Report Title: **2023/24 TREASURY MANAGEMENT MID YEAR REPORT**

Report to: **Cabinet and Council**

Date of meeting: 13 November 2023, 14 December

Responsible Cabinet Member: Cllr Carl Smith, Portfolio Holder for Governance, Finance and Major Projects

Responsible Director / Officer: Financial Services Manager

Is this a Key Decision? No

Date added to Forward Plan of Key Decisions if a Key Decision:

EXECUITVE SUMMARY

This report presents for the 2023/24 financial year the following:

1. The mid-year position for treasury management;
2. The borrowing requirement and debt for the current financial year;
3. The mid-year borrowing position;
4. Reporting on quarter 2 2023/24 treasury and capital prudential indicators

compared with the Treasury Management Strategy and Investment Strategy

RECOMMENDATIONS :

That Cabinet recommend to Council:
To approve the treasury management half yearly report for 2023/24 and the amended target as outlined at 9.10.

1. INTRODUCTION AND BACKGROUND

1.1. The Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Council to approve treasury management semi-annual and annual reports.

1.2. This report 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 normal quarterly Capital report.

1.3. The Councils treasury management strategy for 2023/24 was approved by Council on 21st February 2023. The Council has borrowed and invested substantial 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 remains central to the Councils treasury management strategy.

1.6 This report provides a monitoring position for the first six months of the 2023/24 financial year.

2. LOCAL CONTEXT

2.1 On 31 March 2023, the Council had net borrowing of £108.176 million arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary	31.3.23 Actual £m	31.3.24 Forecast £m
General Fund CFR	£76.424	£101.300
HRA CFR	£91.306	£93.400
Total CFR	**£167.730**	**£194.700**
Less: *Other debt liabilities	(£0.564)	(£0.500)
Loans CFR	**£167.166**	**£194.20**
Less: External borrowing	(£108.176)	(£88.386)
Internal (over) borrowing	£58.990	£105.814
Less: Balance sheet resources	(£58.990)	(£66.100)
New borrowing	**£0.000**	**£39.714**

** Finance leases, transferred debt that form part of the Councils total debt*
*** shows only loans to which the Council is committed and excludes optional refinancing*

2.2 The treasury management position on 30 September 2023 and the change over the period is shown in Table 2 below.

Table 2: Treasury Management Summary	31.3.23 Balance £m	2023/24 Movement £m	30.9.23 Balance £m	30.9.23 Rate %
Long-term borrowing				
- PWLB	£71.385	£0.00	£71.386	3.15%-4.40%
- LOBO's	£3.000	£0.00	£3.000	4.95%
- Other	£14.100	(£0.100)	£14.000	3.35%-4.65%
Short-term borrowing	£33.001	(£4.901)	£28.100	3.90%-5.60%
Total borrowing	**£121.486**	**(£4.949)**	**£116.537**	
Long-term investments	£1.000	£0	£1.000	N/A
Short-term investments	£9.000	£0	£9.000	0.15%-0.30%
Cash and cash equivalents	£3.310	£1.260	£4.570	5.29%
Total investments	**£13.310**	**£1.260**	**£14.570**	
New borrowing / (Treasury Investments)	**£108.176**	**(£6.209)**	**£101.967**	

Note: the figures in the table are from the balance sheet in the Council's draft statement of accounts, but adjusted to exclude operational cash, accrued interest and other accounting *adjustments. Long-term investments consist of CCLA Property Fund a mid-long-term strategic investment and short-term investments consist of Local Authorities.*

2.3 The decrease in net borrowing in table 2 is result of a fall in short-term borrowing. The requirement to borrow has reduced due to increased internal resources this is largely as a result of Government grant funding being received, but not yet utilised on capital projects.

3 BORROWING

3.1 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 Council.

3.2 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.

4 BORROWING ACTIVITY – MID YEAR

4.1 As outlined in the treasury strategy, 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, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective. The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

4.2 There was a substantial rise in the cost of both short- and long-term borrowing over the last 18 months. Bank Rate rose by 1% from 4.25% at the beginning of April to 5.25% at the end of September. Bank Rate was 2% higher than at the end of September 2022.

