Treasury Management

Borrowing and Investments

1. Table 1 below shows the 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 has maintained its strategy of keeping borrowing and investments below their underlying levels to reduce risk and make a net saving.

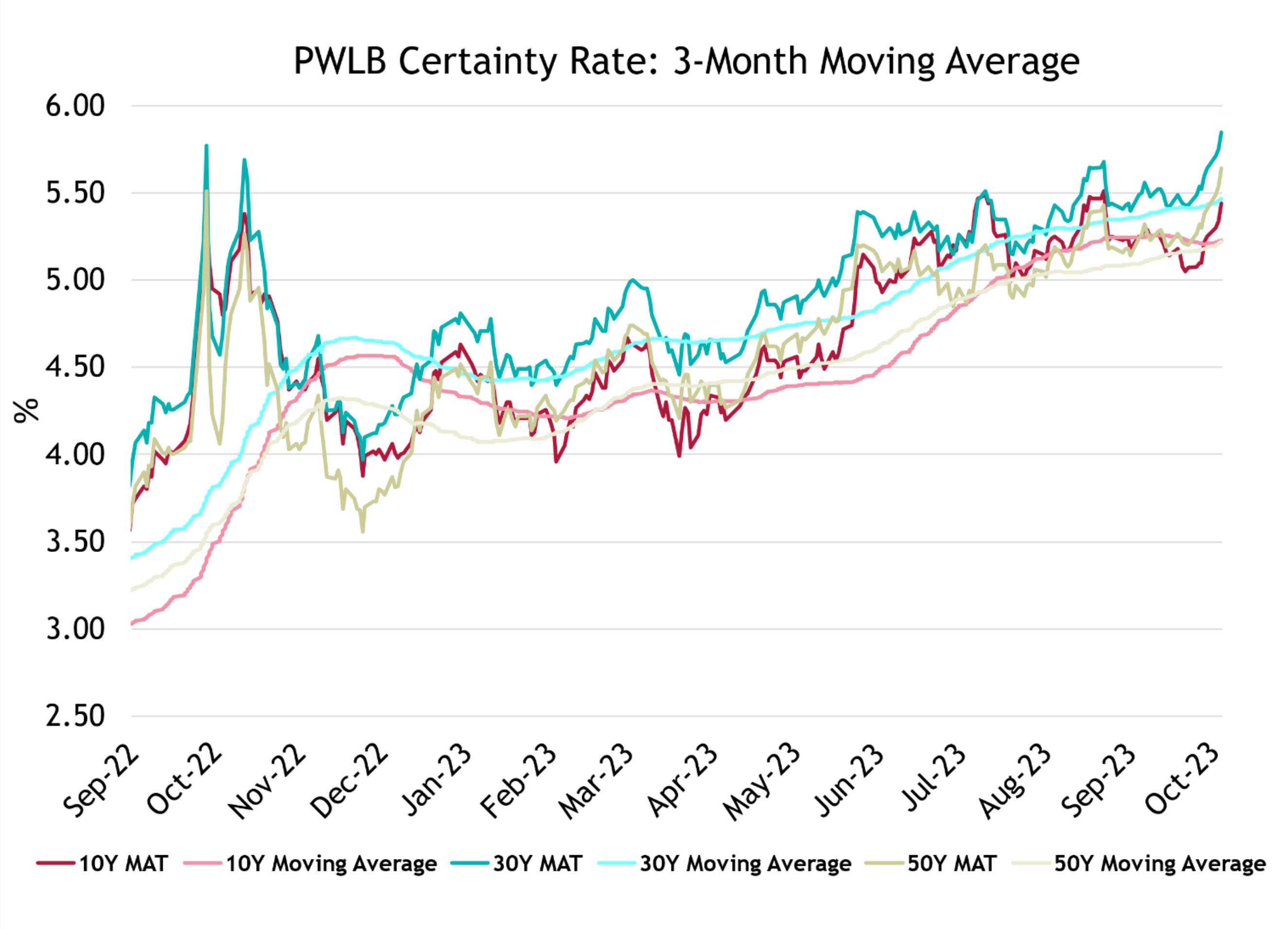
2. **Table 1 - Borrowing and Investments**

	31-Mar-23 Actual £M	31-Mar-23 Average Yield / Rate %	30-Sep-23 Actual £M	30-Sep-23 Average Yield / Rate %	31-Mar-24 Forecast £M	31-Mar-24 Forecast Average %
Long Term Borrowing						
Public Works Loan	289.19	3.52	283.90	2.95	357.80	3.20
LOBO Loans from Banks	9.00	4.86	4.00	4.83	4.00	4.83
	298.19	**3.63**	**287.90**	**3.00**	**361.80**	**3.24**
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**	**307.90**	**3.65**	**381.80**	**3.33**
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	5.73
Total Gross External Debt	**360.29**	**4.08**	**364.18**	**4.08**	**435.25**	**4.09**
Investments:						
Managed In-House						
Government & Local Authority	(11.06)	4.05	0.00	0.00		
Cash (Instant access)	(15.49)	4.08	(36.90)	5.30	(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)	4.40	(27.00)	3.00
Total Investments	**(54.56)**	**4.08**	**(64.93)**	**4.43**	**(48.00)**	**4.05**
Net Debt	**305.73**		**299.25**		**387.25**	

