Blaby District Council

Cabinet Executive

Date of Meeting	18 September 2023
Title of Report	**Quarter 1 Treasury Management Update 2023/24**
	This is not a Key Decision and is on the Forward Plan
Lead Member	**Cllr. Maggie Wright - Finance, People & Performance (Deputy Leader)**
Report Author	Finance Group Manager
Corporate Priority	Medium Term Financial Strategy (MTFS)

1. What is this report about?

1.1 This report provides Members with an update on the Council's treasury activities for the quarter ended 30th June 2023, and the economic factors that have affected those activities. This is an additional report stemming from the 2023/24 Prudential Code, which requires that treasury management updates should be reported on a quarterly basis from 1st April 2023 onwards. The Code stipulates that the additional two quarterly reports (Quarters 1 and 3) need to be adequately scrutinised but do not need to be reported to full Council

1.2 The report also demonstrates compliance with the prudential indicators that were approved by Council on 22nd February 2023.

2. Recommendation(s) to Cabinet Executive

2.1 That the latest position in respect of treasury activities, and the prudential indicators, are accepted.

3. Reason for Decisions Recommended

3.1 The 2023/24 edition of the Prudential Code has added a requirement for quarterly reporting of treasury management activities and prudential indicators. Whilst quarters 1 and 3 do not need to be formally reported to full Council, there is an implicit understanding that they should be adequately scrutinised by Cabinet Executive.

4. Matters to consider

4.1 Background

The Chartered Institute of Public Finance Accountancy (CIPFA) Code of Practice for Treasury Management 2021 recommends that Members are updated on treasury management activities at least quarterly. This report, therefore, ensures that the Council is following best practice in accordance with the Code. The financial year 2023/24 is the first year in which Cabinet will receive quarterly treasury updates.

Whilst it is a requirement of the Code that the annual and mid-year reports on treasury activity must be ratified by full Council, the reports for the first and third quarters of the financial year only need to be presented to Cabinet.

4.2 Economic Update

The economic update for the first quarter of 2023/24, provided by Link Group, the Council's treasury management advisors, is included at Appendix A.

It should be noted that changes to the UK economy, and their resulting implications for the Council's treasury activities, can often be fast-paced and, therefore, some of the economic data may be partially out of date by the time it is reported.

On 11th May, the Monetary Policy Committee (MPC) voted in favour of a 0.25% increase in Bank Rate, taking it up to 4.50%. At their subsequent meeting in June, Bank Rate was raised by a further 0.50% to 5.00%. These increases in Bank Rate are a conscious effort on the MPC's part to bring down inflation. Further increases are expected to follow in subsequent months.

4.3 Interest Rate Forecasts

The Council has appointed Link Group as its treasury management advisors and part of Link's service is to assist the Council to formulate a view on interest rates. The Public Works Loans Board (PWLB) rate forecasts below are based on the Certainty Rate (the standard rate minus 0.20%) which has been accessible to most local authorities since 1st November 2012.

The latest forecast at Appendix B, made on 26th June 2023, sets out a view that both short and long-dated interest rates will be elevated for quite some time, as the Bank of England seeks to reduce inflation, against a backdrop of a stubbornly robust economy and a tight labour market.

Link's forecasts have steadily increased during the quarter as supporting data has continued to spring upside surprises, and the Bank of England has under-estimated the prevalence of inflation and how tight the labour market is.

The expectation is that, whilst the Bank of England will be keen to loosen monetary policy once inflation pressures have been relieved, the Bank Rate is likely to have to increase further and remain at its peak until the second quarter of 2024 as a minimum.

In terms of PWLB rates, gilt yields have shifted upwards, especially at the shorter end of the yield curve, but remain volatile. Certainty rates for 5 to 50 years are generally in the range of 4.90% to 5.60%. It is likely that the markets have already built in most impacts on gilt yields of the likely increases in Bank Rate.

The balance of risks to economic growth in the UK is to the downside.

Downside risks to current forecasts for UK gilt yields and PWLB rates are:

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, the rising gilt yields we have seen of late).

- **The Bank of England** increases Bank Rate too fast and too far over the coming months, and subsequently brings about a deeper and longer UK recession than we currently anticipate.

- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.

- **Geopolitical risks,** for example in Ukraine/Russia, China/Taiwan/US, Iran, North Korea, and Middle Eastern countries, which could lead to increasing safe-haven flows.

- **A broadening of banking sector fragilities,** which have been successfully addressed in the near-term by central banks and the market generally, but which may require further intervention if short-term interest rates stay elevated for longer than is anticipated.

Upside risks include:

- Despite the recent tightening by 0.5%, the **Bank of England proves too timid** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to remain elevated for a longer period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project.

- **The pound weakens** because of a lack of confidence in the UK Government's fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.

- Longer-term **US treasury yields** rise strongly if inflation remains more stubborn than the market currently anticipates, pulling gilt yields up higher consequently.

- Projected **gilt issuance, inclusive of natural maturities and QT,** could be too much for the markets to comfortably digest without higher yields compensating.

4.4 Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2023/24, which includes the Annual Investment Strategy, was approved by the Council on 22nd February 2023. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity, aligned with the Council's risk appetite. In the current economic climate, over and above keeping investments short-term to cover cash flow needs, there is a benefit to seek out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

Investment rates have improved dramatically during the first quarter of 2023/24 and are expected to improve further as Bank Rate continues to increase over the next few months.

Creditworthiness.
There have been few changes to credit ratings over the quarter under review. However, officers continue to closely monitor these, and other measures of creditworthiness to ensure that only appropriate counterparties are considered for investment purposes.

