Crawley Borough Council

Report to Overview and Scrutiny Commission
27 November 2023

Report to Cabinet
29 November 2023

Treasury Management Mid-Year Review 2023/2024

Report of the Head of Corporate Finance (FIN/637)

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1. Purpose

1.1 This report provides an update on the Council's Treasury Management Strategy for the two first quarters of 2023/2024.

2. Recommendations

2.1 To the Overview and Scrutiny Commission:

That the Commission consider the report and decide what comments, if any, it wishes to submit to the Cabinet.

2.2 To the Cabinet

That the Cabinet is recommended to note the report and the treasury activity for the first two quarters of 2023/2024.

3. Reasons for the Recommendations

3.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management (the TM Code) recommends that members be updated on treasury management activities regularly (Treasury Management Strategy, annual and mid-year reports). This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

4. Interest rate forecasts

4.1 The Council's treasury advisor, Arlingclose Limited, has provided the following forecast:

	Current	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26
Official Bank Rate													
Upside risk	0.00	0.25	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	1.00	1.00
Central Case	**5.25**	**5.25**	**5.25**	**5.25**	**5.00**	**4.75**	**4.25**	**4.00**	**3.75**	**3.50**	**3.25**	**3.00**	**3.00**
Downside risk	0.00	0.00	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00

5. Annual Investment Strategy

5.1 The Treasury Management Strategy for 2023/24, which includes the Annual Investment Strategy, was approved by Council on 22 February 2023. In accordance with the TM Code it sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity;
- Yield; and
- Ethical investment policy

6. Compliance with Treasury and Prudential Limits

6.1 It is a statutory duty for the Council to determine and keep under review the level of affordable borrowing it determines as prudent. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved Treasury Management Strategy.

6.2 During the financial year to date the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy and in compliance with the Council's Treasury Management Practices. The prudential and treasury Indicators are shown in Appendix 3.

7. Investment Portfolio 2023/24

7.1 The CIPFA TM Code defines treasury management investments as those which arise from the Authority'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.

7.2 The Council held £105.004m of investments as at 30 September 2023 (£98.025m at 31 March 2023). Summary table below:

INVESTMENT PORTFOLIO	Actual 31 March 2023 £000	Net Movement £000	Actual 30 September 2023 £000	30 September 2023 Income Return %	30 September 2023 Weighted Average Maturity Days
Treasury investments					
Banks & building societies (unsecured)	379	4,675	5,054	5.01%	99
Government	11,296	(10,546)	750	5.37%	125
Local authorities	62,000	20,600	82,600	3.75%	193
Money Market Funds	14,350	(7,750)	6,600	5.34%	1
Cash plus funds	10,000	0	10,000	0.84%	5
TOTAL TREASURY INVESTMENTS *	98,025	6,979	105,004	3.94%	177

* Capital expenditure was budgeted at £68.7m for 2023/24. £14.9m has been spent to 30 September 23. The revised estimate is £54.6m. See Quarter 2 Budget Monitoring elsewhere on the agenda for further details.

A full list of investments held on 30th September 2023 is in appendix 2.

7.3 The Head of Corporate Finance confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2023/24.

7.4 Investment performance for the financial year to 30 September 2023:

Investments managed in-house	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
31.03.2023 30.09.2023	4.91 4.56	A+ A+	17% 7%	104 174	1.72 3.83
Similar Las **All LAs**	**4.43** **4.47**	**AA-** **AA-**	**56%** **59%**	**63** **13**	**4.71** **4.79**

7.5 The rate of return above is lower than the average shown as the Council has invested for longer periods, as shown in the weighted average maturity column. This has allowed the Council to achieve higher than average returns in the past but means that it is slower to pick up additional yield when rates increase.

7.6 In the strategy set at the start of the year, the Council projected that there would be a rise in interest rates. At the time, the base rate was 4.25%, it is currently 5.25% and the expectation is that it will remain at 5.25% till year-end.,

7.7 The 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 4.0% and 5.6%.

7.8 The average rate on the Council's investments is 3.19% for the first half of the year, this is mostly as a result of investments that were taken out before the rate increases. As these mature, the average rate will increase.

8. Non-Treasury Investments

8.1 The definition of investments in CIPFA's TM Code covers 'all the financial assets of the Authority as well as other non-financial assets which the Authority 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).'

8.2 The Council held £44.841m (see Appendix 2) of commercial investments in directly owned properties.

8.3 The Council also held £52.568m of service investments in

- Directly owned property £52.268m
- Loan to The Hawth £0.3m

8.4 Service investments are not held primarily for financial return but support service objectives of the Council. These investments generated £0.3m of investment income for the Authority after taking account of direct costs, representing a rate of return of 2.26%.

