Treasury Management

Borrowing and Investments

1. Table 1 below shows the year's opening balance of borrowing and investments, current levels, and the year-end forecast. Forecast borrowing is based on the forecast capital programme and will be subject to review during the year.

The Authority maintained its strategy of keeping borrowing and investments below their underlying levels to reduce risk and make a net saving.

2. **Table 1 - Borrowing and Investments**

	31-Mar-23 Actual £M	31-Mar-23 Average Yield / Rate %	30-Jun-23 Actual £M	30-Jun-23 Average Yield / Rate %	31-Mar-24 Forecast £M	31-Mar-24 Forecast Average %
Long Term Borrowing						
Public Works Loan	289.19	3.52	288.70	3.52	380.10	2.80
LOBO Loans from Banks	9.00	4.86	9.00	4.86	9.00	4.87
	298.19	**3.63**	**297.70**	**3.63**	**389.10**	**2.82**
Short Term Borrowing						
Other Local Authorities	5.00	3.36	0.00	0.00	0.00	0.00
Total External Borrowing	**303.19**	**2.96**	**297.70**	**2.94**	**389.10**	**2.78**
Other Long Term Liabilities						
PFI Schemes	44.37	9.56	43.55	9.56	41.08	9.56
Deferred Debt Charges (HCC)	12.73	3.27	12.73	3.27	12.37	3.27
Total Gross External Debt	**360.29**	**4.08**	**353.98**	**4.08**	**442.55**	**3.85**
Investments:						
Managed In-House						
Government & Local Authority	(11.06)	4.05	(8.92)	4.81		
Cash (Instant access)	(15.49)	4.08	(14.78)	4.74	(20.00)	5.50
Cash (Notice Account)	0.00	0.00	0.00	0.00	0.00	0.00
Long Term Bonds	(1.01)	5.27	(1.03)	5.27	(1.00)	5.27
Managed Externally						
Pooled Funds (CCLA) & Shares	(27.00)	4.04	(27.00)	4.29	(27.00)	3.00
Total Investments	**(54.56)**	**4.08**	**(51.73)**	**4.33**	**(48.00)**	**4.09**
Net Debt	**305.73**		**302.25**		**394.55**	

3. After taking into account maturing and new debt requirements in year and a forecast reduction in investment balances, net borrowing is expected to increase by £88.82M, to £394.55M.

This forecast is subject to change; most notably regarding the increased use of balances, (which increase borrowing need as use of internal borrowing will reduce) and changes to the capital programme, which due to the current financial environment is subject to ongoing review against the backdrop of rising inflation (which is significantly increasing construction costs) and rising interest rates which has seen the cost of borrowing increase dramatically.

4. The interest cost of financing the council's long and short term loan debt is charged to the general fund revenue account and is detailed below together with a summary of performance to date.

	Borrowing
5.	As at June 2023, the forecast cost of financing the council's loan debt is £21.92M of which £6.37M relates to the HRA, however this will be subject to movement as the need for further borrowing for the remainder of the year becomes more certain.
6.	As outlined in the treasury strategy, the Authority's primary objective when borrowing is 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 Authority's long-term plans change being a secondary objective. The Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.
7.	There has been a substantial rise in the cost of both short- and long-term borrowing over the last 18 months. In this quarter, Bank Rate rose from 4.25% at the beginning of April to 5.0% at the end of the quarter; significantly higher than its level of 1.25% at the end of June 2022. Gilt yields faced upward pressure since early April following signs that UK growth has been more resilient and inflation stickier than expected. Consequently, PWLB borrowing rates continued to rise over the quarter. On 30th June, the PWLB certainty rates for maturity loans were 5.25% for 10-year loans, 5.36% for 20-year loans and 4.95% for 50-year loans. Their equivalents on 31st March 2023 were 4.33%, 4.70% and 4.41% respectively.
8.	A new PWLB HRA rate which is 0.4% below the certainty rate has been 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 and for refinancing existing HRA loans, providing a window of opportunity for HRA-related borrowing and to loans relating to the HRA maturing during this time frame.
9.	The Authority has previously raised the majority of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Authority does not intend to do this and will therefore retain its access to PWLB loans.
10.	**Loans restructuring**: The sharp rise in gilt yields over the past 18 months has now resulted in some of the Authority's loans being in or close to a discount position if repaid early. However, as the prepaid loans would need to be replaced by new loans at higher interest rates, this isn't a cost-effective option for the Authority.
11.	**LOBO loans**: The Authority continues to hold £9M of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate and terms or to repay the loan at no additional cost. With market interest rates having risen, the probability of LOBOs also increased. £3M of LOBO loans had semi-annual call option dates during the April-June quarter, however no lender exercised their option. All the LOBO loans have call dates within the next 12 months and we have liaised with our treasury management advisors Arlingclose over the likelihood of the options being exercised. If the option is exercised and an increased rate proposed, the Authority will only accept the new rate if it is judged to be a fair rate given the continued existence of future options and the

prevailing interest rate at the time. If required, the Authority will repay the LOBO loans with available cash or by borrowing from other local authorities or the PWLB.

