REPORT TITLE: TREASURY MANAGEMENT MID-YEAR REPORT 2023/24

9 NOVEMBER 2023

REPORT OF CABINET MEMBER: Cllr Neil Cutler, Cabinet Member for Finance and Performance

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WARD(S): ALL WARDS

PURPOSE

In accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management, this report provides details of the performance of the treasury management function; on the effects of the decisions taken and the transactions executed in the second quarter of 2023/24. This report also confirms there have been no further instances of non-compliance with the council's Treasury Management Strategy Statement and Treasury Management Practices during this financial year.

RECOMMENDATIONS:

1. Note the mid-year Treasury Management Report for 2023/24.

IMPLICATIONS:

1 COUNCIL PLAN OUTCOME

1.1 Treasury management is an integral part of helping to deliver the council Strategy and all of its outcomes. Of key importance is ensuring the security and sufficient liquidity of the council's cash and investment balances whilst, where possible, optimising the yield from those investments. The income from investments is available to be used by the council in achieving its objectives.

2 FINANCIAL IMPLICATIONS

2.1 Effective treasury management ensures both the financial security and liquidity of the council.

3 LEGAL AND PROCUREMENT IMPLICATIONS

3.1 The Council's Treasury Management Strategy Statement (TMSS) follows the latest codes of practice and the Ministry of Housing, Communities and Local Government (MHCLG) (now known as the Department for Levelling Up, Housing and Communities (DLUHC)) and CIPFA guidance.

3.2 With effect from September 2014 Hampshire County Council (HCC) and Winchester City Council (WCC) established arrangements for the joint discharge of functions under Section (101)(1) and (5) of the Local Government Act 1972 and Section 9EA and 9EB Local Government Act 2000. Under this arrangement, HCC's Investments and Borrowing Team provide a Treasury Service which includes the management of WCC's cash balances and investment of surplus cash or sourcing of short-term borrowing in accordance with the agreed TMSS.

4 WORKFORCE IMPLICATIONS

4.1 HCC's Investments and Borrowing Team carry out the day to day management of the council's cash balances and investments. The council's in-house finance team undertake the accounting and retain responsibility for long-term borrowing decisions.

5 PROPERTY AND ASSET IMPLICATIONS

5.1 None

6 CONSULTATION AND COMMUNICATION

6.1 This report has been produced in consultation with HCC's Investments & Borrowing team.

7 ENVIRONMENTAL CONSIDERATIONS

7.1 Following the council's declaration of a Climate Emergency in June 2019 and in line with the ethical stances in its investment policy, the council has no direct or indirect equity investments in companies directly involved in the fossil fuel industry.

8 EQUALITY IMPACT ASSESSMENT

8.1 There are no actions which arise directly from this report.

9 DATA PROTECTION IMPACT ASSESSMENT

9.1 None required

10 RISK MANAGEMENT

Risk	**Mitigation**	**Opportunities**
Returns from investments are too low	A diversified strategy that attempts to manage the balance between liquidity risk, credit risk and yield within the council's risk appetite.	Returns above budgeted levels
A counterparty fails	A diversified strategy that has relatively low levels of counter-party risk	
Cash is not available	A balanced portfolio of liquid and long term funds are held to ensure cash is available to utilise. The council also mitigates this risk through cashflow forecasting	More accurate and immediate cashflow forecasting can help improve the return on investments through more active treasury management activity

11 SUPPORTING INFORMATION:

12 Introduction

12.1 The council has adopted the key recommendations of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code), last updated in 2021 which requires the council to approve, as a minimum, four treasury management reports a year, including an annual strategy and outturn report.

13 Summary

13.1 The report fulfils the council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code and provides an update on the performance of the treasury management function during the second quarter of 2023/24.

13.2 The council’s treasury management strategy was most recently updated and approved at a meeting of Full Council in February 2023. The council has borrowed and invested sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the council’s treasury management strategy.

