REPORT TITLE: TREASURY MANAGEMENT Q1 REPORT 2023/24

11 OCTOBER 2023

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

Contact Officer: Liz Keys Tel No: 01962 848421 Email lkeys@winchester.gov.uk

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 first three months of the financial year; and confirmation that there were no instances of non-compliance with the council's Treasury Management Strategy Statement and Treasury Management Practices, for the first quarter of 2023/24.

RECOMMENDATIONS:

1. Note the Q1 Treasury Management Report for 2023/24.

2. Note that whilst there no instances of non-compliance with the council's Treasury Management Strategy in Q1, there was an overnight breach of the counterparty limit in August as outlined in section 20 of the report. The breach was rectified the following day and no financial loss was incurred.

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 follows the latest codes of practice and the MHCLG 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 Treasury Management Strategy Statement.

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 ASSESSEMENT

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, treasury management semi-annual and annual outturn reports.

12.2 This quarterly report provides an additional update and includes the new requirement in the 2021 Code, mandatory from 1st April 2023, of quarterly reporting of the treasury management prudential indicators. The non-treasury prudential indicators are incorporated in the council's quarterly finance and performance monitoring reports.

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 first 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 All treasury activity in the first quarter has also complied with the council's Treasury Management Strategy and Investment Strategy for 2023/24, and all relevant statute, guidance and accounting standards. However, a breach of the Strategy did occur on an overnight basis in Q2, and this is explained in further detail in the Compliance section later in this report. In addition, 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 From the start of the quarter until May it looked like peak global monetary policy rates were in sight as inflation continued to ease and central banks turned more dovish in tone. Only a few weeks later, stronger and more persistent inflation data, particularly in the UK, changed the picture. Central

Bank rhetoric and actions remained consistent with combatting inflation. The Bank of England, US Federal Reserve, and European Central Bank all increased interest rates over the period, even in the face of potential economic slowdowns in those regions.

14.3 Inflation fell from its peak of 11.1% reached in October 2022, but annual headline CPI in May 2023 was higher than the consensus forecast at 8.7% (8.4% expected), largely driven by services inflation, while the annual measure of underlying core inflation rose to 7.1% from 6.8%.

14.4 After a sharp rise in interest rate expectations, with clearly serious implications for mortgage markets due to higher inflation and wage data, the Bank of England's Monetary Policy Committee (MPC) reaccelerated monetary policy tightening over the period with a 0.25% rise in May and a 0.5% rise in June 2023, taking the Bank Rate to 5.0%. At both meetings the vote was 7-2 in favour of increasing rates, with the two dissenters preferring to keep rates on hold.

14.5 Interest rate expectations priced in further hikes in policy rates. Arlingclose, the authority's treasury adviser, revised its forecast to include a further 0.5% of monetary tightening to take Bank Rate to 5.5%; as at the date of this report, the Bank Rate had increased by a further 0.25% in August 2023, taking the rate to 5.25%. The risks, however, are that rates could be higher; financial markets are forecasting policy interest rates above 6%. The MPC are next scheduled to meet to consider the Bank Rate on the 21 September 2023, and a verbal update will be provided to this meeting.

14.6 With many mortgages at low fixed rates now systematically being re-set over the next 12-24 months at higher rates there has been a lagged effect of the feed through of monetary policy on households' disposable income. The economic slowdown is expected to develop over time and therefore, despite the GfK measure of consumer confidence improving to -24 in June 2023, it is likely confidence will be negatively affected at some point. The manufacturing sector contracted during the quarter according to survey data, which will eventually feed into services, whose expansion is slowing.

Financial markets

14.7 Financial market sentiment and bond yields remained volatile, the latter continuing their general upward trend as uncertainty and concern over higher inflation and higher interest rates continued to dominate.

14.8 Gilt yields rose over the period to 30 June 2023. The 5-year UK benchmark gilt yield rose from 3.30% to 4.67%, the 10-year gilt yield from 3.43% to 4.39%, and the 20-year yield from 3.75% to 4.51%. Yields remain elevated and, being the basis for the PWLB's lending rates, this impacts the cost of borrowing, keeping interest rates higher.

Credit review

14.9 Having 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, in March 2023 Arlingclose reduced the advised maximum duration limit for all banks on its recommended counterparty list to 35 days. No changes were made to the names on the list.

14.10 Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress but made no changes to the counterparty list or recommended durations over the quarter. Nevertheless, 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 On the 31 March 2023, the council had net investments of £23.6m. The treasury management position at 30 June 2023 and the change over the quarter is shown in Table 1 below.

