Surrey Heath Borough Council
Audit. Standards and Risk Committee
14 December 2023

Treasury Management 2023/24
Quarterly Report – 2st Quarter 2023

Portfolio Holder:	Councillor Cllr Leanne Macintyre - Performance and Finance
Date Portfolio Holder signed off:	15 November 2023
Strategic Director:	Bob Watson
Report Author:	Miriam Norris/Sarah Ball
Key Decision:	no
Wards Affected:	**All**

Summary and purpose

This report advises members of the Audit Standards and Risk Committee of the performance of the treasury management service for the second quarter of 2023/24 as at 30 September 2023 and confirms the compliance with the Treasury Management Indicators for 2023/24.

Recommendation

The Committee is advised to RESOLVE that they

(i) note the Treasury Management report for the period 1 July to 30th September 2023.

1. Background and Supporting Information

1.1 This report sets out the performance of the Council's investments and borrowing for the first six months of the year. It also confirms that the Council is complying with the Treasury Management Indicators set by Council as part of the Treasury Management Strategy.

1.2 As at the 30 September 2023, the service has not breached any of the Treasury Management Indicators set for 2023/24. These are:

Treasury Management Indicator 23/24	

Minimum Counterparty Credit Rating	A
Liquidity Risk Indicator Limit	£5m
Interest Rate Exposure Limit	£1m
Maturity Structure of Borrowing	Upper 100%, Lower 0%
Principal Sums invested for Periods longer than a year. Individual counterparty limit	£2.5m

1.3 The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that authorities report on the performance of the treasury management function at least quarterly.

1.4 The Council's Treasury Management Strategy for 2023/24 was recommended by the Executive on 14 February 2023 and approved by Council on 22 February 2023.

1.5 The CIPFA Prudential Code 2021 includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's Capital Strategy, complying with CIPFA's requirement, was approved by Council on 22 February 2023.

1.6 Through investment, the Council is potentially exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The Council is also exposed to increases in revenue costs on its borrowing due to changes in interest rates. The Council seeks to moderate this impact by following the advice of its treasury advisers. This report covers treasury and borrowing activity and the associated monitoring and control of risk.

2. Local Context

2.1 At 31 March 2023, the Council's underlying need to borrow for capital purposes is referred to as the Capital Financing Requirement (CFR) for the Council. The 2022/23 CFR was £207 million (2021/22 - £210 million), a reduction of £3 million from the previous year due to the annual Minimum Revenue Provision charge £2.7 million and only £88k of annual capital expenditure financed from borrowing.

2.2 Forecast Capital Programme expenditure for 2023/24 is £5.419m based on this the forecast CFR for 2023/24 will be £208 million which will be within the operational boundary set for the year.

2.3 The Council must not borrow in excess of its the Authorised Limit for external borrowing of **£235 million**. This Prudential Indicator was approved by Council as part of the annual Budget for 2023/24.

3. Borrowing Activity to the 30 September 2023 (Quarter 2)

3.1 At 30 September 2023 the Council held £167 million of borrowing as part of its strategy for funding its previous and current year's capital programme and short-term cashflow.

3.2 The borrowing position is shown in the table below

30 September 2023	£ million
Public Works Loan Board (long term, fixed rate)	50.1
Phoenix Loans (2 x loans, both fixed rate)	48.6
Local Authorities (short term fixed deals < 24 months)	68.5
Total Borrowing	**167.2**

3.3 As at the end of September 2023, the weighted average rate for our long term debt was **2.73%** and our short term debt was **3.51%**. A full list of the counterparties lending to the Council including the maturity dates and interest rates is attached at **Appendix 1**.

4. Investment Activity to 30 September 2023 (Quarter 2)

4.1 The Council will invest cash balances that are not immediately required for cash flow management purposes. These are often short-term and will vary based on the liquidity requirement of the Council.

4.2 The Council's investment position at the end of the second quarter of the year is **£15.5 million**, as detailed in the table below:

Actual Portfolio as at 30 September 2023	£ million
Bank & Building Societies	0.5
Government – DMO	3.0
Money Market Funds	10.0
Government - Other Local Authorities	0.0
Other Pooled Funds (CCLA property)	2.0
Total Treasury Investments	**15.5**

5. Interest Rate Update

5.1 The Council has appointed Link Group as its treasury advisors and part of their service is to assist the Council to formulate a view on future interest rates.

5.2 The latest forecast, provided by Link Group on 25th September 2023, sets out a view that short, medium and long-dated interest rates will be elevated for some little while, as the Bank of England seeks to squeeze inflation out of the economy.

