
LOBO Loans from Banks	9.00	4.89	9.00	4.86	9.00	4.87
	255.30	**2.95**	**276.74**	**2.90**	**321.59**	**2.82**
Short Term Borrowing						
Other Local Authorities	0.00	0.00	0.00	0.00	0.00	3.00
Other	0.36	0.38	0.44	2.46	0.44	0.00
Total External Borrowing	**255.66**	**2.83**	**277.18**	**2.89**	**322.03**	**2.78**
Other Long Term Liabilities						
PFI Schemes	47.52	9.01	45.95	9.56	44.37	9.56
Deferred Debt Charges (HCC)	13.10	2.66	12.92	3.27	12.73	3.27
Total Gross External Debt	**316.28**	**3.87**	**336.04**	**4.08**	**379.13**	**3.85**
Investments:						
Managed In-House						
Government & Local Authority	(24.41)	0.00	(8.55)	1.98		
Cash (Instant access)	(54.50)	0.51	(29.96)	3.31	(20.00)	4.00
Cash (Notice Account)	0.00	0.00	0.00	0.00	0.00	0.00
Long Term Bonds	(1.06)	5.27	(1.01)	5.27	(1.01)	5.27
Managed Externally						
Pooled Funds (CCLA) & Shares	(27.25)	3.81	(27.00)	3.84	(27.00)	3.00
Total Investments	**(107.22)**	**3.46**	**(66.52)**	**3.64**	**(48.01)**	**3.46**
Net Debt	**209.06**		**269.52**		**331.12**	

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 £122.06M.

   A review of the capital programme is being undertaken which has resulted in a reduction in borrowing and a re-profiling of schemes to move borrowing into later years.

4. The interest cost of financing the council's long term 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.

   Rates for new long term borrowing are higher than budgeted and are on an upward trend. However, the higher interest rates are having a positive impact on investment income, and this somewhat mitigates the impact on the revenue budget.

	Borrowing
5.	The forecast cost of financing the council's loan debt is £16.81M of which £5.19M 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.	The cost of both long and short term borrowing has risen dramatically over last 9 months, with rates at the end of December 2023 around 2% - 3% higher than those at the beginning of April 2023. Rate rises have been driven primarily by inflation and the need for central banks to control this by raising interest rates. Particularly dramatic rises were seen in September after the 'mini-budget' which included unfunded tax cuts and additional borrowing to fund consumer energy price subsidies: over a twenty-four-hour period, some PWLB rates increased to 6%. Rates have now fallen from September peaks but remain well above recent historical norms. The PWLB 10 year maturity certainty rate stood at 4.59% at the end of 2022. We currently do not have any short term debt, we anticipate borrowing short term before year end, while the rates are more favourable than long term, to replace maturing long term debt, expected reduction in reserves and to fund the capital programme for the year.
7.	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.
8.	As outlined in the treasury strategy, the Authority's primary 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 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.
9.	The Authority has an increasing CFR due to the capital programme, and after future debt maturities currently has an estimated borrowing requirement of £48.42M 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

	2022/23 £M
New Capital Expenditure	52.14
Repayment of Principle (MRP)	(7.92)
Maturing Debt	7.10
Movement in Resources	22.10
	73.42
New Borrowing Taken in Year	(25.00)
Cumulative Borrowing Need	**48.42**

As detailed above, rates continue an upward trajectory and are currently above the rate used for setting budget. Further borrowing will be required during the year and rates will be monitored to determine the appropriate time; current advice is to take short term borrowing when required.

