Surrey Heath Borough Council
Executive
19 September 2023

Treasury Management 2023/24
Quarterly Report – 1st Quarter 2023

Portfolio Holder:	Councillor Cllr Leanne MacIntyre - Finance
Date Portfolio Holder signed off:	14 August 2023
Strategic Director:	Bob Watson
Report Author:	Miriam Norris
Key Decision:	no
Wards Affected:	**All**

Summary and purpose

This report advises members of the performance of the treasury management service for the first quarter of 2023/24 as at 30 June 2023 and confirms the compliance with the Treasury Management Indicators for 2023/24.

Recommendation

The Executive is advised to RESOLVE that the Treasury Management report for the period 1 April to 30th June 2023 be noted.

1. Background and Supporting Information

1.1 This report sets out the performance of the Council's investments and borrowing for the first three months of the year. It is 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 June 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, referred to as the Capital Financing Requirement (CFR) for the Council was £208 million. The CFR includes all unfunded capital expenditure – i.e spend where resources have not been specifically allocated. The 2022/23 actual borrowing was £170 million (2021/22 - £185 million).

2.2 The Council must not borrow in excess of its prudential indicator set at budget Council which is an upper operational limit of borrowing of **£230 million**.

3. Borrowing Activity to the 30 June 2023 (Quarter 1)

3.1 At 30 June 2023 the Council held £176 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 June 2023	**£ million**
Public Works Loan Board (long term, fixed rate)	50.5
Phoenix Loans (2 x loans, both fixed rate)	49
Local Authorities (short term fixed deals < 24 months)	76.5
Total Borrowing	**176**

3.3 As at the end of June 2023, the weighted average rate for our long term debt was **2.73%** and our short term debt was **3.45%**. 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 June 2023 (Quarter 1)

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 first quarter of the year is **£15.3 million**, as detailed in the table below:

Actual Portfolio as at 30 Jun 2023	£ million
Bank & Building Societies	0.2
Government – DMO	10.0
Money Market Funds	3.0
Government - Other Local Authorities	0.0
Other Pooled Funds (CCLA property)	2.1
Total Treasury Investments	**15.3**

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 26 June 2023, sets out a view that both short-dated and long-dated interest rates will remain raised for the immediate future, as the Bank of England seeks to manage the inflationary pressures in the national 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:

- A 0.2% month on month rise in real GDP in April, partly due to fewer strikes;
- CPI inflation falling from 10.1% to 8.7% in April, before remaining at 8.7% in May. This was the highest reading in the G7 economies;
- Core CPI inflation rise in both April and May, reaching a new 31-year high of 7.1%;
- A tighter labour market in April, as the 3 month, year on year growth of average earnings rose from 6.1% to 6.5%;
- Interest rates rise by a further 75bps (0.75%) over the quarter, taking the Bank of England Base Rate from 4.25% to 5.00%;
- 10-year gilt yields nearing the "mini-Budget" peaks, as inflation surprised to the upside.

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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 to the Executive and the Performance and Finance Scrutiny Committee. Previously this requirement was only twice a year following the setting of the annual strategy.

8. Proposal and Alternative Options

8.1 The Executive 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 considerations 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 Executive'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

