# Surrey Heath Borough Council
## Audit, Standards and Risk Committee
## 26 March 2024

---

# Treasury Management 2023/24
# Quarter 3 Report – 31 December 2024

**Portfolio Holder:** Councillor Cllr Leanne Macintyre - Finance
**Date Portfolio Holder signed off:** 19 March 2024
**Strategic Director:** Bob Watson
**Report Author:** Vicky Worsfold/ 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 third quarter of 2023/24 as at 31 December 2023 and confirms the compliance with the Treasury Management Indicators for 2023/24.


**Recommendation**

The Executive is advised to RESOLVE that they

(i) note the Treasury Management report for the period 1 October to 31 December 2023.

**1. Background and Supporting Information**

1.1 This report sets out the performance of the Council's investments and borrowing for the first nine 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 31 December 2023, the service has not breached any of the Treasury Management Indicators set for 2023/24. These are:

| **Treasury Management Indicator 2023/24** | |
|---|---|
| Minimum Counterparty Credit Rating | A |
| Liquidity Risk Indicator Limit | £5 million |
| Interest Rate Exposure Limit | £1 million |
| Maturity Structure of Borrowing | Upper 100%, Lower 0% |
| Principal Sums invested for Periods longer than a year (Individual counterparty limit) | £2.5 million |

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 this 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 The Council's underlying need to borrow for capital purposes is referred to as the Capital Financing Requirement (CFR). 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 £5.419 million 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 period

3.1 The Council held £165 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

| 31 December 2023 | £ million |
|---|---|
| Public Works Loan Board (long term, fixed rate)<br>Phoenix Loans (2 x loans, both fixed rate)<br>Local Authorities (short term fixed deals < 24 months) | 50.0<br>48.6<br>66.5 |
| **Total Borrowing** | **165.1** |

3.3 As at the end of December 2023, the weighted average rate for our long term debt was **2.73%** and our short term debt was **4.62%**. 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 for the period

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 period is **£17.4 million**, as detailed in the table below:

| **Actual Portfolio as at 31 December 2023** | **£ million** |
|---|---|
| Bank & Building Societies | 1.6 |
| Government – DMO | 7.0 |
| Money Market Funds | 6.8 |
| Government - Other Local Authorities | 0.0 |
| Other Pooled Funds (CCLA property) | 2.0 |
| **Total Treasury Investments** | **17.4** |

## 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 updated on 20 December 2023, reveals a more cautious outlook compared to the market consensus in recent months. However, over the previous fortnight, there has been a notable shift in the UK market's outlook, anticipating a more aggressive stance on interest rate cuts. This change was initially driven by positive sentiment regarding US inflation. Subsequently, domestic factors such as last week's weaker wage inflation data and the recent CPI inflation (3.9%) and core inflation (5.1%) prints for November further fuelled this revised perspective.

5.3 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 third quarter of 2023/24 saw:

- A 0.3% month on month decline in real GDP in October, potentially partly due to unseasonably wet weather, but also due to the ongoing drag from higher interest rates. Growth for the second quarter, ending 30 September, was revised downwards to -0.1% and growth on an annual basis was also revised downwards, to 0.3%;
- A sharp fall in wage growth, with the headline 3myy rate declining from 8.0% in September to 7.2% in October, although the ONS "experimental" rate of unemployment has remained low at 4.2%;
- CPI inflation continuing on its downward trajectory, from 8.7% in April to 4.6% in October, then again to 3.9% in November;
- Core CPI inflation decreasing from April and May's 31 years' high of 7.1% to 5.1% in November, the lowest rate since January 2022;
- The Bank of England holding rates at 5.25% in November and December;
- A steady fall in 10-year gilt yields as investors revised their interest rate expectations lower.