9. Borrowing

9.1 The Council borrowed £260.325m in March 2012 for HRA self-financing, £249.325m remains held. The average borrowing rate is 3.19%. There has been no requirement for further borrowing in 2023/2024.

10. Minimum Revenue Provision

10.1 As part of the Treasury Management Strategy the Council also approves a Minimum Revenue (MRP) policy statement. The aim of the MRP policy statement is to ensure that where the Council finances capital expenditure by borrowing, whether internal through use of cash or external funds, it puts aside resources annually to repay the debt in later years.

10.2 The MRP policy statement detailed the availability of the Council to make voluntary overpayments of MRP to reduce revenue charges in later years. In 21/22 and 22/23 voluntary overpayments were made in relation to the appropriation of the garages from the Housing Revenue Account to the General Fund.

10.3 The General Fund revenue budget monitoring reports detail increasing budgetary pressures being experienced in 23/24, therefore, it is likely that the benefit of the voluntary overpayments be taken in this financial year by means of an ‘MRP holiday’ to ease the strain on the General Fund.

10.4 The charge for MRP going forward will be reviewed with the aim of ensuring a prudent provision to cover the debt over the life of the garage assets.

11. Implications

11.1 The Council is under a duty to manage its resources prudently and therefore due consideration must always be given to its borrowing and lending strategy. A wide range of local authority financial activities, including borrowing, lending, financial management, and the approval of types of investment vehicle are governed by legislation and various regulations. The Council is obliged to comply with these. There are no other legal implications arising in this report.

11.2 The financial implications are addressed throughout this report.

11.3 Risks are highlighted throughout this report, but Appendix 3 addresses the risk to security, liquidity and yield of the Council’s investment strategy.

12. Background Papers

Treasury Management Strategy for 2023/2024 – Cabinet, 1 February 2023 [report FIN/608 refers]
Quarterly Budget Monitoring 2023/2024 Quarter 2 – Cabinet, 29 November 2023 [report FIN/635 refers]
2023/2024 Budget and Council Tax – Cabinet, 1 February 2023 [FIN/606 refers]
“Treasury Management in the Public Services - Code of Practice and Cross-Sectoral Guidance Notes”, 2021 Edition - Chartered Institute of Public Finance and Accountancy
“The Prudential Code for Capital Finance in Local Authorities”, 2021 Edition - Chartered Institute of Public Finance and Accountancy
DCLG Guidance on Local Government Investments (Third Edition)

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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.

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.

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.

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%.

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.

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.

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.

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.

The US Federal Reserve increased its key interest rate to 5.25-5.50% over the period, pausing in September following a 0.25% rise the month before, and indicating that it may have not quite completed its monetary tightening cycle.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

Detailed holdings at 30 September 2023 **APPENDIX 2**

Counter Party	Deal Ref	Issue	Maturity	Days to Mature	Interest Rate	Nominal (£m)	Total (£m)	Limit (£m)	Rating
UK BANKS									
Lloyds Bank plc	20		01/10/2023	1	2.00%	0.186		10.000	
	2811		01/10/2023	1	5.14%	0.100	0.286	10.000	A-
National Westminster Bank Plc	2800	25/05/2023	13/01/2024	105	5.13%	4.768	4.768	15.000	
CENTRAL GOVERNMENT									
DMADF Cash Account	2819	02/08/2023	02/02/2024	125	5.37%	0.750	0.750	Unlimited	AA-
LOCAL AUTHORITIES									
Birmingham City Council	2756	28/04/2023	26/04/2024	209	3.50%	5.000	5.000	15.000	AA-
Blackpool BC	2796	27/06/2023	27/10/2023	27	4.46%	5.000	5.000	15.000	AA-
Blaenau Gwent County Borough Council	2786	26/05/2023	27/11/2023	58	4.30%	5.000	5.000	15.000	AA-
Broxbourne Borough Council	2801	18/08/2023	16/08/2024	321	4.75%	3.000	3.000	15.000	AA-
Cambridgeshire CC	64	22/07/2022	22/01/2024	114	1.00%	5.000	5.000	15.000	AA-
Cheltenham Borough Council	2817	02/08/2023	02/10/2023	2	5.20%	2.000	2.000	15.000	AA-
Cornwall Council	2787	11/04/2023	11/10/2023	11	4.20%	5.000	5.000	15.000	AA-
Derbyshire County Council	2742	11/05/2023	10/05/2024	223	1.50%	3.000	0.000	0.000	AA-
	2743	31/05/2023	30/05/2024	243	1.50%	2.000	5.000	15.000	AA-
Gloucester City Council	2798	30/06/2023	28/06/2024	272	4.70%	5.000	5.000	15.000	AA-
Kirklees Metropolitan Council	2698	01/04/2022	02/04/2024	185	0.50%	5.000	5.000	15.000	AA-
Lancashire CC	2749	01/11/2022	01/11/2023	32	2.50%	2.000	0.000	0.000	AA-
	2781	21/04/2023	20/10/2023	20	4.50%	3.000	5.000	15.000	AA-
London Borough of Barking and Dagenham	2806	27/07/2023	27/03/2024	179	4.82%	5.000	5.000	15.000	AA-
City of Liverpool	2790	31/05/2023	30/11/2023	61	4.50%	5.000	5.000	15.000	AA-
Moray Council	2799	08/09/2023	06/09/2024	342	4.75%	3.000	3.000	15.000	AA-
Royal Borough of Windsor & Maidenhead	2808	29/09/2023	28/03/2024	180	4.83%	5.000	5.000	15.000	AA-
Rushmoor Borough Council	2813	17/07/2023	15/07/2024	289	5.85%	2.000	2.000	15.000	AA-
Sevenoaks District Council	65	12/06/2023	12/06/2026	986	4.85%	2.600	2.600	15.000	AA-
Uttlesford District Council	2738	07/06/2023	06/06/2024	250	2.25%	5.000	5.000	15.000	AA-
West Lindsey District Council	2803	21/09/2023	19/09/2024	355	5.00%	5.000	5.000	15.000	AA-