4.3 UK gilt yields were volatile, mainly facing upward pressure since early April following signs that UK growth had been more resilient, inflation stickier than expected, and that the Bank of England saw persistently higher rates through 2023/24 as key to dampening domestic demand. Gilt yields, and consequently PWLB borrowing rates, rose and broadly remained at elevated levels. On 30th September, the PWLB certainty rates for maturity loans were 5.26% for 10-year loans, 5.64% for 20-year loans and 5.43% for 50-year loans. Their equivalents on 31st March 2023 were 4.33%, 4.70% and 4.41% respectively.

4.4 A new PWLB HRA rate which is 0.4% below the certainty rate was made available from 15th June 2023. Initially available for a period of one year, this discounted rate is to support local authorities borrowing for the Housing Revenue Account.

4.4 At 30th September 2023 the Council held £116.537m of loans, an decrease of £4.9m to 31st March 2023, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30th September are summarised in Table 3 below.

Table 3: Borrowing Position	31.3.23 Balance £m	Net Movement £m	30.9.23 Balance £m	30.9.23 Rate %	30.9.23 Maturity (years)
Public Works Loan Board	£71.386	£0	£71.386	3.15%-4.40%	10-40
*Banks (LOBO)	£3.000	£0	£3.000	4.95%	1-2
Banks (fixed term)	£7.000	£0	£7.000	3.35%-3.98%	<42-55
Local authorities (long-term)	£7.100	(£0.049)	£7.051	4.22%-4.44%	>1
Local authorities (short-term)	£33.000	(£4.900)	£28.100	3.90%-5.60%	<1
Total borrowing	**£121.486**	**(£4.949)**	**£116.537**		

**The LOBO has a call option which the lender can exercise every 5 years the next call date is November 2024*

4.4 The Council's short-term borrowing cost has continued to increase with the rise in Bank Rate and short-dated market rates. The average rate on the Council's short-term loans at 30th September 2023 of £28.1m was 4.75%, this compares with 0.28% on £18m loans 12 months ago.

Table 3B: Long-dated Loans borrowed	Amount £m	Rate %	Period (Years)
PWLB Maturity Loan	£5.000	4.25%	30-35 years
PWLB Maturity Loan	£3.000	4.40%	25-30 years
PWLB Maturity Loan	£5.000	3.70%	20-25 years
PWLB Maturity Loan	£27.000	3.47%-3.49%	15-20 years
PWLB Maturity Loan	£24.000	3.37%-3.46%	10-15 years
PWLB Maturity Loan	£7.383	3.15%-3.34%	5-10 years
Bank Loan	£7.000	3.35%-3.98%	40-55 years
Bank LOBO Loan	£3,000	4.95%	1 - 2 years
Local Authority Loan	£1,051	4.44%	5-10 years
Total borrowing	**£82,434**		

4.5 The Councils borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short- and long-term borrowing was maintained.

4.6 There remains a strong argument for diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields + 0.80%. The Council will evaluate and pursue these lower cost solutions and opportunities with its advisor Arlingclose.

4.7 The UK Infrastructure Bank is one alternative source of funding which offers funding at gilt yields + 0.40% (0.40% below the PWLB certainty rate) and the possibility of more flexible funding structures than the PWLB. Funding from UKIB is generally only available for certain types of projects that meet its criteria of green energy, transport, digital, water and waste. The minimum loan size is £5 million.

4.8 **LOBO loans:** The Council continues to hold £3m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost.

4.9 As market interest rates rose, there was increased probability of call options on the LOBOs being exercised by lenders. The Council's LOBO lenders do not have an option to increase rates within the next 12 months. Therefore, there is no immediate risk to these loans requiring early repayment or experiencing rate rises.

5 TREASURY INVESTMENT ACTIVITY

5.4 CIPFA revised TM Code defines treasury management investments as those which arise from the Council's cash flows or treasury risk management activity that ultimately represents balances which need to be invested until the cash is required for use in the course of business.

5.5 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Councils investment balances ranged between £12 and £26 million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position	**31.3.23 Balance £m**	**Net Movement £m**	**30.9.23 Balance £m**	**Rate %**
Banks & building societies (unsecured)	(£0.872)	£0.872	£0	0%
Government (incl. local authorities)	£9.000	(£0)	£9.000	0.15%-0.30%
Money Market Funds	£4.180	£0.390	£4.570	5.29%
Other Pooled Funds - Property funds	£1.000	£0	£1.000	N/A
Total investments	**£13.308**	**£1.262**	**£14.570**	

5.6 Both the CIPFA Code and government guidance 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 Councils objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

5.7 As demonstrated by the liability benchmark in this report, the Authority 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 asset classes and boost investment income.