	Investment
10.	The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves. During the year investment balances have ranged between £109.37M and £59.96M and are currently £66.52M and expected to reduce to £48M by year end. Bank Rate has increased from 0.75% in April 2023 to 3.5% at 31 December 2023, with the prospect of further increases to come. Short-dated cash rates, which had ranged between 0.7% - 1.5% at the end of March, rose by around 2.7% for overnight/7-day maturities and 3.0% for 6-12 month maturities. By end of December, the rates on DMADF deposits ranged between 3.3% and 3.6%. The return on the Council's sterling low volatility net asset value (LVNAV) Money Market Funds ranged between 0.48% - 0.54% in early April and between 3.14% and 3.51% at the end of December Forecast income is now £1.90M, £0.88M higher than originally budgeted which helps to partly mitigate the increase in borrowing costs.
	Investment Performance
11.	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.
12.	Our current investments in bonds reduced from £3M to £1M following maturities in 2021/22 and we maintained the property funds at £27M, with all other cash being placed in short term deposits as shown in table 1 in paragraph 2.
13.	As detailed in paragraph 10 our cash balances have continued to be higher than forecast but at £38.51M have reduced by £22.97M since highest point in year (July) when we held £61.48M. 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.
14.	Investments managed internally are currently averaging a return of 3.07% which is higher than the average unitary authority at 2.85% whilst maintaining a higher credit rating at AA- compared to A+. Total income returns at 3.32% is also higher than the average for both unitary (3.07%) and LA's (2.93%), this is primarily due to historic investment in EIB bonds which return 5.27%, although on a small balance of £1M, since maturities cannot be replaced at the same level. We hold 40% of our investments in strategic funds which offer higher return over the long term as detailed in paragraphs 15 to 18 below which is higher than the average but in line with our strategy. As detailed in paragraph 18 below the capital value of our external funds has fallen 10.91% in the last quarter, which is consistent across all local authorities that hold funds in pooled funds. The income return was and still remains the driver to invest, as forecast income is due to exceed budget.

External Managed Investments

15. 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.

16. 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.

17. 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.

18. During the Quarter 3, financial markets experienced some relief from the losses endured through most of the year, although it was a mixed picture. Globally, equities saw positive returns as did some corporate bonds, but government bonds generally suffered as did Commercial property returns, which tend to operate on a lag. These saw significant declines over the quarter, as market pricing finally reflected the economic and interest rate environment. The overall April-December period remained a very difficult environment for almost all asset classes, largely driven by central bank rate increases in the fight against high inflation and Russia's continuing invasion of Ukraine.

The increase in policy rates in the UK, US and Eurozone and the prospect of low growth/recessionary period ahead was also challenging for equities, the FTSE All Share index falling from 4187 on 31st March to 4075 on 30th December, whilst the MSCI World Index fell from 3053 to 2602 over the same period. The fall in equity valuations is reflected in the equity and multi-asset income funds. Commercial property prices also fell for similar reasons, and this was reflected in the Authority's property fund.

Financial market volatility and uncertainty remain due to stagflation fears, little sight of the war in Ukraine ending soon and ongoing supply chain issues, a lingering problem yet to be fully resolved.

The change in the Authority's funds' capital values and income earned over the 9-month period is shown in Table 3 below. If rates remain at this level the total forecast dividend for the year is £1.07M.

Table 3 - Pooled Fund Performance (Year to Date)

Quarter Ending	Valuation £M	Movement since Reported in SOA	Divide £M
1st April	30.89		
30th June	32.51	1.61	0.26
30th September	31.13	0.23	0.30
31st December (Est)	26.31	(4.58)	0.28
Total			0.84

Financial Review and Outlook

19. 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 4 - Arlingclose's Economic Outlook for the remainder of 2022/23 (based on 19th December 2022 interest rate forecast)

	Current	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Official Bank Rate													
Upside risk	0.00	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25	1.25
Arlingclose Central Case	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	3.50	3.25	3.25	3.25	3.25
Downside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00

20. The economic interest rate outlook provided by the Council's treasury advisor, Arlingclose Ltd, for December 2022 is based on the following underlying assumptions:

- The MPC raised Bank Rate by 50bps to 3.5% in December as expected, with signs that some members believe that 3% is restrictive enough. However, a majority of members think further increases in Bank Rate might be required. Arlingclose continues to expect Bank Rate to peak at 4.25%, with further 25bps rises in February, March and May 2023.