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 £81.52M, to £387.25M. This is a reduction of £7.30M from the last reported position of £394.55M, due to a reduction proposed capital spend of £21.47M but is partly offset by an increase in the draw on balances of £14.15M.

This forecast remains subject to change; most notably regarding the increased use of balances, (which will increase borrowing need as the ability to use 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.

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 September 2023, the forecast cost of financing the council's loan debt is £21.42M of which £5.96M 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.	There was a substantial rise in the cost of both short- and long-term borrowing over the last 18 months. Bank Rate rose by 1% from 4.25% at the beginning of April to 5.25% at the end of September. Bank Rate was 2% higher than at the end of September 2022. UK gilt yields were volatile, mainly facing upward pressure since early April following signs that UK growth had been more resilient, inflation stickier than expected, and that the Bank of England saw persistently higher rates through 2023/24 as key to dampening domestic demand. Gilt yields, and consequently PWLB borrowing rates, rose and broadly remained at elevated levels. On 30th September, the PWLB certainty rates for maturity loans were 5.26% for 10-year loans, 5.64% for 20-year loans and 5.43% for 50-year loans. Their equivalents on 31st March 2023 were 4.33%, 4.70% and 4.41% respectively.
8.	A new PWLB HRA rate which is 0.4% below the certainty rate has been made available from 15th September 2023. Initially available for a period of one year, this discounted rate is to support local authorities borrowing for the Housing Revenue Account and for refinancing existing HRA loans, providing a window of opportunity for HRA-related borrowing and to £6.36M 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 etc. 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.	The chart below shows the pattern of the PWLB Certainty Rate 3-month moving average over the last year. Rates rose sharply in November 2022 following turmoil in markets, it then fell back but has since been on an upward trajectory.



11. **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 considered a cost-effective option for the Authority.

12. **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 at the end of 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 take appropriate action as necessary.

13. **Short-term borrowing:** cost continued to increase with the rise in Bank Rate in July and August. We took £20M (5.79%) of short term debt during this period, to maintain liquidity and anticipate further borrowing before year end. Table 2 below shows the movement in year.

Rates have fallen slightly since the Bank of England maintained the base rate at its meeting on 20th September and are currently around 5.80% for a 1 year loan.

Any borrowing will be done in consultation with our TM advisors, as although short term borrowing is currently higher than 25 year maturity debt at 5.75%, long term debt is expected to fall in the medium term and the overall cost needs to be considered.

14. **Table 2: Movement in Borrowing during the year**

Movement during the year	2022/23 Actual £M	2023/24 Movement in year £M	30-Sep-23 £M	Average Life
Long-term borrowing Carried Forward	255.30		298.19	
Maturities in year	(7.11)		(10.29)	
New borrowing taken in year	50.00		0.00	
Net Long Term Borrowing	**298.19**	**(10.29)**	**287.90**	**26 Years**
Short-term borrowing Carried Forward	0.36		5.00	
Maturities in year	(0.36)		(5.00)	
New borrowing taken in year	5.00		20.00	
Net Short Term Borrowing	**5.00**	**15.00**	**20.00**	**7 Months**
Total Borrowing	**303.19**	**4.71**	**307.90**	

Please note that these figures do not reflect the accounting convention of moving loans maturing in the year from long term to short term so will differ from the maturity analysis

15. The Authority has an increasing CFR due to the capital programme, and after future debt maturities currently has an estimated borrowing requirement of £79.22M 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 3 below.

Table 3 – Estimated Borrowing Requirement

	2023/24 £M	Previously Reported £M	Movement £M
New Capital Expenditure	35.92	57.39	(21.74)
Repayment of Principle (MRP)	(8.69)	(8.69)	(0.00)
Maturing Debt	20.60	15.60	5.00
Movement in Resources	51.39	37.24	14.15
	99.22	**101.54**	**(2.32)**
New Borrowing Taken in Year	(20.00)	(0.00)	(20.00)
Cumulative Borrowing Need	**79.22**	**101.54**	**(22.32)**

Other Debt Activity

16. Although not classed as borrowing the Council has previously raised capital finance via Private Finance Initiative (PFI). The balance at the end of the year, after allowing for repayment in year of £3.14M is £44.38M.