13.3 Treasury management in the context of this report is defined as: “the management of the organisation’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

13.4 Hampshire County Council’s Investments & Borrowing Team has been contracted to manage the council’s treasury management balances since September 2014 but overall responsibility for treasury management remains with Winchester City Council. No treasury management activity is without risk and as such the effective identification and management of risk are integral to the council’s treasury management objectives.

13.5 A breach of the council’s Treasury Management Strategy and Investment Strategy for 2023/24 did occur on an overnight basis in August 2023, and this was explained in detail in the Quarter 1 Report. No other breaches of the TMSS have occurred during 2023/24. Advice in undertaking treasury management activities has been provided by the council’s treasury advisers, Arlingclose.

13.6 The Prudential Code 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 latest iteration of the council’s Capital and Investment Strategy, complying with CIPFA’s requirement, was approved by Full Council in February 2023 (CAB3389).

14 External Context

14.1 The following sections outline the key economic themes in the UK against which investment and borrowing decisions have been made so far in 2023/24.

Economic commentary

14.2 UK inflation has remained high over the period, keeping market expectations elevated of how much further the Bank of England (BoE) would hike rates. The Bank of England’s (BoE) Monetary Policy Committee (MPC) continued tightening monetary policy over most of the period, taking Bank Rate to 5.25% in August 2023, however, inflation data published in the latter part of the period undershot expectations, causing financial markets to reassess the peak in BoE Bank Rate. This was followed by the BoE deciding to keep Bank Rate on hold at 5.25% in September 2023.

14.3 Economic growth in the UK remained relatively weak over the period. In calendar Quarter 2 2023, the economy expanded by 0.4%, beating market expectations of a 0.2% increase. However, monthly Gross Domestic Product (GDP) data showed a 0.5% contraction in July 2023, which was the largest fall to date this calendar year and worse than the 0.2% decline predicted.

14.4 Although still high, inflation has fallen from its peak as annual headline CPI (Consumer Prices Index) declined to 6.7% in July 2023 from 6.8% in the previous month against market expectations for a rise. The largest downward contribution came from food prices.

14.5 Following the September MPC meeting, Arlingclose modestly revised its interest forecast to reflect the central view that 5.25% will now be the peak in Bank Rate.

Financial markets

14.6 Financial market sentiment and bond yields remained volatile, with the latter generally trending downwards as there were signs inflation, while still high, was moderating and interest rates were at a peak. Gilt yields fell towards the end of the period.

Credit review

14.7 In March 2023 Arlingclose completed a review of its credit advice on unsecured deposits at UK and non-UK banks following concerns of a wider financial crisis after the collapse of Silicon Valley Bank, and the purchase of Credit Suisse by UBS, as well as other well-publicised banking sector issues. As a result, Arlingclose reduced the advised maximum duration limit for all banks on its recommended counterparty list to 35 days for unsecured investments. This stance continued to be maintained during Quarter 2 of the financial year.

14.8 Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress and no changes were made to recommended bank durations over Quarter 2 of the financial year. Credit default swaps are used as an indicator of credit risk, where higher premiums indicate higher perceived risks. Northern Trust Corporation was added to the counterparty list.

14.9 Heightened market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the council’s counterparty list recommended by Arlingclose remains under constant review.

15 Local Context

15.1 At 31 March 2023, the council had net investments of £23.6m. The treasury management position at 30 September 2023 and the change over the first half of the year is shown in Table 1.

Table 1: Treasury management summary	31/03/23 Balance £m	Movement £m	30/09/23 Balance £m	30/09/23 Rate %
Long-term borrowing	(156.7)	0.0	(156.7)	3.25
Short-term borrowing	(5.0)	0.0	(5.0)	2.70
Total borrowing	**(161.7)**	**0.0**	**(161.7)**	**3.24**
Long-term investments	5.0	0.0	5.0	3.87
Short-term investments	7.0	5.7	10.3	5.15
Cash and cash equivalents	11.6	2.0	16.0	5.15
Total investments	**23.6**	**7.7**	**31.3**	**4.94**
Net borrowing	**(138.1)**	**7.7**	**(130.4)**	

Note: the figures in Table 1 are from the balance sheet in the council's accounts but adjusted to exclude operational cash, accrued interest and other accounting adjustments.