12. Short-term borrowing cost has continued to increase with the rise in Bank Rate and short-dated market rates and is currently around 5.85% for a 1 year loan. We currently do not have any short term debt, but anticipate borrowing short term before year end.

Any borrowing will be done in consultation with our advisors as although short term borrowing is currently higher than 25 year maturity debt at 5.36%, long term debt is expected to fall in the medium term and the overall cost needs to be considered.

13. The Authority has an increasing CFR due to the capital programme, and after future debt maturities currently has an estimated borrowing requirement of £101.54M for the year, as determined by the Liability Benchmark which considers capital spend, maturing debt, usable reserves and working capital and is summarised in Table 2 below.

Table 2 – Estimated Borrowing Requirement

	2023/24 £M
New Capital Expenditure	57.39
Repayment of Principle (MRP)	(8.69)
Maturing Debt	15.60
Movement in Resources	37.24
	101.54
New Borrowing Taken in Year	(0.00)
Cumulative Borrowing Need	**101.54**

Investment

14. Both the CIPFA Code and government guidance require the Authority 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 Authority's 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.

As demonstrated in table 2 above, 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 sectors and boost investment income.

15. The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves. During the year investment balances have ranged between £86.95M and £48.08M and are currently £51.73M and expected to reduce to £48M by year end.

16. Bank Rate increased by 0.75%, from 4.25% at the beginning of April to 5% by the end of June, 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 4.6% and 4.9%.

Forecast income is now £2.26M, £0.34M higher than originally budgeted which helps to partly mitigate the increase in borrowing costs.

	Investment Performance
17.	The council's advisors undertake quarterly investment benchmarking across its client base. We previously had a more diversified portfolio and at higher interest rates than the average as a result of moving into the bond programme earlier than most clients, but there is now more competition for bonds from both government bodies and other local authorities, so opportunities to replace maturing bonds are limited and we have seen a fall in suitable instruments. With this in mind, and the changes to Prudential code to only borrow when cash flows dictate, our investments primarily now consist of a previous long-term investment in property funds and short term investments for cash flow purposes.
18.	Our current investment in bonds remains at £1M and we maintained the pooled property fund at £27M, with all other cash being placed in short term deposits as shown in table 1.
19.	As detailed in paragraph 15 our cash balances are currently higher than forecast but at £51.73M have reduced by £35.22M since highest point, in April, when we held £86.95M. Our target is to reduce this to a £20M working balance to reduce borrowing and therefore net interest costs but this will be dependent on actual capital spend and movement in balances.
20.	Investments managed internally are currently averaging a return of 4.81% which is slightly higher than the average unitary authority at 4.47% whilst maintaining a higher credit rating at AA- compared to A+. Total income returns at 4.15% is lower than the average for both unitary (4.30%) and LA's (4.32%), this is due to lower cash balances available to invest, £25M as opposed to £62M for other Unitaries and £67M for other Local Authority. Cash is performing well in the current financial environment. We hold 51% of our investments in strategic funds which offer higher return over the long term, as detailed in paragraphs 21 to 24, which is higher than the average but not unexpected as our cash flows have reduced. The capital value of our external strategic funds has fallen by a further £0.04M in the last quarter, which is consistent across all local authorities that hold funds in pooled property funds. The income return was and still remains the driver to invest.
	External Managed Investments
21.	The council has invested £27M in pooled property funds as an alternative to buying property directly. As previously reported these funds offer the potential for enhanced returns over the longer term but may be more volatile in the shorter term. They are managed by professional fund managers which allows the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments.
22.	Because these funds have no defined maturity date but are usually available for withdrawal after a notice period (180 days), their performance and continued suitability in meeting the Authority's investment objectives is regularly reviewed.
23.	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. Considering their performance over the long-term and the Authority's latest cash flow forecasts, investment in these funds has been maintained but will be monitored carefully especially as the statutory override on accounting for gains and losses on pooled investment funds ends on 31st March 2025, when any difference between initial investment and the current value will be a cost/gain to the Authority. We have ongoing discussions with Arlingclose about the implications for the investment strategy and what action may need to be taken.

24. Financial market conditions were volatile during the quarter, but favourable in some areas. Resilient economic data, which led to diminishing talk of recessions at a time when interest rate peaks are thought to be near initially helped UK, euro-area and US equity markets. However, UK equities fell in May (sterling's strength weighed on some sectors) and ended the quarter marginally lower.

UK property markets continued to struggle as higher interest rates, bond yields and 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.

Fixed income markets, however, moved lower as interest rate expectations picked up again. This was most apparent in the UK government gilts with rising yields (i.e., prices falling) on higher than expected inflation. Corporate bond yields also rose but were helped by a narrowing in credit spreads as the fallout from the March mini-bank crisis continued to fade.

The change in the funds' capital values and income earned over the 3-month period is shown in Table 3 below. If rates remain at this level the forecast dividend for the year is £1.16M.