5.8 In furtherance of these objectives, no new long-term borrowing was undertaken in the first half of 2023-24. This strategy enabled the Council to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

5.9 Bank Rate increased by 1%, from 4.25% at the beginning of April to 5.25% by the end of September. 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 4.8%.

5.10 Liquid cash was diversified over several counterparties and/or Money Market Funds to manage both credit and liquidity risks. £10m that is available for longer-term investment which consists of £1m in CCLA Property Fund and £9m in Local Authorities.

5.11 The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below.

Table 5: Investment Benchmarking – Treasury investments managed in-house	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity days)	Rate of Return %
31.03.2023 30.09.2023	5.10 4.31	A+ A+	32% 34%	290 160	1.50% 1.97%
Similar Las All LAs	4.43 4.47	AA- AA-	56% 59%	63 13	4.95% 4.92%

Weighted average maturity applies to the council's investment portfolio of local authority and money market funds.
**The 2023/24 TMSS set the limit per institution at £5m with which the Council complied.*
£4.6m of the total £14.5m investments exposed to bail-in on 30/9/2023 was invested in Money Market Funds which are pooled funds which have a highly diversified portfolio of money market and other instruments. The Money Market Funds which are used by the Council to maintain high credit security and liquidity.

5.12 Externally Managed Pooled Funds: £1m of the Councils investments are held in externally managed strategic pooled Property funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds generated a return of £9k which is used to support services in year.

5.13 Investor sentiment for UK commercial property was more settled than in Q3 and Q4 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 bottoming out. 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.

5.14 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 Council's 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.

5.15 **Statutory override:** 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 two years until 31st 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.

5.16 The Council had budgeted £201k income from treasury investments in 2023/24. Income received (April-September) was £182k, whist a further £21k has been declared and is due to be paid by October.

6 NON-TREASURY INVESTMENTS

6.1 The definition of investments in CIPFA's revised 2021 Treasury Management Code 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).

6.2 Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) and Welsh Government also includes within the definition of investments all such assets held partially or wholly for financial return.

6.3 At the balance sheet date of 30th September 2023, the Council also held £49m of investments in directly owned property, loans to homeowners and local bodies and investments in a trading subsidiary. There has been no significant change from 31st March 2023 (subject to audit).

6.4 These investments are budgeted to generate £4.9m of investment income for the Council after taking account of direct costs. This income is over a number of properties which provide varying rates of return.

7. TREASURY PERFORMANCE

7.1 The Council measures the financial performance of its treasury management activities in terms of its impact on the revenue budget. The table below sets out the comparison of the impact on borrowing between budget and actuals, as shown in Table 6 below:

Table 6: Performance- Revenue Implications of Treasury Management Activity	**Budget 2023-24 £m**	**Forecast 2023-24 £m**	**Variance (+)/-**
General Fund Interest Paid	£1.82	£1.59	(£0.23)
HRA Interest Paid	£3.15	£3.30	£0.15
General Fund Interest Received	(£0.47)	(£0.34)	£0.13
HRA Interest Received	(£0.04)	(£0.03)	£0.01
Minimum Revenue Provision (MRP)	£2.13	£2.03	(£0.10)

7.2 The amount of the Council’s revenue budget required to be set aside for the future repayment of external borrowing is known as the Minimum Revenue Provision (MRP). This amount is calculated by reference to the Council’s balance sheet as at the end of the previous financial year. The underspend on MRP relates to slippage in the capital programme in the 2023/24 financial year and less borrowing required to fund the capital spend.

7.3 The General Fund interest paid is lower due to a delay to the borrowing being undertaken to finance capital spend as anticipated when the budget was set. This has been mitigated by interest receivable not yet received from loans to Equinox that were previously anticipated when the budget was set. The HRA borrowing is slightly higher than the budget due to higher interest rates than when the budget was set.

8. FINANCIAL IMPLICATIONS – COMPLIANCE REPORT

8.1 The Chief Finance Officer reports that all treasury management activities undertaken during the quarter complied fully with the CIPFA Code of Practice and the Councils approved Treasury Management Strategy, compliance with specific investment limits is demonstrated in table 6 below.

8.2 Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 6 below.