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 Audit, Standards and Risk 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 2023/24 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 include 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 |
|---|---|
| **Authors/Contact Details** | Vicky Worsfold - Strategic Finance Manager<br>vicky.worsfold@surreyheath.gov.uk<br><br>Miriam Norris - Treasury Business Partner<br>miriam.norris@surreyheath.gov.uk |
| **Strategic Director** | Bob Watson - Strategic Director of Finance & Customer Services.<br>bob.watson@surreyheath.gov.uk |

# 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 | - | 7,724,106.58 |
| LTB003 | PWLB - Loan No 504203 Ashwood | 26-Jun-15 | 25-Jun-65 | 3.44% | Annuity | - | 5,551,927.16 |
| 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 |
| | | | | | | **-** | **98,620,457.47** |

## SHORT TERM BORROWING

| | | Start Date | Maturity Date | Int Rate | | Total |
|---|---|---|---|---|---|---|
| 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 |
| 200342 | West Midlands Combined Authority | 22-Dec-23 | 20-Dec-24 | 4.10% | - | 10,000,000.00 |
| 200343 | West Yorkshire Combined Authority | 19-Apr-23 | 17-Apr-24 | 4.25% | - | 10,000,000.00 |
| 200344 | Crawley Borough Council | 15-Dec-23 | 16-Sep-24 | 4.80% | - | 3,000,000.00 |
| 200345 | Havant Borough Council | 26-Sep-23 | 24-Sep-24 | 5.00% | - | 5,000,000.00 |
| 200346 | West of England CA | 14-Dec-23 | 12-Dec-24 | 4.90% | - | 5,000,000.00 |
| 200347 | West Midlands Combined Authority | 22-Dec-23 | 20-Dec-24 | 5.00% | - | 10,000,000.00 |
| 200349 | Lancashire Combined Fire Authority | 14-Dec-23 | 12-Dec-24 | 5.05% | - | 3,500,000.00 |
| 200352 | Derbyshire Dales District Council | 13-Nov-23 | 11-Nov-24 | 5.80% | - | 3,000,000.00 |
| | | | | | **-** | **66,500,000.00** |
| | **Total Borrowing** | | | | **-** | **165,120,457.47** |

**Appendix 2**

## Economic state of the nation – a technical update

- The third quarter of 2023/24 saw:
  - A 0.3% m/m decline in real GDP in October, potentially partly due to unseasonably wet weather, but also due to the ongoing drag from higher interest rates. Growth for the second quarter, ending 30th September, was revised downwards to -0.1% and growth on an annual basis was also revised downwards, to 0.3%;
  - A sharp fall in wage growth, with the headline 3myy rate declining from 8.0% in September to 7.2% in October, although the ONS "experimental" rate of unemployment has remained low at 4.2%;
  - CPI inflation continuing on its downward trajectory, from 8.7% in April to 4.6% in October, then again to 3.9% in November;
  - Core CPI inflation decreasing from April and May's 31 years' high of 7.1% to 5.1% in November, the lowest rate since January 2022;
  - The Bank of England holding rates at 5.25% in November and December;
  - A steady fall in 10-year gilt yields as investors revised their interest rate expectations lower.
- The revision of GDP data in Q2 to a 0.1% q/q fall may mean the mildest of mild recessions has begun. Indeed, real GDP in October fell 0.3% m/m which does suggest that the economy may stagnate again in Q3. The weakness in October may partly be due to the unseasonably wet weather. That said, as the weakness was broad based it may also be the case that the ongoing drag from higher interest rates is more than offsetting any boost from the rise in real wages.
- However, the rise in the flash composite activity Purchasing Managers Index, from 50.7 in November to 51.7 in December, did increase the chances of the economy avoiding a contraction in Q3. The improvement was entirely driven by the increase in the services activity balance from 50.9 to 52.7. (Scores above 50 point to expansion in the economy, although only tepid in this instance.) The press release noted that this was primarily driven by a revival in consumer demand in the technological and financial services sectors. This chimes with the further improvement in the GfK measure of consumer confidence in December, from -24 to -22. The services PMI is now consistent with non-retail services output growing by 0.5% q/q in Q3, but this is in stark contrast to the manufacturing sector where the output balance slumped from 49.2 to 45.9 and, at face value, the output balance is consistent with a 1.5% q/q fall in manufacturing output in Q3.
- The 0.3% m/m fall in retail sales volumes in October means that after contracting by 1.0% q/q (which was downwardly revised from -0.8% q/q) in Q2, retail activity remained weak at the start of Q3. That suggests higher interest rates are taking a bigger toll on real consumer spending.
- Higher interest rates have filtered through the financial channels and weakened the housing market but, overall, it remains surprisingly resilient with only marginal falls showing year on year on the Halifax (-1%) and Nationwide (-1.8%) indices. However, the full weakness in real consumer spending and real business investment has yet to come as currently it is estimated that around two thirds to a half of the impact of higher interest rates on household interest payments has yet to be felt.
- Overall, we expect real GDP growth to remain subdued throughout 2024 as the drag from higher interest rates is protracted but a fading of the cost-of-living crisis and interest rate cuts in the second half of 2024 will support a recovery in GDP growth in 2025.
- The labour market remains tight by historical standards, but the sharp fall in wage growth seen in October will reinforce the growing belief in markets that interest rates will be cut mid-2024. Wage growth eased in October much faster than the consensus expected. Total earnings fell by 1.6% m/m, which meant the headline 3myy rate eased from 8.0% in September to 7.2% in October. This