Table 1: Treasury management summary	**31/03/23 Balance £m**	**Movement £m**	**30/06/23 Balance £m**	**30/06/23 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	3.50
Short-term investments	7.0	(0.7)	6.3	4.27
Cash and cash equivalents	11.6	5.9	17.5	4.73
Total investments	**23.6**	**5.2**	**28.8**	**4.41**
Net borrowing	**(138.1)**	**5.2**	**(132.9)**	

Note: the figures in Table 2 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 £5.2m reflects the normal pattern of the Council's cash balances, with 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. No change to the borrowing position has occurred in the first quarter of 2023/24.

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 and so may lead to new borrowing, unless directly and primarily related to the functions of the Authority. 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 Authority has not invested in assets primarily for financial return or that are not primarily related to the functions of the Authority. 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 June 2023 the council held £161.7m of loans, the vast majority of which (£156.7m) relates to the financing settlement of the HRA in 2012. Outstanding loans on 30 June 2023 are summarised in Table 2 below.

Table 2: Borrowing position	**31/03/23 Balance £m**	**Net movement £m**	**30/06/23 Balance £m**	**30/06/23 Weighted average rate %**	**30/06/23 Weighted average maturity (years)**
Public Works Loan Board	(161.7)	0.0	(161.7)	3.24	19.8
Total borrowing	**(161.7)**	**0.0**	**(161.7)**	**3.24**	**19.8**

Note: The figures in the table above 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 CIPFA published a revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes on 20 December 2021. These define treasury management investments as investments that arise from the organisation'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 £25.2m and £43.0m due to timing differences between income and expenditure. The investment position is shown in Table 3 below.

Table 3: Treasury investment position	**31/03/23 Balance £m**	**Movement £m**	**30/06/23 Balance £m**	**30/06/23 Income return %**	**30/06/23 Weighted average maturity (years)**
Short term investments:					
Banks and building societies:					
- Unsecured	3.3	(3.3)	0.0	3.17	0.09
- Secured	0.0	1.3	1.3	5.13	0.54
Money market funds	7.8	9.7	17.5	4.73	0.00
Government:					
- UK treasury bills	6.5	(2.5)	4.0	4.51	0.23
Cash plus funds	1.0	0.0	1.0	2.22	0.00
Total	**18.6**	**5.2**	**23.8**	**4.61**	**0.07**
High yield investments					
- Pooled property fund*	5.0	0.0	5.0	3.50	N/A
Total	**5.0**	**0.0**	**5.0**	**3.50**	N/A
Total investments	**23.6**	**5.2**	**28.8**	**4.41**	**0.06**

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

Note: the figures in Table 4 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 Treasury Management Strategy Statement (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 Bank Rate increased by 0.75%, from 4.25% at the beginning of April to 5% by the end of June 2023, with the prospect of further increases to come. Short-dated cash rates rose commensurately, with 3-month rates rising to around 5.25% and 12-month rates to nearly 6%. The rates on DMADF deposits also rose, ranging between 4.8% and 5.4% by the end of June and Money Market Rates between 4.7% and 4.9%.

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

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	3.95
30.06.2023	A+	77	27	4.73
Similar LAs	A+	65	45	4.50
All LAs	A+	63	11	4.44

18.7 Table 5 shows the average credit rating of the portfolio has dropped from AA- to A+, with an increase in bail-in risk exposure when compared to March 2023. This does not reflect that a significant proportion of liquid balances are invested in money market funds, which are technically exposed to bail-in risk however these are diversified products and are considered by Arlingclose to be 'bail-in risk light'. Despite this, the council's investment portfolio compares favourably to other Arlingclose clients, with a higher average rate of return and lower maturity profile than comparative Authorities.

Externally managed pooled property fund

18.8 £5m of the Authority'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 23.35% since purchase.

18.9 UK property markets continued to struggle as higher interest rates and bond yields and higher funding costs weighed on the sector. There was some improvement in May, building on signs of returning investor interest and transactional activity in calendar Q1 and a perception that the downturn in commercial real estate may be bottoming out. This has helped support capital values and rental income. The additional move upwards in yields in late May/June and the prospect of sluggish economic growth however constrain the outlook.

18.10 Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's medium- to long-term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rates.

18.11 In April 2023 the Department for Levelling Up, Housing and Communities 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 the Department for Levelling Up Housing and Communities (DLUHC) and Welsh Government also broadens the definition of investments to include all such assets held partially or wholly for financial return.

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 9th February 2023, and in the General Fund Outturn (CAB3416) presented to Cabinet on 13th September 2023.

20 Compliance Report

20.1 The council confirms compliance of all treasury management activities undertaken during the first quarter of 2023/24 with the CIPFA Code of Practice and the council's approved Treasury Management Strategy.