Table 6: Debt Limits	2023/24 Maximum	30.9.23 Actual	2023/24 Operational Boundary	2023/24 Authorised Limit	Complied? Yes/No
Borrowing	£122.461	£116.537	£202.000	£207.000	Yes
Long term liabilities, PFI and Finance Leases	£0.598	£0.598	£2.000	£2.000	Yes
Total debt	**£123.059**	**£117.135**	**£204.000**	**£209.000**	Yes

'Maximum' is the highest actual outstanding borrowing at any point during the first six months of 2023/24

8.3 The authorised limit for external debt represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit is set by the Council as part of the annual treasury management strategy. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the long term. The operational boundary is the limit beyond which external debt is not normally expected to exceed. In most cases this would be similar to the CFR but may be lower or higher depending on the levels of actual debt.

8.4 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.

Table 7: Investment Limits	2023/24 April-Sept Maximum £m	30.9.23 Actual £m	2023/24 Limit £m	Complied? Yes/No
Any single organisation, except the UK Government	£0.220m	£0.028m	£1.6m each	Yes
Any group of pooled funds under the same management	£6.000m	£1.000m	£8m per manager	Yes
UK Central Government	Nil	Nil	Unlimited	Yes
UK Central Government Local Authorities	£9.000m	£9.000m	£3m per LA (2 years)	Yes
Money Market Funds	£16.365m	£4.570m	£5m per fund - unlimited	Yes

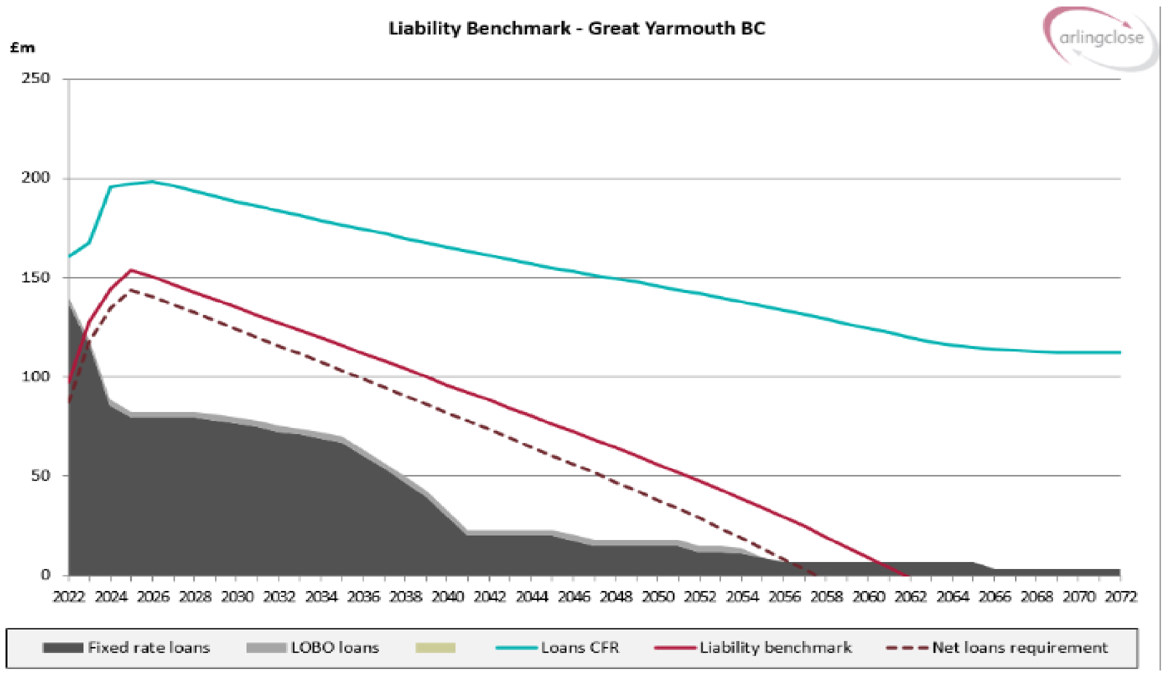
9. TREASURY MANAGEMENT PRUDENTIAL INDICATORS

9.1 As required by the 2021 CIPFA Treasury Management Code, the Council measures and manages the following treasury management prudential indicators.