Appendix 1

LONG TERM BORROWING

	Start Date	Maturity Date	Interest Rate		Total
PWLB - Loan No 504063 St Georges	23-Apr-15	22-Apr-65	3.16%	-	7,769,044.73
PWLB - Loan No 504203 Ashwood	26-Jun-15	25-Jun-65	3.44%	-	5,582,031.97
PWLB - Loan Ref 507410 Trade City	24-May-18	24-May-33	2.65%	-	1,500,000.00
PWLB - Loan Ref 507411 Trade City	24-May-18	24-May-43	2.77%	-	2,500,000.00
PWLB - Loan Ref 507412 Trade City	24-May-18	24-May-53	2.65%	-	4,000,000.00
PWLB - Loan Ref 507413 Trade City	24-May-18	24-May-63	2.52%	-	5,000,000.00
PWLB - Loan No 508733 Theta	12-Mar-19	12-Mar-39	2.03%	-	4,800,000.00
PWLB - Loan No 508734 Theta	12-Mar-19	12-Sep-41	2.52%	-	1,500,000.00
PWLB - Loan No 508735 Theta	12-Mar-19	12-Sep-46	2.53%	-	1,500,000.00
PWLB - Loan No 508736 Theta	12-Mar-19	12-Sep-51	2.48%	-	1,500,000.00
PWLB - Loan No 508737 Theta	12-Mar-19	12-Sep-56	2.43%	-	1,500,000.00
PWLB - Loan No 508738 Theta	12-Mar-19	12-Sep-61	2.40%	-	1,500,000.00
PWLB - Loan No 508739 Theta	12-Mar-19	12-Sep-66	2.39%	-	1,500,000.00
PWLB - Loan No 508746 Vulcan Way	13-Mar-19	13-Mar-39	2.01%	-	10,400,000.00
Phoenix Loan 1	22-Feb-21	22-Feb-61	2.85%	-	24,307,806.82
Phoenix Loan 2	22-Feb-22	22-Feb-62	2.91%	-	24,663,041.92
Total Long Term Borrowing				**-**	**99,521,925.44**

SHORT TERM BORROWING

	Start Date	Maturity Date	Interest Rate		Total
Barnsley Metropolitan Borough Council	30-Aug-22	29-Aug-23	1.90%	-	3,000,000.00
Hyndburn Borough Council	31-Aug-22	30-Aug-23	1.85%	-	2,000,000.00
Mid Sussex District Council	26-Sep-22	26-Sep-23	2.70%	-	3,000,000.00
Renfrewshire Council	14-Nov-22	13-Nov-23	2.90%	-	5,000,000.00
West Yorkshire Police	15-Dec-22	14-Dec-23	3.00%	-	10,000,000.00
Leicester City Council	16-Dec-22	15-Dec-23	2.98%	-	5,000,000.00
Renfrewshire Council	16-Dec-22	15-Dec-23	2.95%	-	5,000,000.00
Ryedale District Council	20-Dec-22	19-Dec-23	3.00%	-	1,500,000.00
West Midlands Combined Authority	23-Dec-22	22-Dec-23	3.00%	-	10,000,000.00
Fylde Borough Council	03-Feb-23	02-Feb-24	4.65%	-	2,000,000.00
West Midlands Combined Authority	17-Feb-23	16-Feb-24	4.60%	-	5,000,000.00
West Midlands Combined Authority	16-Jun-23	14-Jun-24	4.30%	-	5,000,000.00
West of England CA	19-Jun-23	17-Jun-24	4.25%	-	5,000,000.00
Heretsmere Borough Council	02-Feb-23	02-Aug-23	4.10%	-	5,000,000.00
West Yorkshire Combined Authority	19-Apr-23	17-Apr-24	4.25%	-	10,000,000.00
Total Short Term Borrowing				**-**	**76,500,000.00**
Total Borrowing				**-**	**176,021,925.44**

this loan was taken out to replace August 2023 maturities. It has been invested with DMO until the various maturity dates (see below)

DMO investments (West Yorkshire CA loan)				
Investment	19-Apr-23	02-Aug-23	4.34%	5,000,000.00
Investment	19-Apr-23	29-Aug-23	4.36%	3,000,000.00
Investment	19-Apr-23	30-Aug-23	4.36%	2,000,000.00
				10,000,000.00