5.3 Where possible the Council has sought to mitigate the impact of the rising interest rates by taking advantage of forward dealing for better rates, releasing some of its core investment balances to repay debt and locking in some longer term loans.

5.4 As the forecast for the medium to long term is that rates will start to fall in step with the forecasted reduction in the headline rate of inflation, the policy will be to continue to roll-over short term loans at the best rates possible and use surplus balances to repay some of the short term loans (or defer re-financing of these) with a view to possibly locking in longer term deals when the interest markets offer a reasonable rate.

6. Economic Update

6.1 The first quarter 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).

6.2 A full economic update can be found at the end of this report at **Appendix 2**. Please note that this appendix is derived from the Link Group update and therefore is in a more technical format than the rest of this report.

7. Reasons for Recommendation

7.1 CIPFA's treasury management code requires that authorities report on the performance of the Treasury Management (TM) function at least quarterly a year. Previously this requirement was only twice a year following the setting of the annual strategy.

8. Proposal and Alternative Options

8.1 The Committee is asked to note the 23/24 quarterly treasury management report.

9. Contribution to the Council's Five Year Strategy

9.1 The returns from Treasury Management investments and the levels of prudential support the approved five-year strategy and the annual budget set at Council.

10. Resource Implications

10.1 None directly as a result of this paper, but the investment income and borrowing costs do impact the annual revenue budget.

11. Section 151 Officer Comments:

11.1 Robust treasury management forms part of the management of the Council's cash balances.

11.2 All investments are made with regard to security of the funds, the timing of when funds are needed (liquidity) and the need to make a return with due consideration of the previous two points first.

11.3 The Council will always consider investing funds in the most ethical way wherever practicable.

12. Legal and Governance Issues

12.1 The report demonstrates that the Council is complying with the Prudential Framework.

13. Monitoring Officer Comments:

13.1 The Committee's terms of reference includes the delegation to monitor, review and to report to the Council if necessary the Treasury activity in relation to the performance of the Council's services.

14. Other Considerations and Impacts

Environment and Climate Change

14.1 Details of these are in the individual service areas that the budgets support

Equalities and Human Rights

14.2 Details of these are in the individual service areas that the budgets support

Risk Management

14.3 Weak returns on investments could lead to a reduction in income generated to support the revenue budget. The Council will never pursue higher risk options just to make a higher return.

14.4 There is increased uncertainty and an increase in the perceived risk in financial institutions and the economy. This is mitigated by use of more secure investment vehicles, which will usually mean a lower rate of return, however security of the investment is the primary consideration.

14.5 The Council will also take and, if suitable, act on advice from its advisers in relation to levels of return and the risks associated with investments and its borrowing strategy. There are risks that interest rates can change and that any investment is not guaranteed.

14.6 It is noted that the investments ratings provided by credit ratings agencies are only a guide and do not give 100% security. There is always a risk that an institution may be unable to repay its loans whatever the credit rating. However this can be mitigated by spreading investments amongst a number of institutions and where possible with a higher rating. Although the Treasury Management strategy will allow a wider use of counterparties, the Council currently restricts itself to investments in Money Market Funds (which by their nature are 'AAA rated'), other Local Authorities and central government deposit facilities which are backed by the UK Government's rating.

Community Engagement

14.7 Where necessary engagement will be taken through individual service areas the budgets support

Background Papers	None
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Appendix 1