15.2 The decrease in net borrowing of £7.7m reflects an increase in total investments and no change in the level of borrowing. Increased investment balances reflect the normal pattern of the Council's cash balances, with typically higher balances at the start of the financial year due to, for example, higher receipt of council tax in the first quarter compared to the final quarter.

16 Borrowing Update

16.1 CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement (CFR) and so may lead to new borrowing, unless directly and primarily related to the functions of the Authority. Public Works Loan Board (PWLB) loans are no longer available to local authorities planning to buy investment assets primarily for yield unless these loans are for refinancing purposes.

16.2 The council has not invested in assets primarily for financial return or that are not primarily related to the functions of the council. It has no plans to do so in future.

16.3 The council is a net borrower and as stated in the Treasury Management Strategy 2023/24, the council expects a positive liability benchmark across the forecast period, which generally means an authority is required to take external borrowing to fund the gap between its resources and the CFR. Although the council currently has taken external borrowing, this is not predicted to be sufficient to meet the CFR and, depending on the internal borrowing position, further borrowing will be considered by the Section 151 Officer if required.

16.4 The Section 151 Officer will review the current pooled fund investment prior to making any external borrowing decisions.

17 Borrowing Strategy

17.1 At 30 September 2023 the council held £161.7m of loans, the vast majority of which (£156.7m) relates to the financing settlement of the Housing Revenue Account (HRA) in 2012. Outstanding loans at 30 September 2023 are summarised in Table 2.

Table 2: Borrowing position	**31/03/23 Balance £m**	**Net movement £m**	**30/09/23 Balance £m**	**30/09/23 Weighted average rate %**	**30/09/23 Weighted average maturity (years)**
Public Works Loan Board	(161.7)	0.0	(161.7)	3.24	19.5
Total borrowing	**(161.7)**	**0.0**	**(161.7)**	**3.24**	**19.5**

Note: The figures in the Table 2 are from the balance sheet in the council's accounts but adjusted to exclude accrued interest.

17.2 The council's chief 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. The flexibility to renegotiate loans should the council's long-term plans change is a secondary objective.

17.3 This borrowing strategy has been monitored with the assistance of Arlingclose and has enabled the council to keep long-term borrowing costs low and mitigates against future interest rate increases.

18 Treasury Investment Activity

18.1 The CIPFA Treasury Management Code now defines treasury management investments as those investments which arise from the Authority's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

18.2 The council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year to date the council's investment balances have ranged between £25.3m and £44.2m due to timing differences between income and expenditure. The investment position is shown in Table 3.

Table 3: Treasury investment position	31/03/23 Balance £m	Movement £m	30/09/23 Balance £m	30/09/23 Income return %	30/09/23 Weighted average maturity (years)
Short term investments:					
Banks and building societies:					
- Unsecured	3.3	(0.2)	3.1	4.47	0.00
- Secured	0.0	1.3	1.3	5.44	0.29
Money market funds	7.8	5.1	12.9	5.30	0.00
Government:					
- UK treasury bills	6.5	(4.5)	2.0	5.01	0.18
- Local Authorities	0.0	4.5	4.5	5.54	0.44
High quality bonds	0.0	1.5	1.5	5.44	0.25
Cash plus funds	1.0	0.0	1.0	2.85	0.01
Total	**18.6**	**7.7**	**26.3**	**5.15**	**0.12**
High yield investments					
- Pooled property fund*	5.0	0.0	5.0	3.87	N/A
Total	**5.0**	**0.0**	**5.0**	**3.87**	**N/A**
Total investments	**23.6**	**7.7**	**31.3**	**4.94**	**0.10**

* The rate provided for the pooled property fund investment is reflective of annualised income returns over the year to 30 September 2023.