Table 3 - Pooled Fund Performance (Year to Date)

Quarter Ending	Valuation £M	Movement since Reported in SOA	Divide £M
1st April	25.80		
30th June (Est)	25.77	(0.04)	0.29
Total			0.29

Financial Review and Outlook

25. A summary of the external factors, which sets the background for Treasury, as provided by the council's treasury advisors, Arlingclose Ltd, is summarised below:

Table 4 - Arlingclose's Economic Outlook (23rd June 2023 interest rate forecast)

	Current	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26
Official Bank Rate													
Upside risk	0.00	0.50	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	5.00	5.50	5.50	5.50	5.25	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00
Downside risk	0.00	0.50	0.50	0.50	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

26. The economic interest rate outlook provided by the Council's treasury advisor, Arlingclose Ltd, for June 2023 is based on the following underlying assumptions:

- The MPC raised Bank Rate by 50bps to 5.0% in June. Due to current inflation and wage data, we believe that Bank Rate will rise to 5.25% in August and to 5.50% in September.
- The risks lie to the upside. Further strong inflation data for June (released in July) will likely result in another 50bps rise in Bank Rate in August.
- The MPC will cut rates in the medium term to stimulate the UK economy but will be reluctant to do so until services inflation and wage growth ease. The stickiness of these data suggests that rate cuts will happen later than previously expected. We see rate cuts from Q2 2024 to a low of around 3% by mid-2025.

	• Arlingclose expects long-term gilt yields to eventually fall from current levels reflecting the lower medium-term path for Bank Rate. However, yields will remain relatively higher than in the past, partly due to quantitative tightening, with continued elevated volatility.
	Economic background
27.	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. The UK situation was not welcome news for the Bank of England. GDP growth was weak, confirmed at 0.1% in Q1, although more recent monthly GDP data has been somewhat better. The housing market has stalled, consumer demand is weak but seemingly recovering despite higher interest rates, and labour demand remained strong, with repercussions for wage growth which is accelerating. April data showed the unemployment rate increased to 3.8% (3mth/year) while the employment rate rose to 76.0%. Pay growth was 6.5% for total pay (including bonuses) and 7.2% for regular pay, the largest growth rate of the latter outside of the Covid pandemic. Once adjusted for inflation, however, growth in total pay and regular pay remained negative. 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%. 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 reaccelerated monetary policy tightening over the period with a 0.25% rise in May to a 0.5% rise in June, taking 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. Interest rate expectations priced in further hikes in policy rates. Arlingclose, the authority's treasury adviser, revised its forecast to forecast a further 0.5% of monetary tightening to take Bank Rate to 5.5%. The risks, however, are that rates could be higher; financial markets are forecasting policy interest rates above 6%. With many mortgages at low fixed rates now systematically being re-set over the next 12-24 months at higher rates at the end of their fixed rate period, 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 rising to -24 in June, 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. Despite the US Federal Reserve increasing its key interest rate to 5.00-5.25% over the period, activity in the region continued to defy monetary tightening, particularly in labour markets which have so far appeared robust, supporting the Fed's assertations of two more rate hikes after it paused in June. Annual US inflation continued to ease, falling from 4.9% in April to 4.0% in May, the lowest level since March 2021. US GDP growth at 2% annualised in the first calendar quarter of 2023 was also significantly stronger than expected against the initial estimate of 1.3%. In the euro zone, the picture was somewhat different. The European Central Bank maintained its hawkish tone and increased its key deposit, main refinancing, and marginal lending interest

	rates to 3.50%, 4.00% and 4.25% respectively. There were signs of weakening activity, particularly in Germany whose manufacturing sector has taken a hit from high energy prices and weaker global demand. However, inflation remained sticky, annual headline CPI fell to 5.5% in June while annual core inflation rose to 5.4% from 5.3%, which means the ECB is unlikely to stop monetary tightening.
	Financial markets
28.	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. Gilt yields rose over the period. 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%. The Sterling Overnight Rate (SONIA) averaged 4.37% over the quarter.
	Credit background
29.	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.
30.	Over the period S&P upgraded NatWest Group and related entities to A+ (except NatWest Markets which was upgraded to A), revised the UK sovereign outlook to stable from negative, and upgraded both Barclays Bank PLC and Barclays Bank UK PLC to A+. Fitch put the US sovereign rating on Rating Watch Negative following increased political partisanship which at the time was hindering the latest resolution to raise the debt ceiling. It also upgraded the outlook on United Overseas Bank to stable, the outlook on Clydesdale to positive, and the outlook on Bank of Montreal to stable. Moody's withdrew Guildford BC's rating (who chose not to continue being rated) and affirmed the Aaa rating of the European Investment Bank. 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 Authority's counterparty list recommended by Arlingclose remains under constant review.
	Prudential Indicators
31.	As required by the 2021 CIPFA Treasury Management Code, the Authority monitors and measures the following treasury management prudential indicators, which together with Capital Prudential Indicators can be seen in Appendix 3 (6 – 11): • Liability Benchmark • Maturity Structure of Borrowing • Long-term Treasury Management Investments • Security • Liquidity • Interest Rate Risk Indicator