Investment counterparty criteria
The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

CDS prices
For UK banks, these have retreated from the spikes caused by the Truss/ Kwarteng policy approach in September 2022. Prices are not misaligned with other creditworthiness indicators, such as credit ratings. Nevertheless, it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances.

Investment balances
The average level of funds available for investment purposes during the quarter was £31.774m. These were a mixture of temporary, cashflow funds where the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme, and longer-term core funds.

In terms of investment performance, the Council measures its rate of return against the Sterling Overnight Index Averages (SONIA). The following table reflects the backward-looking benchmark, which reflects where the market was positioned when investments were placed.

Financial year to quarter ended 30th June 2023

	Bank Rate	SONIA	7 day	30 day	90 day	180 day	365 day
High	5.00	4.93	4.93	4.57	4.38	4.10	3.14
Low	4.25	4.18	4.18	4.02	3.81	3.32	2.27
Average	4.44	4.37	4.34	4.27	4.11	3.74	2.70
Spread	0.75	0.75	0.75	0.55	0.57	0.78	0.87

The Council's approved budget for in-house investment income in 2023/24 is £360,000. On 30th June, the Council had already secured a return of £341,976 at an average rate of 4.32%.

A further £45,000 is budgeted to be received from the Lothbury Property Trust. Investment income at the end of the first quarter was £8,920 at an average rate of 3.92%. The value of the property fund on 30th June 2023 was £830,966 compared with the initial deposit of £1,000,000.

Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 30th June 2023. A full list of investments held at the end of the quarter is shown at Appendix C.

4.5 Borrowing

The Council can raise cash through borrowing to fund expenditure on its capital programme. The amount of borrowing needed each year is determined by capital expenditure plans, the underlying borrowing requirement, the availability of other capital resources, and prevailing economic conditions.

In quarter 1 of 2023/24, no new borrowing has been undertaken and there have been no scheduled loan repayments, meaning that the outstanding debt is £5,929,939 on 30th June 2023. The budget makes allowance for borrowing £2m during 2023/24 but the extent to which this will be taken up is dependent upon PWLB rates in force during the year.

For a number of years, the Council has been an internally borrowed cash position, and balances will need to be replenished at some point in the future, subject to expenditure demands. This strategy is prudent whilst investment rates are lower than borrowing rates, and also serves to mitigate counterparty risk. In the short-term it is planned to maintain internal borrowing, but officers will closely monitor the reserves, balances and cashflows that support this position.

No rescheduling of borrowing was undertaken in the first quarter. Opportunities to do so are limited in the current economic climate because the difference between new borrowing rates and early redemption rates would lead to substantial exit costs (premiums) being incurred.

4.6 Compliance with Treasury and Prudential Limits

The Council’s treasury and prudential indicators are shown in Appendix D.

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the quarter ended 30th June 2023, the Council has operated within the treasury and prudential indicators set out in the Council’s Treasury Management Strategy Statement for 223/24.

All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

5. What will it cost and are there opportunities for savings?

5.1 Treasury management decisions and activities are driven by the capital programme and the Council’s overall financial position and will impact on the interest payable and receivable budgets which are included in the quarterly budget monitoring report elsewhere on the agenda.

6. What are the risks and how can they be reduced?

6.1

Current Risk	Actions to reduce the risks
That external borrowing might not be undertaken at the most advantageous rate	Treasury officers maintain regular contact with the Council’s advisors, Link Group, who monitor movements in interest rates on our behalf. The aim is always to drawdown loans when interest rates are at their lowest point.
Credit risk – the risk that other parties might fail to pay amounts due, e.g., deposits with banks etc.	The Annual Investment Strategy sets the criteria through which the Council decides with whom it may invest. The lending list is updated regularly to reflect changes in credit ratings.
Liquidity risk – the Council might not have sufficient funds to meet its commitments	Daily monitoring of cash flow balances. Access to the money markets to cover any short-term cash shortfall.
Refinancing and maturity risk – the risk that the Council might need to renew a loan or investment at disadvantageous interest rates	Monitoring of the maturity profile of debt to make sure that loans do not all mature in the same period. Monitoring the maturity profile of investments to ensure there is sufficient liquidity to meet day to day cash flow needs.

Market risk – losses may arise because of changes in interest rates etc	Maximum limits are set for exposure to fixed and variable interest rates. The Finance team will monitor market rates and forecast interest rates to limit exposure
Loss on the Property Fund investment if property values continue to fall	The Lothbury Property Trust should be seen as a longer-term investment where the value of the fund can fluctuate both upwards and downwards. Historically, property prices tend to rise over time. Due to concerns reported to Council in July, officers are closely monitoring the proposed restructuring of the fund which is designed to ensure its future viability.

7. Other options considered

7.1 None, this report is a requirement of the 2023/24 Prudential Code.

8. Environmental impact

8.1 There is no direct environmental impact arising from this report. However, the Council continues to utilise sustainable investment opportunities in line with its approved investment criteria.

9. Other significant issues

9.1 In preparing this report, the author has considered issues related to Human Rights, Legal Matters, Human Resources, Equalities, Public Health Inequalities, and Climate Local and there are no areas of concern.

10. Appendix

10.1 Appendix A – Economic Update

10.2 Appendix B – Interest Rate Forecast

10.3 Appendix C – Investments Held at 30th June 2023

10.4 Appendix D – Treasury and Prudential Indicators

11. Background paper(s)

11.1 None.

12. Report author's contact details

Nick Brown Finance Group Manager
Nick.Brown@blaby.gov.uk 0116 272 7625