Blaby District Council

Cabinet Executive

Date of Meeting	6 November 2023
Title of Report	**Treasury Management Mid Year Monitoring Report 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 To provide members with an update on the Council's treasury activities for the half year ended 30th September 2023, and the economic factors which have affected those activities.

1.2 To demonstrate compliance with the Council's prudential indicators which were approved on 22nd February 2023.

2. Recommendation(s) to Cabinet Executive and Council

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 regulatory framework governing treasury management activities includes a requirement that the Council should, as a minimum, receive quarterly treasury monitoring reports in addition to the forward-looking annual treasury strategy and the backward-looking annual treasury report.

3.2 This report fulfils the requirement above and incorporates the needs of the Prudential Code to ensure adequate monitoring of capital expenditure plans and the Council's prudential indicators. The treasury strategy and prudential indicators for 2023/24 were contained in the report approved by Council on 22nd February 2023.

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 activities at least quarterly. This report, therefore, ensures that the Council is following best practice in accordance with the Code. It is the second quarterly report to be presented to Cabinet Executive but the first which requires ratification by full Council.

As part of the February strategy report Council also approved a range of Prudential Indicators for 2023/24 which are designed to ensure that the Council's capital expenditure plans are prudent, affordable, and sustainable. Officers monitor performance against these indicators on a quarterly basis, and the results are shown at Appendix D, compared with the original estimate and the forecast outturn position. As well as reviewing treasury activity to date, this report provides an explanation for any divergence from the original estimates.

4.2 Economic Update

The economic update for the first 6 months 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.

At its meeting on 20th September 2023, the Monetary Policy Committee (MPC) voted by a majority of 5-4 to maintain the Bank Rate at 5.25%. Four members were in favour of a further increase of 0.25% but weak inflation in August appears to have been the deciding factor in leaving the rates unchanged.

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 25th September 2023, sets out a view that short, medium, and long-dated interest rates will be elevated for quite some time, as the Bank of England seeks to squeeze inflation out of the economy.

4.4 Prudential Indicators

The Annual Treasury Management Strategy for 2023/24, including the Annual Investment Strategy, was approved by Council on 23rd February 2023. There have been no policy changes to the strategy to date this financial year, and so the details in this report are an update to the original plans based on the latest economic position and budgetary changes which have already been approved.

The Council's treasury and prudential indicators are set out in Appendix D. It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the first half year the Council has operated within the treasury and prudential indicators that were approved in February.

Capital Expenditure & Financing
The Council's capital expenditure plans and sources of finance is the first Prudential Indicator appearing at Appendix D. The original approved programme for 2023/24 was £3.618m of which it was planned that £2.295m would be financed through borrowing.

Since February further additions have been made to the programme, including £5.349m unspent budgets brought forward from the previous financial year, and £1.742m of other additions approved by Council on 26th September 2023 in relation to strategic asset reviews and net zero plans. The other additions are covered in more detail in the quarterly Capital Programme Review Reports (Quarter 1 – 18th September 2023, Quarter 2 - elsewhere on this agenda).

As a result of these changes, the 2023/24 Capital Programme totalled £10,450m on 30th September with a borrowing requirement of £6.452m.

Capital Financing Requirement
Another key Prudential Indicator is the Capital Financing Requirement (CFR) which is a measure of the Council's underlying need to borrow for capital purposes. If the latest Capital Programme is fully spent the CFR will rise to £20.300m by 31st March 2024, compared with the original estimate of £19.902m. It is probable that the CFR will continue to exceed actual debt for the foreseeable future due to the Council's ongoing practice of borrowing internally to finance capital investment. However, over time, the gap between the CFR and external debt will gradually close as reserves and balances are utilised, and further borrowing is undertaken.

Borrowing Limits
Appendix A shows the Operational Boundary for External Debt, and the Authorised Limit for External Debt as approved by Council in February. The first of these represents the level of external debt that the Council would not normally expect to exceed. It is normally a similar figure to the CFR but can vary according to the actual level of external debt. The Authorised Limit is the maximum level of borrowing permitted. Even if the Council fully spends

its Capital Programme and borrows to fund expenditure, external debt will remain below the Authorised Limit. However, this is highly unlikely and it this point in time it is not recommended that the borrowing limits need to be increased.

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 the first six months of 2023/24, no new borrowing has been undertaken. However, there have been scheduled loan repayments of £ 107,661, meaning that the outstanding debt is £5,822,278 on 30th September 2023. The budget makes allowance for new borrowing of £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 several 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 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.