20.2 During the second quarter of 2023/24 an overnight breach of the Strategy occurred. On 15th August, £4.5m was invested with the BlackRock Money Market Fund (MMF), taking the total investment with the Fund to £9.38m which is above the £7m counterparty limit outlined in the Strategy. This error was spotted the following day and immediately corrected to bring the amount invested below the strategy limit, so the overall exposure was minimal and there was no financial loss. The breach was reported to the S151 officer on 23 August 2023.

20.3 This error was a result of the BlackRock trade being mistakenly allocated against another MMF on internal records, and therefore the controls intended to identify that a potential trade would breach the strategy were not triggered.

20.4 Subsequent discussions have emphasised the importance of accuracy, with a review of the process taking place to avoid future breaches.

20.5 Compliance with the authorised limit and operational boundary for external debt is demonstrated in Table 5 below.

Table 5: Debt limits	**Q1 2023/24 Maximum £m**	**30/06/23 Actual £m**	**2023/24 Operational Boundary £m**	**2023/24 Authorised Limit £m**	**Complied?**
Total debt	162.4	162.4	296.8	310.5	✓

20.6 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.

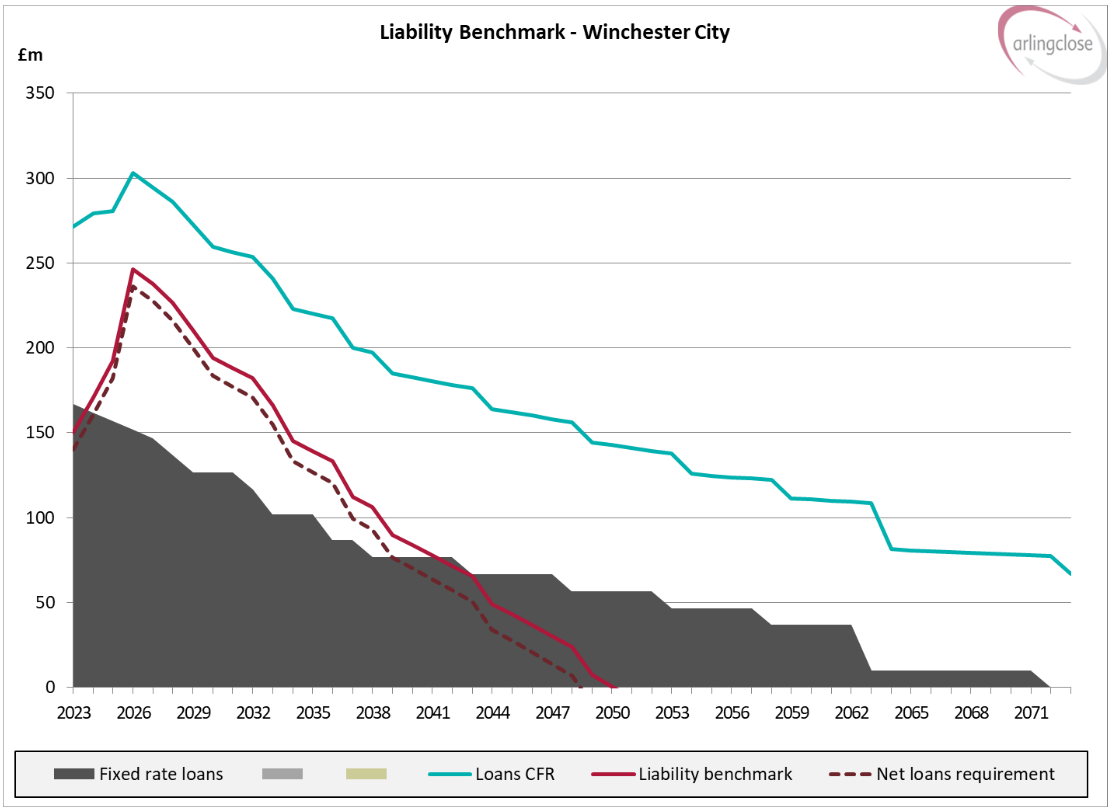
21 Treasury Management Indicators

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

Liability benchmark

21.2 This new 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	10	10	10
Liability benchmark	**148.1**	**170.8**	**192.1**	**246.2**
Existing borrowing	**(161.7)**	**(156.7)**	**(151.7)**	**(151.7)**



21.3 The table and graph above 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	**31/03/23 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%	✓

Principal sums invested for periods longer than a year

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: Price risk indicator	**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 The table includes investments in strategic pooled funds of £5m as although these can usually be redeemed at short notice, the council intends to hold these investments for at least the medium term.

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

Other Background Documents:-

None

APPENDICES:

None