9.2 **Liability Benchmark:** This new indicator compares the Authority'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 of £7m required to manage day-to-day cash flow.

Liability Benchmark	31.3.23 Actual	31.3.24 Forecast	31.3.25 Forecast	31.3.26 Forecast
Loans CFR	167.7	195.5	197.5	198.5
External Borrowing	(121.0)	(82.4)	(82.3)	(82.2)
Less: Balance sheet resources (including working capital)	(50.0)	(66.1)	(58.9)	(63.1)
Investments/New borrowing	**(3.3)**	**47.0**	**56.3**	**53.2**
Plus: Liquidity allowance	7.0	7.0	7.0	7.0
Liability benchmark	**124.7**	**136.4**	**145.5**	**142.5**
Existing borrowing	*121.0*	*82.3*	*82.2*	*82.1*

9.3 Following on from the medium-term forecast above, the long-term liability benchmark assumes capital expenditure funded by borrowing in line with the current forecast capital programme, minimum revenue provision and income, expenditure and reserves all in line with the 2023/24 budget and forecasts.



9.4 Whilst borrowing may be above the liability benchmark, strategies involving borrowing which is significantly above the liability benchmark carry higher risk.

9.5 **Maturity Structure of Borrowing**: This indicator is set to control the Councils exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

Maturity Structure of Borrowing	30.9.23 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	29%	50%	0%	Yes
12 months and within 24 months	3%	50%	0%	Yes
24 months and within 5 years	0%	60%	0%	Yes
5 years and within 10 years	8%	80%	0%	Yes
10 years and above	60%	100%	0%	Yes

9.6 Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

9.7 **Long-term Treasury Management Investments:** The purpose of this indicator is to control the Councils exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury management limits are:

Long-term Treasury Management Investments	2023/24	2024/25	2025/26	No fixed date
Actual principal invested beyond year end	£7m	£1m	£1m	£1m
Limit on principal invested beyond year end	£10m	£10m	£10m	£1m
Complied?	Yes	Yes	Yes	Yes

9.8 Long-term investments with no fixed maturity date include strategic pooled funds, real estate investment trusts and directly held equity but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

9.9 **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average (credit rating/ credit score) of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Security	30.9.23 Actual	2023/24 Target	Complied?
Portfolio average credit rating	A+	A	Yes

9.10 **Liquidity**: The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments it can borrow each quarter without giving prior notice.

Liquidity	30.9.23 Actual	2023/24 Target	Complied?
Liquid short-term deposits	£4.570m	£7m	No

Forecast projections of investment balances have decreased by 8% due to large capital projects, and also capital receipts anticipated in 2023/24 when the target was set are yet to be realised. These receipts are still predicted to be received in 2023/24 which should improve liquidity position in line with set indicator. **This remains under review and it is recommended that the target is revised to £3m.**

9.11 **Interest Rate Exposures**: This indicator is set to control the Councils exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

Interest rate risk indicator	30.9.23 Actual	2023/24 Limit	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	£58	£50	No

Upper limit on one-year revenue impact of a 1% fall in interest rates	(£61)	(£50)	No

The above limits were breached because they were based on lower loan and higher investment balances which reflected the Councils portfolio as at 31/12/2023 when the Treasury Management Strategy was written. The Councils loan balances have increased by 41% and investment balances have decreased by 8% due to large capital projects and for cashflow purposes.

9.12 The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at current rates.

9.13 For context, the changes in interest rates during the quarter were:

	31/3/23	30/9/23
Bank Rate	4.25%	5.25%
1-year PWLB certainty rate, maturity loans	4.78%	5.69%
5-year PWLB certainty rate, maturity loans	4.31%	5.22%
10-year PWLB certainty rate, maturity loans	4.33%	5.26%
20-year PWLB certainty rate, maturity loans	4.70%	5.64%
50-year PWLB certainty rate, maturity loans	4.41%	5.43%

The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at new market rates.

10. Capital Prudential Indicators

10.1 The Council measures and manages its capital expenditure, borrowing and capital investments with references to the following indicators.

10.2 It is now a requirement of the CIPFA Prudential Code that these are reported on a quarterly basis. The figures below have been updated in line with the 2022/23 accounts, which are still subject to audit and with reference to capital expenditure position at the end of quarter 2.

10.3 **Capital Expenditure:** The Council has undertaken and is planning capital expenditure as summarised below.