MONEY MARKET FUNDS								
Aberdeen Liquidity Fund	5	01/10/2023	1	5.29%	1.600	1.600	6.000	AAA
Federated Prime Rate Cash Man	1	01/10/2023	1	5.35%	5.000	5.000	6.000	AAA
STRATEGIC FUNDS								
Royal London	2714	01/10/2023	1	3.62%	10.000	10.000	10.000	A+
			157		**105.004**			
INVESTMENT PROPERTIES								
Ashdown House					8.085			
49-51 High Street					1.145			
Atlantic House					3.574			
The Create Building					27.141			
Other					4.896			
					44.841			
					149.845			

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

Debt Limits

£000	2023/24 Maximum	30.9.23 Actual	2023/24 Operational Boundary	2023/24 Authorised Limit	Complied?
Borrowing	250,325	249,325	249,356	269,356	Yes
Finance Leases	31	31	31	31	Yes
Total debt	**250,356**	**249,356**	**249,387**	**269,387**	Yes

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.

Investment Limits

	2023/24 Maximum	30.9.23 Actual	2023/24 Limit	Complied?
Any single organisation, except the UK Government	£5m	£0.29m	£10m	Yes
Any group of organisations under the same ownership	-	-	£10m	Yes
Any group of pooled funds under the same management	-	-	£25m	Yes
Negotiable instruments held in a broker's nominee account	-	-	£25m	Yes
Limit per non-UK country	-	-	£10m	Yes
Registered providers and registered social landlords	-	-	£10m	Yes
Unsecured investments with building societies	-	-	£10m	Yes
Loans to unrated corporates	-	-	£5m	Yes
Money Market Funds	£42.82m	£6.6m	Unlimited	Yes
Strategic pooled funds	£10m	£10m	£20m	Yes
Real Estate Investment Trusts	-	-	£20m	Yes

Financing costs as a proportion of net revenue stream

Financing costs as a proportion of net revenue stream	30.9.23 Actual
General Fund	-3.15%
HRA	14.68%

Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating 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.

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

Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling one-week period, without additional borrowing.

	30.9.23 Actual	2023/24 Target	Complied?
Total cash available within 1 week	£16.6m	£3m	Yes

Interest Rate Exposures: This indicator is set to control the Authority's 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 Target	Complied?
Upper limit on one-year revenue impact of a 1% rise in interest rates	£0.125m	£1m	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	£0.125m	£1m	Yes

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.

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

Refinancing rate risk indicator	30.9.23 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	5%	20%	0%	Yes
12 months and within 24 months	5%	20%	0%	Yes
24 months and within 5 years	18%	30%	0%	Yes
5 years and within 10 years	39%	40%	0%	Yes
10 years and within 20 years	33%	50%	0%	Yes
20 years and within 30 years	0%	10%	0%	Yes
30 years and within 40 years	0%	10%	0%	Yes

40 years and within 50 years	0%	10%	0%	Yes

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.