Appendix 2

Economic state of the nation – a technical update

- The first quarter of 2023/24 saw:
    - A 0.2% m/m rise in real GDP in April, partly due to fewer strikes;
    - CPI inflation falling from 10.1% to 8.7% in April, before remaining at 8.7% in May. This was the highest reading in the G7;
    - Core CPI inflation rise in both April and May, reaching a new 31-year high of 7.1%;
    - A tighter labour market in April, as the 3myy growth of average earnings rose from 6.1% to 6.5%;
    - Interest rates rise by a further 75bps over the quarter, taking Bank Rate from 4.25% to 5.00%;
    - 10-year gilt yields nearing the “mini-Budget” peaks, as inflation surprised to the upside.
- The economy has weathered the drag from higher inflation better than was widely expected. The 0.2% m/m rise in real GDP in April, following March’s 0.3% m/m contraction will further raise hopes that the economy will escape a recession this year. Some of the strength in April was due to fewer strikes by train workers and teachers in that month. Moreover, some of the falls in activity in other areas in April were probably temporary too. Strikes by junior doctors and civil servants contributed to the fall in health output (0.9% m/m) and the meagre 0.1% m/m increase in public administration.
- The fall in the composite Purchasing Managers Index (PMI) from 54.0 in May to a three-month low of 52.8 in June (>50 points to expansion in the economy, <50 points to contraction) was worse than the consensus forecast of 53.6. Both the services and manufacturing PMIs fell. The decline in the services PMI was bigger (from 55.2 to 53.7), but it remains consistent with services activity expanding by an annualised 2%. The fall in the manufacturing PMI was smaller (from 47.1 to 46.2), but it is consistent with the annual rate of manufacturing output falling from -0.8% in April to around -5.0%. At face value, the composite PMI points to the 0.1% q/q rise in GDP in Q1 2023 being followed by a 0.2% q/q gain in Q2 2023.
- Meanwhile, the 0.3% m/m rise in retail sales volumes in May was far better than the consensus forecast of a 0.2% m/m decline and followed the robust 0.5% m/m rise in April. Some of the rise was due to the warmer weather. Indeed, the largest move was a 2.7% m/m jump in non-store sales, due to people stocking up on outdoor-related goods. But department stores also managed to squeeze out a 0.6% m/m rise in sales and the household goods sub-sector enjoyed a reasonable performance too. Overall, the figures were far better than analysts had expected. In addition, the GfK measure of consumer confidence rebounded from -27 to a 17-month high of -24 in June.
- The recent resilience of the economy has been due to a confluence of factors including the continued rebound in activity after the pandemic, households spending some of their pandemic savings, and the tight labour market and government handouts both supporting household incomes. That said, as government support fades, real household incomes are

unlikely to grow rapidly. Furthermore, higher interest rates will mean GDP is likely to contract later this year. Our central assumption is that inflation will drop to the 2.0% target only if the Bank triggers a recession by raising rates from 5.00% now to at least 5.5% and keeps rates there until at least mid-2024. Our colleagues at Capital Economics estimate that around 60% of the drag on real activity from the rise in rates has yet to bite, and the drag on the quarterly rate of real GDP growth over the next year may be about 0.2ppts bigger than over the past year.

- The labour market became tighter over the quarter and wage growth reaccelerated. Labour demand was stronger than the consensus had expected. The three-month change in employment rose from +182,000 in March to +250,000 in April. Meanwhile, labour supply continued to recover as the size of the labour force grew by 303,000 in the three months to April. That was supported by a further 140,000 decline in inactivity as people returned to work from retirement and caring responsibilities (while inactivity due to long-term sick continued to rise). But it was not enough to offset the big rise in employment, which meant the unemployment rate fell from 3.9% to 3.8%
- The tighter labour market supported wage growth in April, although the 9.7% rise in the National Living Wage on 1st April (compared to the 6.6% increase in April last year) probably had a lot to do with it too. The 3myy rate of average earnings growth reaccelerated from 6.1% to 6.5% (consensus 6.1%) and UK wage growth remains much faster than in the US and the Euro-zone. In addition, regular private sector wage growth increased from 7.1% 3myy to 7.6%, which left it well above the Bank's forecast for it to fall below 7.0%. Overall, the loosening in the labour market appears to have stalled in April and regular private sector wage growth was well above the Bank's forecast.
- CPI inflation stayed at 8.7% in May (consensus 8.4%) and, perhaps more worryingly, core CPI inflation rose again, from 6.8% to a new 31-year high of 7.1%. The rise in core inflation built on the leap from 6.2% in March to 6.8% and means it is accelerating in the UK while it is slowing in the US and the Euro-zone (both fell to 5.3%). A further decline in fuel inflation, from -8.9% to -13.1%, and the second fall in food inflation in as many months, from 19.3% to 18.7%, explained why overall CPI inflation didn't rise. And the scheduled fall in the average annual utility price from £2,500 to £2,074 on 1st July means overall CPI inflation will probably ease in the coming months. But the problem is that the recent surge in core inflation and the reacceleration in wage growth shows that domestic inflationary pressures are still strengthening.
- This suggests the Bank may have more work to do than the Fed or ECB. Indeed, the Bank of England sounded somewhat hawkish in the June meeting. This came through most in the MPC's decision to step up the pace of hiking from the 25bps at the previous two meetings. The 7-2 vote, with only two members voting to leave rates unchanged at 4.50%, revealed support for stepping up the fight against high inflation.
- That said, the Bank has not committed to raising rates again or suggested that 50bps rises are now the norm. What it did say was that "the scale of the recent upside surprises in official estimates of wage growth and services CPI inflation suggested a 0.5 percentage point increase in interest rates was required at this particular meeting". Moreover, the Committee did not strengthen its forward guidance that any further rate hikes would be conditional on the data. However, it looks highly probable, given the on-going strength of inflation and employment data, that the Bank will need to raise rates to at least 5.5%