Capital Expenditure	**2022/23 actual £m**	**2023/24 forecast £m**	**2024/25 budget £m**	**2025/26 budget £m**
General Fund services	18.0	48.5	23.4	12.3
Council housing (HRA)	11.5	15.4	9.5	9.3
Capital investments	0.2	12.8	1.0	0

10.4 The main General Fund capital projects include:

- North Quay Redevelopment
- 6 Day Market & Market Realm Redevelopment
- Wintergardens Restoration
- Conversion of former Palmers Department store to Learning Hub

10.5 HRA capital expenditure is recorded separately and includes the building and acquisition of new homes over the forecast period to replace sales under Right to Buy in line with government guidance. Programmed capital expenditure is also driven to maintaining and improve the overall stock currently held by the HRA, this is prepared over the medium term and reviewed and updated annually.

10.6 Capital investments include loans and shares made for service purposes and property to be held primarily for financial return in line with the definition in the CIPFA Treasury Management Code.

10.7 **Capital Financing Requirement**: The Council's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt. The actual CFR is calculated on an annual basis, but an updated CFR forecast at 30th June 2023 is shown below.

Capital Financing Requirement	31.3.2023 actual	31.3.2024 forecast	31.3.2025 budget	31.3.2026 budget
General Fund services	74.3	87.0	87.3	87.4
Council housing (HRA)	91.3	93.4	94.3	95.1
Capital investments	2.1	14.3	15.1	15.0
TOTAL CFR	**167.7**	**194.7**	**196.7**	**197.5**

10.8 **Gross Debt and the Capital Financing Requirement**: Statutory guidance is that debt should remain below the capital financing requirement, except in the short term. The Authority has complied and expects to continue to comply with this requirement in the medium term as is shown below.

Gross Debt and the Capital Financing Requirement	31.3.2023 actual	31.3.2024 forecast	31.3.2025 budget	31.3.2026 budget	Debt at 30.9.2023
Debt (incl. PFI & leases)	122.0	82.8	82.6	82.4	117.1
Capital Financing Requirement	167.7	194.7	196.7	197.5	

10.9 **Proportion of Financing Costs to Net Revenue Stream**: Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants.

Proportion of Financing Costs to Net Revenue Stream	2022/23 actual	2023/24 forecast	2024/25 budget	2025/26 budget
Financing costs (£m)	2.2	3.9	4.6	4.8
Proportion of net revenue stream	14.6%	25.3%	29.4%	35.8%

11. NATIONAL CONTEXT AND ECONOMIC COMMENTARY

11.1 Economic background: UK inflation remained stubbornly high over much the period compared to the US and euro zone, keeping expectations elevated of how much further the Bank of England (BoE) would hike rates compared to the regions. 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 very soon after by the BoE deciding to keep Bank Rate on hold at 5.25% in September, against expectation for another 0.25% rise.

11.2 Economic growth in the UK remained relatively weak over the period. In calendar Q2 2023, the economy expanded by 0.2%. However, monthly GDP data showed a 0.5% contraction in July, the largest fall to date in 2023 and worse than the 0.2% decline predicted which could be an indication the monetary tightening cycle is starting to cause recessionary or at the very least stagnating economic conditions.

11.3 July data showed the unemployment rate increased to 4.3% (3mth/year) while the employment rate rose to 75.5%. Pay growth was 8.5% for total pay (including bonuses) and 7.8% for regular pay, which for the latter was the highest recorded annual growth rate. Adjusting for inflation, pay growth in real terms were positive at 1.2% and 0.6% for total pay and regular pay respectively.

11.4 Inflation continued to fall from its peak as annual headline CPI declined to 6.7% in July 2023 from 6.8% in the previous month against expectations for a tick back up to 7.0%. The largest downward contribution came from food prices. The core rate also surprised on the downside, falling to 6.2% from 6.9% compared to predictions for it to only edge down to 6.8%.

11.5 The Bank of England's Monetary Policy Committee continued tightening monetary policy over most of the period, taking Bank Rate to 5.25% in August. Against expectations of a further hike in September, the Committee voted 5-4 to maintain Bank Rate at 5.25%. Each of the four dissenters were in favour of another 0.25% increase.

11.6 Financial market Bank Rate expectations moderated over the period as falling inflation and weakening data gave some indication that higher interest rates were working. Expectations fell from predicting a peak of over 6% in June to 5.5% just ahead of the September MPC meeting, and to then expecting 5.25% to be the peak by the end of the period.