- The MPC will cut rates in the medium term to stimulate a stuttering UK economy but will be reluctant to do so until wage growth eases. Rate cuts in the first half of 2024.
- Arlingclose expects gilt yields to remain broadly steady over the medium term, although with continued volatility across shorter time periods.
- Gilt yields face pressures to both sides from hawkish US/EZ central bank policy on one hand to the weak global economic outlook on the other. BoE bond sales and high government borrowing will provide further underlying support for yields.

21. The influence of the mini-budget on rates and yields continues to wane following the more responsible approach shown by the new incumbents of Downing Street.

Volatility in global markets continues, however, as investors seek the extent to which central banks are willing to tighten policy, as evidence of recessionary conditions builds. Investors have been more willing to price in the downturn in growth, easing financial conditions, to the displeasure of policymakers. This raises the risk that central banks will incur a policy error by tightening too much.

The UK economy is already experiencing recessionary conditions and recent GDP and PMI data suggests the economy entered a technical recession in Q3 2022. The resilience shown by the economy has been surprising, despite the downturn in business activity and household spending. Lower demand should bear down on business pricing power–recent data suggests the UK has passed peak inflation.

The lagged effect of the sharp tightening of monetary policy, and the lingering effects of the mini-budget on the housing market, widespread strike action, alongside high inflation, will continue to put pressure on household disposable income and wealth. The short-to medium-term outlook for the UK economy remains bleak.

Demand for labour appears to be ebbing, but not quickly enough in the official data for most MPC policymakers. The labour market remains the bright spot in the economy and persisting employment strength may support activity, although there is a feeling of borrowed time. The MPC focus is on nominal wage growth, despite the huge real term pay cuts being experienced by the vast majority. Bank Rate will remain relatively high(er) until both inflation and wage growth declines.

	Global bond yields remain volatile as investors price in recessions even as central bankers push back on expectations for rate cuts in 2023. The US labour market remains tight, and the Fed wants to see persistently higher policy rates, but the lagged effects of past hikes will depress activity more significantly to test the Fed's resolve. While the BoE appears to be somewhat more dovish given the weak outlook for the UK economy, the ECB seems to harbour (worryingly) few doubts about the short term direction of policy. Gilt yields will be broadly supported by both significant new bond supply and global rates expectations due to hawkish central bankers, offsetting the effects of declining inflation and growth.
	<u>Economic background</u>
22.	The conflict in Ukraine continued to keep global inflation elevated and the UK and global economic outlook remains weak. Political uncertainty in the UK improved in the later part of the period following a change in government to what financial markets perceived as being more fiscally prudent. The economic backdrop during the April to December period continued to be characterised by high energy and commodity prices, high inflation and the associated impact on consumers' cost of living, as well as little likelihood that the Russia-Ukraine hostilities will end any time soon. China started to lift some of its zero-Covid policy restrictions at the end of the period causing a sharp increase in infections, but also leading to questions over potential under reporting of the number of cases by the Chinese government due to how it is counting the figures. Central Bank rhetoric and action continued to remain robust. The Bank of England, Federal Reserve and the European Central Bank all increased interest rates over the period and committed to fighting inflation, even in the face of potential recessions in those regions. UK inflation remained high, but there were tentative signs it may have peaked. Annual headline CPI registered 10.7% in November, down modestly from 11.1% in October. RPI was 14% in November, down from 14.2% in October, but slightly above expectations for a larger fall to 13.9%. The labour market remained tight but with some evidence of softening demand for new labour. The unemployment rate 3m/year for April-June was 3.8%, which declined to 3.6% in July-September and picked up again to 3.7% in October-December. The inactivity rate was 21.5% in the latest quarter, down by 0.1% compared to the previous period. Pay growth in October-December was 6.1% for both total pay (including bonuses) and for regular pay. Once adjusted for inflation, however, both measures fell by 2.7%. Household disposable income remained under pressure, pushing consumer confidence down to a record low of –49 in September, but following months showed registered modest improvements to December's reading of –42. Quarterly GDP for the April-June quarter was revised upwards to 0.2% (from -0.1%), following revisions to household and government spending, but fell by -0.3% in the July-September quarter, a larger decline than the -0.2% predicted. The Bank of England increased the official Bank Rate to 3.5% over the period. From 0.75% in March, the Monetary Policy Committee (MPC) pushed through rises at every subsequent meeting over the period, with outsized hikes of 50bps in August and September, 75bps in November and then another 50bps in December. November's rise was voted by a majority of 7-2, with one MPC member preferring a 0.5% rise and another a 0.25% rise. The December vote was 6-3, with two members preferring to keep Bank Rate on hold at 3% while one member wanted a larger increase of 0.75%. Once again, the Committee noted that domestic