Note: the figures in Table 3 are from the balance sheet in the council's accounts but adjusted to exclude operational cash, accrued interest and other accounting adjustments.

18.3 The CIPFA Code and government guidance both require the council 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 council's objective when investing money is therefore to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults against the risk of receiving unsuitably low investment income. The council's TMSS sets out how it will manage and mitigate these risks.

18.4 As demonstrated by the liability benchmark in this report, the council 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.

18.5 Over this financial year to date Bank Rate has increased by 1%, from 4.25% to 5.25% as at 30 September 2023. Short term investment interest rates have risen commensurately, with 3 month rates rising to around 5.25% and 12 month rates to nearly 6%. The interest rates on Debt Management Account Deposit Facility (DMADF) deposits also rose, ranging between 4.8% and 5.4% and Money Market Rates between 5.0% and 5.3%.

18.6 The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 4.

Table 4: Investment benchmarking (excluding pooled funds)	**Credit rating**	**Bail-in exposure %**	**Weighted average maturity (days)**	**Rate of return %**
31.03.2023	AA-	63	27	3.78
30.09.2023	AA-	63	45	4.94
Similar LAs	AA-	56	63	4.71
All LAs	AA-	59	13	4.79

<u>Externally managed pooled property fund</u>

18.7 £5m of the council's investments is invested in an externally managed strategic pooled property fund where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. This fund has generated an average total return of 54.38% since purchase.

18.8 During the period investor sentiment for UK commercial property was more settled than in Quarter 3 and Quarter 4 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 at an end. 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. This had a marginal negative effect on the market value of the council's strategic investment since March 2023, falling from £5.3m to £5.2m at the end of September whilst still representing a £0.2m unrealised gain on the £5m book value.

18.9 Because this fund has no defined maturity date but is available for withdrawal after a notice period, the performance and continued suitability in meeting the council's medium to long-term investment objectives are regularly reviewed. Strategic fund investment is 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.

18.10 In April 2023 DLUHC published the full outcome of the consultation on the extension of the statutory override on accounting for gains and losses on pooled investment funds. The override has been extended for 2 years until 31 March 2025 but no other changes have been made; whether the override will be extended beyond the new date is unknown but commentary to the consultation outcome suggests not. The council will discuss with Arlingclose the implications for the investment strategy and what action may need to be taken.

19 Non-Treasury Investments

19.1 The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the council as well as other non-financial assets which the council 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).

19.2 Investment Guidance issued by DLUHC also broadens the definition of investments to include all such assets held partially or wholly for financial return.

19.3 This could include loans made to local businesses or the direct purchase of land or property and such loans and investments will be subject to the council's normal approval process for revenue and capital expenditure and need not comply with the treasury management strategy.

19.4 Further information on the council's non-Treasury investments is included in the Capital Investment Strategy (CAB3389) presented to Cabinet on 9 February 2023, and in the General Fund Outturn (CAB3416) presented to Cabinet on 13 September 2023.

20 Compliance Report

20.1 As previously detailed in the Q1 Treasury Management Report presented to Audit Committee on 11 October 2023, during Quarter 2 an overnight breach of the Treasury Management Strategy and Investment Strategy occurred. No other breaches of the TMSS have occurred during 2023/24.