11.7 Following the September MPC meeting, Arlingclose, the authority's treasury adviser, modestly revised its interest forecast to reflect the central view that 5.25% will now be the peak in Bank Rate. In the short term the risks are to the upside if inflation increases again, but over the remaining part of the time horizon the risks are to the downside from economic activity weakening more than expected.

11.8 The lagged effect of monetary policy together with the staggered fixed term mortgage maturities over the next 12-24 months means the full impact from Bank Rate rises are still yet to be felt by households. As such, while consumer confidence continued to improve over the period, the GfK measure hit -21 in September, it is likely this will reverse at some point. Higher rates will also impact business and according to S&P/CIPS survey data, the UK manufacturing and services sector contracted during the quarter with all measures scoring under 50, indicating contraction in the sectors.

11.9 Having fallen throughout 2023, annual US inflation started to pick up again in July 2023, rising from 3% in June, which represented the lowest level since March 2021, to 3.2% in July and then jumping again to 3.7% in August, beating expectations for a rise to 3.6%. Rising oil prices were the main cause of the increase. US GDP growth registered 2.1% annualised in the second calendar quarter of 2023, down from the initial estimate of 2.4% but above the 2% expansion seen in the first quarter.

11.10 The European Central Bank increased its key deposit, main refinancing, and marginal lending interest rates to 4.00%, 4.50% and 4.75% respectively in September, and hinted these levels may represent the peak in rates but also emphasising rates would stay high for as long as required to bring inflation down to target.

11.11 Although continuing to decline steadily, inflation has been sticky, Eurozone annual headline CPI fell to 5.2% in August while annual core inflation eased to 5.3% having stuck at 5.5% in the previous two months. GDP growth remains weak, with recent data showing the region expanded by only 0.1% in the three months to June 2023, the rate as the previous quarter.

11.12 **Financial markets:** 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.

11.13 Gilt yields fell towards the end of the period. The 5-year UK benchmark gilt yield rose from 3.30% to peak at 4.91% in July before trending downwards to 4.29%, the 10-year gilt yield rose from 3.43% to 4.75% in August before declining to 4.45%, and the 20-year yield from 3.75% to 4.97% in August and then fell back to 4.84%. The Sterling Overnight Rate (SONIA) averaged 4.73% over the period.

11.14 **Credit review:** 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 purchase of Credit Suisse by UBS, as well as other well-publicised banking sector issues, in March Arlingclose reduced the advised maximum duration limit for all banks on its recommended counterparty list to 35 days. This stance continued to be maintained at the end of the period.

11.15 During the second quarter of the period, Moody's revised the outlook on Svenska Handelsbanken to negative from stable, citing concerns around the Swedish real estate sector.

11.16 Having put the US sovereign rating on Rating Watch Negative earlier in the period, Fitch took further action in August, downgrading the long-term rating to AA+, partly around ongoing debt ceiling concerns but also an expected fiscal deterioration over the next couple of years.

11.17 Following the issue of a Section 114 notice, in September Arlingclose advised against undertaking new lending to Birmingham City Council, and later in the month cut its recommended duration on Warrington Borough Council to a maximum of 100 days.

11.18 Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress and although no changes were made to recommended durations over the period, Northern Trust Corporation was added to the counterparty list.

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

12. CONCLUSIONS

12.1 Overall, the Council remains in line with the Treasury Management Strategy and Capital Strategy as approved in February 2023. The treasury activities continue to be monitored on a daily basis.

13. BACKGROUND PAPERS

13.1 Treasury Management Strategy 2023/24

13.2 Treasury Management Outturn report 2022/23

13.3 2023/24 cashflow, loan/investment register

13.4 Arlingclose updates and reports

13.5 Capital and Investment Strategies 2023/24

Area for consideration Comment	**Comment**
Monitoring Officer Consultation	ELT Consultation
Section 151 Officer Consultation	Report Author
Existing Council Policies See background papers	
Financial Implications eg within existing budgets or funding identified	Included within the report
Legal Implications (including human rights)	None
Risk Implications	Included in the report
Equality Issues/EQIA assessment (if EQIA not required explain why)	None as a direct impact of the report
Details contained in strategy	None
Crime & Disorder	None
Every Child Matters	None