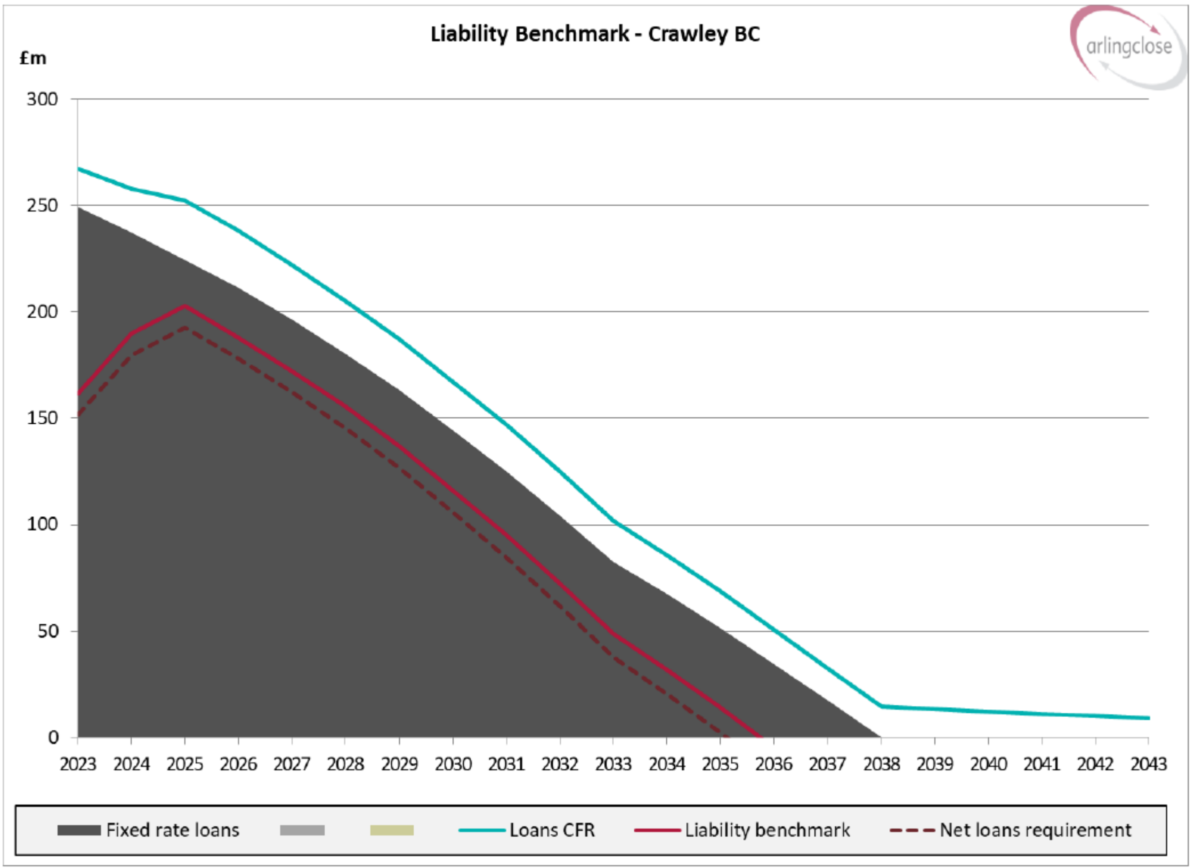
Principal Sums Invested for Periods Longer than a year: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2023/24	**2024/25**	**2025/26**
Actual principal invested beyond year end	£3m	£3m	-
Limit on principal invested beyond year end	£20m	£20m	£20m
Complied?	Yes	Yes	Yes

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 £[X]m required to manage day-to-day cash flow.

£m	**31.3.23 Actual**	**31.3.24 Forecast**	**31.3.25 Forecast**	**31.3.26 Forecast**
Loans CFR	267.3	257.9	252.4	238.4
Less: Balance sheet resources	(115.7)	(78.1)	(59.7)	(60.3)
Net loans requirement	151.6	178.8	192.7	178.1
Plus: Liquidity allowance	10.0	10.0	10.0	10.0
Liability benchmark	**161.6**	**189.8**	**202.7**	**188.1**
Existing borrowing	**249.3**	**237.3**	**224.3**	**211.3**

Following on from the medium-term forecast above, the long-term liability benchmark assumes capital expenditure funded by no future borrowing, minimum revenue provision on new capital expenditure based on a 20 year asset life and income, expenditure and reserves all increasing by inflation of 2.0% p.a. This is shown in the chart below together with the maturity profile of the Authority's existing borrowing.



Liability Benchmark - Crawley BC
£m
300
250
200
150
100
50
0
2023
2024
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2029
2030
2031
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2043
Fixed rate loans
Loans CFR
Liability benchmark
Net loans requirement
arlingclose