20.2 Compliance with specific investment limits is demonstrated in Table 5.

Table 5: Investment limits	**30/09/23 Actual £m**	**2023/24 Limit £m**	**Complied?**
The UK Government	2	N/A	✓
Local authorities & other government entities	6	Unlimited	✓
Secured investments	1.3	Unlimited	✓
Banks (unsecured)	3.1	Unlimited	✓
Building societies (unsecured)	0	7	✓
Registered providers (unsecured)	0	17.5	✓
Money market funds	12.9	Unlimited	✓
Strategic pooled funds	6	35	✓

Table 5: Investment limits	30/09/23 Actual £m	2023/24 Limit £m	Complied?
Real estate investment trusts	0	17.5	✓
Other investments	0	7	✓

20.3 Compliance with the authorised limit and operational boundary for external debt is demonstrated in Table 6.

Table 6: Debt limits	H1 2023/24 Maximum £m	30/09/23 Actual £m	2023/24 Operational Boundary £m	2023/24 Authorised Limit £m	Complied?
Total debt	162.4	161.7	296.8	310.5	✓

20.4 Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure. The operational boundary has not been breached.

21 Treasury Management Indicators

21.1 As required by the 2021 CIPFA Treasury Management Code, the council monitors and measures the following treasury management prudential indicators.

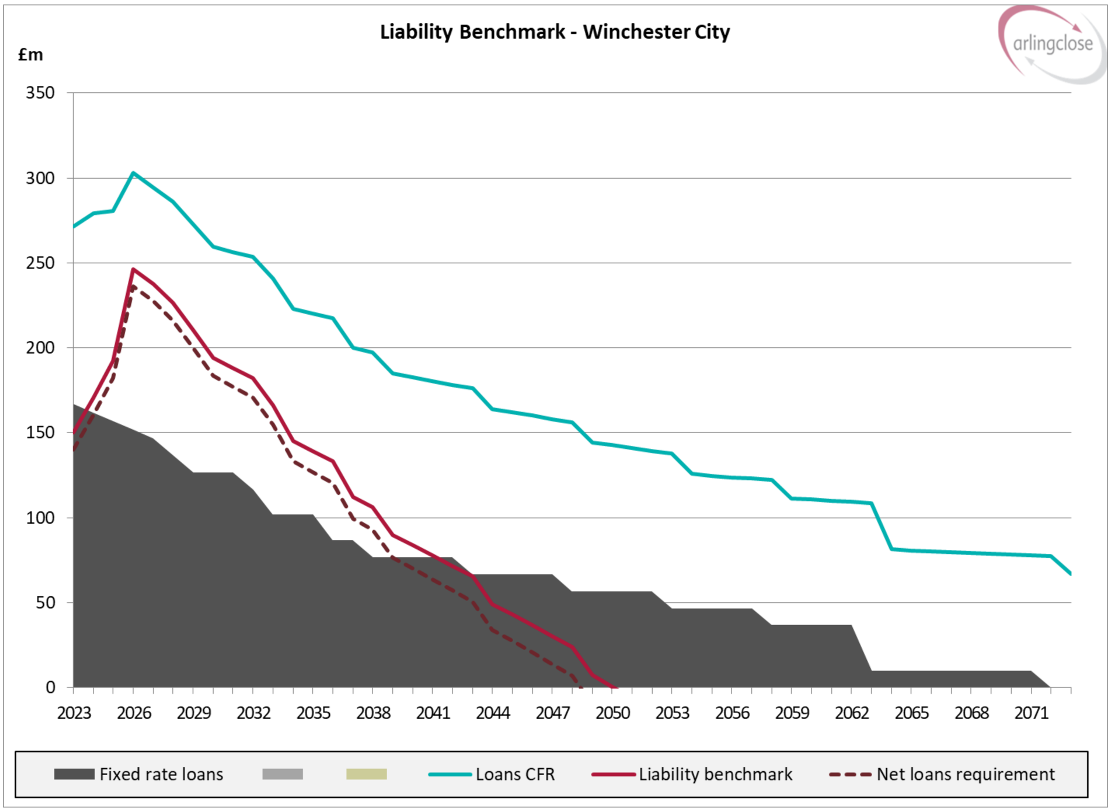
Liability benchmark

21.2 This indicator compares the council's actual existing borrowing against a liability benchmark that has been calculated to show the lowest risk level of borrowing. The liability benchmark is an important tool to help establish whether the council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. It represents an estimate of the cumulative amount of external borrowing the council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level required to manage day-to-day cash flow:

Table 6: Liability benchmark	31/03/23 Actual £m	31/03/24 Forecast £m	31/03/25 Forecast £m	31/03/26 Forecast £m
Loans CFR	271.4	279.5	280.5	302.9
Less: Balance sheet resources	(133.3)	(118.7)	(98.4)	(66.7)
Net loans requirement	**138.1**	**160.8**	**182.1**	**236.2**

Plus: Liquidity allowance	10.0	10.0	10.0	10.0
Liability benchmark	**148.1**	**170.8**	**192.1**	**246.2**
Existing borrowing	**(161.7)**	**(156.7)**	**(151.7)**	**(151.7)**

Graph 1: Liability benchmark



21.3 Table 6 and Graph 1 illustrate the council expects a positive liability benchmark across the forecast period, which generally means an authority is required to take external borrowing to fund the gap between its resources and the CFR. The chart shows that if it is to deliver its capital programme as planned, the council will need to take out additional external borrowing as reflected in the gap between the liability benchmark (the red line) and the existing borrowing (the grey area). This requirement will be considered by the Section 151 Officer in consultation with Arlingclose and the Investments & Borrowing team at Hampshire County Council to ensure borrowing is undertaken at the most appropriate time.

Maturity structure of borrowing

21.4 This indicator is set to control the council's exposure to refinancing risk. The upper and lower limits show the maximum and minimum maturity exposure to fixed rate borrowing as agreed in the TMSS:

Table 7: Refinancing rate risk indicator	31/09/23 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	3%	25%	0%	✓
12 months and within 24 months	3%	25%	0%	✓
24 months and within 5 years	15%	25%	0%	✓
5 years and within 10 years	15%	30%	0%	✓
10 years and within 20 years	22%	50%	0%	✓
20 years and within 30 years	12%	50%	0%	✓
30 years and within 40 years	23%	75%	0%	✓
40 years and within 50 years	6%	100%	0%	✓

Long term Treasury Management Investments

21.5 The purpose of this indicator is to control the council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

Table 8: Long term investments	2023/24	2024/25	2025/26
Actual principal invested beyond year end	£5m	£5m	£5m
Limit on principal invested beyond year end	£25m	£25m	£25m
Complied	✓	✓	✓

21.6 Table 8 includes investments in a strategic pooled property fund of £5m as although this can usually be redeemed at short notice, the council intends to hold this investments for at least the medium term.

Interest rate exposures

21.7 The following indicator shows the sensitivity of the council's current investments and borrowing to a change in interest rates:

Table 9 – Interest rate risk indicator	30/09/23 Actual	Impact of +/-1% interest rate change
Sums subject to variable interest rates:		
Investments	£22.0m	+/- £0.2m
Borrowing	£0.0m	+/- £0.0m

22 OTHER OPTIONS CONSIDERED AND REJECTED

22.1 The council could elect to bring all treasury management activity back in-house. This option has been rejected as the arrangement with Hampshire County Council's Investments and Borrowing team provides significant resilience and economies of scale.

22.2 The council could make more risky investments than those proposed in the Strategy to increase its yield. This has been rejected as priority is given to ensuring security and liquidity in line with the key principles of the CIPFA Treasury Management Code.

BACKGROUND DOCUMENTS:-

Previous Committee Reports:-

AUD119: Treasury Management Practices, 22 June 2015

CAB3390: Treasury Management Strategy 2023/24, 9 February 2023

AG109: Treasury Management Outturn 2022/23, 20 July 2023

AG118: Treasury Management Q1 Report 2023/24, 11 October 2023

Other Background Documents:-

None

APPENDICES:

None