news will be welcomed by the Bank of England. Indeed, the timelier three-month annualised rate of average earnings growth fell from +2.4% to -1.2%. Excluding bonuses, it fell from 5.3% to 2.0%. Furthermore, one of the Bank's key barometers of inflation persistence, regular private sector pay growth, dropped from 7.9% 3myy to 7.3%, which leaves it comfortably on track to fall to 7.2% by December, as predicted by the Bank in November.

- The fall in wage growth occurred despite labour demand being stronger in October than expected. The three-month change in employment eased only a touch from +52,000 in September to +50,000 in October. But resilient labour demand was offset by a further 63,000 rise in the supply of workers in the three months to October. That meant labour supply exceeded its pre-pandemic level for the first time, and the unemployment rate remained at 4.2% in October. In the three months to November, the number of job vacancies fell for the 17th month in a row, from around 959,000 in October to around 949,000. That has reduced the vacancy to unemployment ratio as demand for labour eases relative to supply, which may support a further easing in wage growth in the coming months.
- CPI inflation fell from 6.7% in September to 4.6% in October, and then again to 3.9% in November. Both these falls were bigger than expected and there are clear signs of easing in domestic inflationary pressures. The fall in core CPI inflation from 5.7% to 5.1% in November was bigger than expected (consensus forecast 5.6%). That's the lowest rate since January 2022. Some of the decline in core inflation was due to the global influence of core goods inflation, which slowed from 4.3% to 3.3%. But some of it was due to services inflation falling from 6.6% to 6.3%. The Bank views the latter as a key barometer of the persistence of inflation and it came in further below the Bank's forecast of 6.9% in its November Monetary Policy Report. This will give the Bank more confidence that services inflation is now on a firmly downward path.
- The Bank of England sprung no surprises with its December monetary policy committee (MPC) meeting, leaving interest rates at 5.25% for the third time in a row and pushing back against the prospect of near-term interest rate cuts. The Bank continued to sound hawkish, with the MPC maintaining its tightening bias saying that "further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures". And it stuck to the familiar script, saying that policy will be "sufficiently restrictive for sufficiently long" and that "monetary policy is likely to need to be restrictive for an extended period of time". In other words, the message is that the MPC is not yet willing to endorse investors' expectations that rates will be cut as soon as May 2024.
- Looking ahead, our colleagues at Capital Economics forecast that the recent downward trends in CPI and core inflation will stall over the next few months before starting to decline more decisively again in February. That explains why we think the Bank of England won't feel comfortable cutting interest rates until H2 2024.
- The fall in UK market interest rate expectations in December has driven most of the decline in 10-year gilt yields, which have fallen in line with 10-year US Treasury and euro-zone yields. 10-year gilt yields have fallen from 4.68% in October 2023 to around 3.70% at the time of writing, with further declines likely if the falling inflation story is maintained.
- Investors' growing expectations that the Fed will cut interest rates soon has led to an improvement in risk sentiment, which has boosted the pound and other risky assets. In addition, the rise in the pound, from $1.21 in November to $1.27 now, has also been supported by the recent relative decline in UK wholesale gas prices.
- The further fall in 10-year real gilt yields in December has supported the recent rise in the FTSE 100. That said, the index remains 5% below its record high in February. This modest rise in equities appears to have been mostly driven by strong performances in the industrials and rate-sensitive technology sectors. But UK equities have continued to underperform US and euro-zone equities. The FTSE 100 has risen by 2.2% in December, while the S&P 500 has risen by 3.8%. This is partly due to lower energy prices, which have been a relatively bigger drag on the FTSE 100, due to the index's high concentration of energy companies.