17. In addition, the Authority holds debt in relation to debt transferred from Hampshire County Council on the 1 April 1997 when we became a unitary authority, of £12.74M. This is being repaid over 50 years at £0.36M per annum.

Investment

18. 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.

19. As demonstrated in table 3 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.

20. In line with Bank Rate short-dated cash rates rose commensurately, with 3-month rates rising to around 5.25% and 12-month rates to nearly 6%. 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%.

Forecast income is now £2.81M, £0.97M higher than originally budgeted which helps to partly mitigate the increase in borrowing costs.

Investment Activity

21. The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves. During the year investment balances have ranged between £86.95M and £48.08M and are currently £64.93M and expected to reduce to £48M by year end.

22. **Table 4: Investment activity during the year**

	Balance on 01/04/2023 £M	Investments Repaid £M	New Investments £M	Balance on 30/09/2022 £M	(Increase)/ Decrease in Investment for Year £M	Average Life of Investments Life
Multi- National Bonds (not subject to bail in)	(1.01)	0.02	0.00	(1.03)	(0.02)	2 years
Money Market Funds and Call Account	(15.49)	156.30	(177.71)	(36.90)	(21.41)	on day notice
Government & Local Authority	(11.06)	154.56	(143.50)	0.00	11.06	0 days
Managed Externally (CCLA Pooled funds)	(27.00)	0.00		(27.00)	0.00	Unspecified
Total Investments	**(54.56)**	**310.88**	**(321.21)**	**(64.93)**	**(10.37)**	

Investment Performance

23. The council's TM 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.

24.	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.
25.	As detailed in paragraph 19 our cash balances are currently higher than forecast but at £64.93M have reduced by £22.02M since highest point, in April, when we held £86.95M. 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.
26.	As detailed in Appendix 3, investments managed internally are currently averaging a return of 5.30% which is higher than the average unitary authority at 4.93%, whilst maintaining a high credit rating at AA- compared to A+. Average LA returned 4.92% against a credit rating of AA- Total income returns at 4.72% is in line other unitary (4.71%) but lower than the average for LA's (4.79%). Due to reduction in available balances, we have reduced scope for investment and holding these longer term, and are now more limited to managing day to day cash flows to seek the best returns and to avoid higher borrowing costs. Our cash balances were £37.9M as opposed to £65.2M for other unitaries and £66.5M 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 24, which is higher than the average but not unexpected as our cash balances have reduced. The capital value of our external strategic funds has fallen by a further £0.03M 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.
	<u>External Managed Investments</u>
27.	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.
28.	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.
29.	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.. On the basis that the fund's capital value as of June 2023 was £25.77M, there would be a £1.23M potential loss against the original £27M investment. Therefore, as part of the Medium Term Financial Strategy Quarter 2 Update report to Cabinet in October 2023, an Investment Risk Reserve was created to aside funds to protect the council from incurring such a loss when the statutory override expires in 2025/26. To even out the effects it is proposed to make a contribution to a new Investment Risk Reserve of £0.4M per annum from 2023/24 to 2025/26

to provide cover for the potential loss. The value of the reserve will be kept under review, to ensure it meets the forecast need.

30. Financial market conditions were volatile during the six-month period. Global bond yields rose and remained elevated as it became apparent that policymakers were looking to keep rates high for some time amid persistently higher core inflation and tight labour markets.

The UK, Euro area and US equity markets were initially helped by resilient growth data and diminishing talk of recession. A weaker currency and better-than-expected economic fundamentals were broadly supportive for UK equities. Much of the US stock market's performance was driven by a small number of mega stocks and enthusiasm over artificial intelligence. However, the global outlook was clouded by the slowdown in China.

Investor sentiment for UK commercial property was more settled than in Q3 and Q4 of 2022 when the sharp rise in bond yields resulted in a big fall in property valuations. There were signs of returning investor interest, occupier resilience and a perception that the downturn in commercial real estate may be bottoming out. It helped rental income and led to some stabilisation in capital values. However, the combination of high interest rates and bond yield, higher funding costs and the prospect of sluggish economic growth constrain the outlook for commercial property.

The change in the funds' capital values and income earned over the 6-month period is shown in Table 5 below.

The dividend for this quarter is forecast to be higher due to recent activity, but future dividends likely to be closer to the quarter 1. Based on this the forecast dividend for the year is £1.23M.

31. **Table 5 - 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 E
Total			0.64

Non – Treasury Investments

32. 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).

33. 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.

34. 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 and does not have plans to invest in the future.
35.	Strategic Capital Board will be reviewing the existing asset portfolio in detail over the next 6 months, to ensure all council assets are still providing value for money, as the economic climate has shifted substantially since all were originally invested in. The PIF will form part of this review.