LONG TERM BORROWING

		Start Date	Maturity Date	Int Rate	Type		Total
LTB002	PWLB - Loan No 504063 St Georges	23-Apr-15	22-Apr-65	3.16%	Annuity	-	7,769,044.73
LTB003	PWLB - Loan No 504203 Ashwood	26-Jun-15	25-Jun-65	3.44%	Annuity	-	5,582,031.97
LTB005	PWLB - Loan Ref 507410 Trade City	24-May-18	24-May-33	2.65%	Maturity	-	1,500,000.00
LTB006	PWLB - Loan Ref 507411 Trade City	24-May-18	24-May-43	2.77%	Maturity	-	2,500,000.00
LTB007	PWLB - Loan Ref 507412 Trade City	24-May-18	24-May-53	2.65%	Maturity	-	4,000,000.00
LTB008	PWLB - Loan Ref 507413 Trade City	24-May-18	24-May-63	2.52%	Maturity	-	5,000,000.00
LTB009	PWLB - Loan No 508733 Theta	12-Mar-19	12-Mar-39	2.03%	EIP	-	4,650,000.00
LTB010	PWLB - Loan No 508734 Theta	12-Mar-19	12-Sep-41	2.52%	Maturity	-	1,500,000.00
LTB011	PWLB - Loan No 508735 Theta	12-Mar-19	12-Sep-46	2.53%	Maturity	-	1,500,000.00
LTB012	PWLB - Loan No 508736 Theta	12-Mar-19	12-Sep-51	2.48%	Maturity	-	1,500,000.00
LTB013	PWLB - Loan No 508737 Theta	12-Mar-19	12-Sep-56	2.43%	Maturity	-	1,500,000.00
LTB014	PWLB - Loan No 508738 Theta	12-Mar-19	12-Sep-61	2.40%	Maturity	-	1,500,000.00
LTB015	PWLB - Loan No 508739 Theta	12-Mar-19	12-Sep-66	2.39%	Maturity	-	1,500,000.00
LTB016	PWLB - Loan No 508746 Vulcan Way	13-Mar-19	13-Mar-39	2.01%	EIP	-	10,075,000.00
82021	Phoenix Loan 1	22-Feb-21	22-Feb-61	2.85%	Annuity	-	24,128,543.60
82022	Phoenix Loan 2	22-Feb-22	22-Feb-62	2.91%	Annuity	-	24,490,880.14
						-	**98,695,500.43**

SHORT TERM BORROWING

		Start Date	Maturity Date	Int Rate		Total
200331	Renfrewshire Council	14-Nov-22	13-Nov-23	2.90%	-	5,000,000.00
200332	West Yorkshire Police	15-Dec-22	14-Dec-23	3.00%	-	10,000,000.00
200333	Leicester City Council	16-Dec-22	15-Dec-23	2.98%	-	5,000,000.00
200334	Renfrewshire Council	16-Dec-22	15-Dec-23	2.95%	-	5,000,000.00
200335	Ryedale District Council	20-Dec-22	19-Dec-23	3.00%	-	1,500,000.00
200336	West Midlands Combined Authority	23-Dec-22	22-Dec-23	3.00%	-	10,000,000.00
200337	Fylde Borough Council	03-Feb-23	02-Feb-24	4.65%	-	2,000,000.00
200338	West Midlands Combined Authority	17-Feb-23	16-Feb-24	4.60%	-	5,000,000.00
200339	West Midlands Combined Authority	16-Jun-23	14-Jun-24	4.30%	-	5,000,000.00
200340	West of England CA	19-Jun-23	17-Jun-24	4.25%	-	5,000,000.00
200343	West Yorkshire Combined Authority	19-Apr-23	17-Apr-24	4.25%	-	10,000,000.00
200345	Havant Borough Council	26-Sep-23	24-Sep-24	5.00%	-	5,000,000.00
	Total Short Term Borrowing				**-**	**68,500,000.00**
	Total Borrowing				**-**	**167,195,500.43**

Appendix 2

Economic state of the nation – a technical update

- The first half of 2023/24 saw:
    - Interest rates rise by a further 100bps, taking Bank Rate from 4.25% to 5.25% and, possibly, the peak in the tightening cycle.
    - Short, medium and long-dated gilts remain elevated as inflation continually surprised to the upside.
    - A 0.5% m/m decline in real GDP in July, mainly due to more strikes.
    - CPI inflation falling from 8.7% in April to 6.7% in August, its lowest rate since February 2022, but still the highest in the G7.
    - Core CPI inflation declining to 6.2% in August from 7.1% in April and May, a then 31 years high.
    - A cooling in labour market conditions, but no evidence yet that it has led to an easing in wage growth (as the 3myy growth of average earnings rose to 7.8% in August, excluding bonuses).
- The 0.5% m/m fall in GDP in July suggests that underlying growth has lost momentum since earlier in the year. Some of the weakness in July was due to there being almost twice as many working days lost to strikes in July (281,000) than in June (160,000). But with output falling in 10 out of the 17 sectors, there is an air of underlying weakness.
- The 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.
- 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 (Bailey, Broadbent, Dhingra, Pill and Ramsden) voted for no change and the other four (Cunliffe, Greene, Haskel and Mann) voted for a 25bps hike.
- Like the US Fed, 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 Bailey stated, "we'll be watching closely to see if further increases are needed". The Bank also retained the hawkish guidance that rates will stay "sufficiently restrictive for sufficiently long".
- This narrative makes sense as the Bank of England does not want the markets to decide that a peak in rates will be soon followed by rate cuts, which would loosen financial conditions and undermine its attempts to quash inflation. The language also gives the Bank of England the flexibility to respond to new developments. 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.
- 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).
- 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 the Truss debacle 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.
- 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.