	inflationary pressures are expected to remain strong and continuing rhetoric around combating inflation means further rate rises are predicted.
	Financial markets
23.	Uncertainty remained a key driver of financial market sentiment and bond yields remained relatively volatile due to concerns over elevated inflation and higher interest rates. In September and October, volatility in financial markets was significantly exacerbated by the fiscal plans of the then UK government, leading to an acceleration in the rate of the rise in gilt yields and decline in the value of sterling. However, the subsequent change of government leadership has lead to gilts yields falling in November and December, albeit at higher levels compared to earlier in the period. Over the period the 5-year UK benchmark gilt yield rose from 1.41% to peak at 4.70% in September before ending the calendar year at 3.62%. Over the same timeframe the 10-year gilt yield rose from 1.61% to peak at 4.51% before falling back to 3.67%, while the 20-year yield rose from 1.82% to 4.96% and then declined to 4.03%. The Sterling Overnight Rate (SONIA) averaged 1.75% over the period.
	Credit background
24.	During the last few months of the period, in October Fitch revised the outlook on the UK sovereign to negative from stable following the largely unfunded fiscal package announced at the time, and a few weeks prior revised the outlook on HSBC to stable from negative. Over the same timeframe Moody's also revised the UK sovereign to negative from stable, following swiftly after with a similar move for a number of local authorities and UK banks including Barclays Bank, National Westminster Bank (and related entities) and Santander. Having completed its full review of its credit advice on unsecured deposits at UK and non-UK banks earlier in the year (May), Arlingclose extended the maximum duration limit for five UK banks, four Canadian banks and four German banks to six months. The maximum duration for unsecured deposits with other UK and non-UK banks on Arlingclose's recommended list is 100 days. These recommendations were unchanged at the end of the period. Although local authorities remain under financial pressure, Arlingclose continues to take a positive view of the sector, considering its credit strength to be high. Section 114 notices have been issued by only a handful of authorities with specific issues. While Arlingclose's advice for local authorities on its counterparty list remains unchanged, a degree caution is merited with certain authorities. Arlingclose continued to monitor and assess credit default swap levels for signs of credit stress but made no changes to the counterparty list or recommended durations. Nevertheless, increased 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.
	Revision to CIPFA Codes
25.	CIPFA published revised Prudential and Treasury Management Codes in December 2021. The Prudential Code took immediate effect although detailed reporting requirements could be deferred until the 2023/24 financial year and have not been included in this report whilst we are reviewing the impact of the proposed changes.

26.	The main changes or expected changes from previous codes include: • Additional reporting requirements for the Capital Strategy. • For service and commercial investments, in addition to assessments of affordability and prudence, an assessment of proportionality in respect of the Authority's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services). • Forward looking prudential code indicators must be monitored and reported to members at least quarterly. • A new indicator for net income from commercial and service investments to net revenue stream. • Inclusion of the liability benchmark as a treasury management prudential indicator. CIPFA recommends this is presented as a chart of four balances – existing loan debt outstanding; loans CFR, net loans requirement, liability benchmark – over at least 10 years and ideally cover the authority's full debt maturity profile. • Excluding investment income from the definition of financing costs. • Credit and counterparty policies should set out the Authority's policy and practices relating to Environmental, Social and Governance (ESG) investment considerations. • Additional focus on the knowledge and skills of officers and elected members involved in decision making
27.	Future long-term investments, such as CCLA will be prohibited but we will not need to unwind existing investments.