and to keep rates at their peak until the mid-point of 2024. We still think it is only a matter of time before the rise in rates weakens the economy sufficiently to push it into recession. That is why instead of rising to between 6.00%-6.25%, as is currently priced in by markets, we think rates are more likely to peak between 5.50-6.00%. Our forecast is also for rates to be cut in the second half of 2024, and we expect rates to then fall further than markets are pricing in.

- Growing evidence that UK price pressures are becoming increasingly domestically generated has driven up market interest rate expectations and at one point pushed the 10-year gilt yield up to 4.49% in late June, very close to its peak seen after the "mini-budget". Yields have since fallen slightly back to 4.38%. But growing expectations that rates in the UK will remain higher for longer than in the US mean they are still more than 70 bps above US yields. While higher interest rates are priced into the markets, the likely dent to the real economy from the high level of interest rates is not. That's why we think there is scope for market rate expectations to fall back in 2024 and why we expect the 10-year PWLB Certainty Rate to drop back from c5.20% to 5.00% by the end of this year and to 4.20% by the end of 2024.
- The pound strengthened from $1.24 at the start of April to a one-year high at $1.26 in early May, which was partly due to the risks from the global banking issues being seen as a bigger problem for the US than the UK. The pound then fell back to $1.23 at the end of May, before rising again to $1.28 in the middle of June as the strong core CPI inflation data released in June suggested the Bank of England was going to have to raise rates more than the Fed or ECB in order to tame domestic inflation. However, sterling's strong run may falter because more hikes in the near term to combat high inflation are likely to weaken growth (and, hopefully, at some point inflation too) to such a degree that the policy rate will probably be brought back down, potentially quite quickly, as the economic cycle trends downwards decisively. This suggests that additional rate hikes are unlikely to do much to boost the pound.
- In early April, investors turned more optimistic about global GDP growth, pushing up UK equity prices. But this period of optimism appears to have been short-lived. The FTSE 100 has fallen by 4.8% since 21st April, from around 7,914 to 7,553, reversing part of the 7.9% rise since 17th March. Despite the recent resilience of economic activity, expectations for equity earnings have become a bit more downbeat. Nonetheless, further down the track, more rate cuts than markets anticipate should help the FTSE 100 rally.

MPC meetings 11th May and 22nd June 2023

- On 11th May, the Bank of England's Monetary Policy Committee (MPC) increased Bank Rate by 25 basis points to 4.50%, and on 22nd June moved rates up a further 50 basis points to 5.00%. Both increases reflected a split vote – seven members voting for an increase and two for none.
- Nonetheless, with UK inflation significantly higher than in other G7 countries, the MPC will have a difficult task in convincing investors that they will be able to dampen inflation pressures anytime soon. Talk of the Bank's inflation models being "broken" is perhaps another reason why gilt investors are demanding a premium relative to US and Euro-zone bonds, for example.

- Of course, what happens outside of the UK is also critical to movement in gilt yields. The US FOMC has already hiked short-term rates to a range of 5.00%-5.25%, but a further increase is pencilled in for July, whilst the ECB looks likely to raise its Deposit rate at least once more to a peak of 3.75%, with upside risk of higher to come.