Gilt yields and PWLB certainty rates were on a generally rising trend throughout the first half of 2023/24. At the beginning of April, the 5-year rate was the cheapest part of the curve and touched 4.14% whilst the 25-year rate was relatively expensive at 4.58%.

July saw short-dated rates peak at their most expensive. The 1-year rate spiked to 6.36% and the 5-year rate to 5.93%. Although, in due course, short-dated rate expectations fell, the medium dates shifted higher through August and the 10-year rate pushed higher to 5.51% and the 25-year rate to 5.73%. The 50-year rate was 4.27% on 5th April but rose to 5.45% on 28th September.

Our treasury advisors forecast rates to fall back over the next two to three years as inflation dampens. The CPI measure of inflation is expected to fall below 2% in the second half of 2024, and 50-year rates are expected to stand at 3.90% by the end of September 2025. However, there is a high degree of uncertainty as to whether rates will fall that far.

4.6 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.

Creditworthiness

Following the Government's fiscal event on 23rd September 2022, both Standard & Poors and Fitch rating agencies placed the UK sovereign debt rating on Negative Outlook, reflecting a downside bias to the current ratings in light of expectations of weaker finances and a challenging economic outlook. Nothing further has evolved in the first half of 2023/24.

Officers continue to monitor credit ratings, with support from Link, 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

It remains important, in the current economic climate, to undertake continual monitoring of all aspects of risk and return.

Investment balances

The average level of funds available for investment purposes during the half of the financial year was £33.244m. 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 30th September 2023

	Bank Rate	SONIA	7 day	30 day	90 day	180 day	365 day
High	5.25	5.19	5.19	5.20	5.12	4.78	4.06
Low	4.25	4.18	4.18	4.02	3.81	3.32	2.27
Average	4.81	4.74	4.71	4.64	4.44	4.10	3.16
Spread	1.00	1.01	1.01	1.18	1.31	1.46	1.79

The Council's approved budget for in-house investment income in 2023/24 is £360,000. On 30th September, the Council had already secured a return of £793,459 at an average rate of 4.76%.

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

Property Fund

In addition to the internal investment portfolio, the Council has also invested £1m in the Lothbury Property Trust.

Members will be aware from the Treasury Management Outturn report, presented to Cabinet and Council in July, that Lothbury has suspended the fund due to an unprecedented volume of redemption requests. This prompted the Council to submit a redemption request of its own to ensure that it did not find itself in a worse position than other investors in the event that the fund is deemed to be unsustainable.

Over the last few weeks, officers have been in discussion with Lothbury over the future of the fund. Lothbury had initially been confident that a revised strategy, coupled with a reduced fund size of £500m would be sufficient to ensure the future of the fund. Lothbury have already commenced with a programme of asset disposal designed to reduce the fund to the desired size, and this is seemingly progressing well with receipts exceeding expectations.

At a meeting of investors, held on 14th September, Lothbury presented three options in relation to the future of the fund:

- Continuing with a smaller fund size, as outlined above
- Terminating the fund
- Exploring the option of a merger

Following this, investors had the opportunity to discuss the proposals without the presence of the Lothbury management team. The consensus view was that the redemption requests remained in place and that continuing with a smaller size was not a viable option. Consequently, termination would be the likely outcome although investors were open to exploring the merger with another property fund.

Subsequently, on 17th October, Lothbury have issued a letter to all investors giving notice of the termination of the fund on 31st December 2023. At that point, funds will be distributed to investors, pro rata to their holding in the fund on the termination date. In the event that one of the merger options under consideration is deemed to be viable, and is identified prior to the termination date, Lothbury will seek a mandate from investors at an Extra General Meeting, to clarify whether they wish to move forward with that option and either postpone the termination date, or not proceed with the termination at all.

In the meantime, the disposal programme will continue such that the net proceeds can be distributed to investors as soon as possible.

The value of Blaby's share in the property fund on 30th September 2023 has fallen further to £817,471.

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 terminated	The fund managers have issued a termination notice, signalling their intention to close the fund on 31st December 2023 unless a viable merger option is identified. The Council has already submitted a redemption request to ensure that it is not placed in a worse position than other investors upon termination. However, there remains a real risk that fund proceeds will be insufficient to reimburse investors to the value of their initial investment.

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 September 2023

10.4 Appendix D – Treasury and Prudential Indicators

11. Background paper(s)

11.1 None.

12. Report author's contact details

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