Appendix A

Treasury Management Strategy Statement and Annual Investment Strategy

Mid-Year Review 2023/24

Report of Chief Finance Officer

1. Background

Capital Strategy

In December 2021, CIPFA (Chartered Institute of Public Finance and Accountancy) issued revised Prudential and Treasury Management codes. These require all local authorities to prepare a Capital Strategy which is intended to provide the following:

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

A report setting out our Capital Strategy was taken to Council on 22 February 2023.

Treasury Management

The Council operates a balanced budget, which broadly means that cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned with surplus monies being invested in low-risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the treasury management services is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer-term cash may involve arranging long or short-term loans, or using longer term cash flow surpluses, and, on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly, treasury management is defined as:

> "The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2. Introduction

This report has been written in accordance with the requirements of CIPFA's Code of Practice for Treasury Management.

The primary requirements of the Code are as follows:

(i) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

(ii) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

(iii) Receipt by full council of an annual Treasury Management Strategy Statement – including the Annual Investment Strategy and Minimum Revenue Provision Policy – for the year ahead, a Mid-year Review Report and an Annual Report, covering activities during the previous year.

(iv) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

(v) Delegation by the council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Budget and Performance Panel.

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first part of the 2023/24 financial year
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators
- A review of the Council's investment portfolio for 2023/24
- A review of the Council's borrowing strategy for 2023/24
- A review of any debt rescheduling undertaken during 2023/24
- A review of compliance with Treasury and Prudential Limits for 2023/24

3. Economics update (provided by Link Asset Services)

- *The first half of 2023/24 saw:*
  - *Interest rates rise by a further 100 basis points, taking Bank Rate from 4.25% to 5.25% and, possibly, the peak in the tightening cycle.*
  - *Short, medium and long-dated gilts remain elevated as inflation is continually surprised to the upside.*
  - *A 0.5% month on month decline in real GDP in July, mainly due to more strikes.*
  - *CPI inflation falling from 8.7% in April to 6.7% in August, its lowest rate since February 2022, but still the highest in the G7.*
  - *Core CPI inflation declining to 6.2% in August from 7.1% in April and May, a then 31 years high.*
  - *A cooling in labour market conditions, but no evidence yet that it has led to an easing in wage.*
- *The 0.5% month on month fall in GDP in July suggests that underlying growth has lost momentum since earlier in the year. Some of the weakness in July was due to there being almost twice as many working days lost to strikes in July (281,000) than in June (160,000). But with output falling in 10 out of the 17 sectors, there is an air of underlying weakness.*
- *As the growing drag from higher interest rates intensifies over the next six months, we think the economy will continue to lose momentum and soon fall*

into a mild recession. Strong labour demand, fast wage growth and government handouts have all supported household incomes over the past year. And with CPI inflation past its peak and expected to decline further, the economy has got through the cost-of- living crisis without recession. But even though the worst of the falls in real household disposable incomes are behind us, the phasing out of financial support packages provided by the government during the energy crisis means real incomes are unlikely to grow strongly. Higher interest rates will soon bite harder too. We expect the Bank of England to keep interest rates at the probable peak of 5.25% until the second half of 2024. Mortgage rates are likely to stay above 5.0% for around a year.

- *The tightness of the labour market continued to ease, with employment in the three months to July falling by 207,000. The further decline in the number of job vacancies from 1.017m in July to 0.989m in August suggests that the labour market has loosened a bit further since July. The cooling in labour market conditions still has not fed through to an easing in wage growth.*
- *CPI inflation declined from 6.8% in July to 6.7% in August, the lowest rate since February 2022. The biggest positive surprise was the drop in core CPI inflation, which declined from 6.9% to 6.2%. That reverses all the rise since March and means the gap between the UK and elsewhere has shrunk.*
- *In its latest monetary policy meeting on 20 September, the Bank of England left interest rates unchanged at 5.25%. The weak August CPI inflation release, the recent loosening in the labour market and the downbeat activity surveys appear to have convinced the Bank of England that it has already raised rates far enough. The Bank also retained the hawkish guidance that rates will stay "sufficiently restrictive for sufficiently long".*

4. Interest Rate Forecast

The Council's treasury advisor, Link Asset Services, provided the following forecast on 25 September 2023. This sets out a view that, short, medium and long-dated interest rates will be elevated for some little while as the Bank of England seeks to squeeze inflation out of the economy. The PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1st November 2012:

Link Group Interest Rate View	25.09.23												
	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26
BANK RATE	5.25	5.25	5.25	5.00	4.50	4.00	3.50	3.00	2.75	2.75	2.75	2.75	2.75
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.00	2.80	2.80	2.80	2.80	2.80
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.10	2.90	2.90	2.90	2.90	2.90
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.20	3.00	3.00	3.00	3.00	3.00
5 yr PWLB	5.10	5.00	4.90	4.70	4.40	4.20	4.00	3.90	3.70	3.70	3.60	3.60	3.50
10 yr PWLB	5.00	4.90	4.80	4.60	4.40	4.20	4.00	3.80	3.70	3.60	3.60	3.50	3.50
25 yr PWLB	5.40	5.20	5.10	4.90	4.70	4.40	4.30	4.10	4.00	3.90	3.80	3.80	3.80
50 yr PWLB	5.20	5.00	4.90	4.70	4.50	4.20	4.10	3.90	3.80	3.70	3.60	3.60	3.60

5. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy (TMS) for 2023/24, which includes the Annual Investment Strategy was approved by the Council on 22 February 2023. The underlying TMS approved previously requires revision in light of the change in MRP policy. The required changes are reflected in the quarter 2 position reported in Annex A and will be forwarded on to Budget & Performance Panel for consideration and comment then to Full Council for approval.

6. Investment Portfolio

In accordance with the CIPFA Treasury Management Code of Practice the Council's investment priorities are set out 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 and with the Council's risk appetite. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also 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.

Following the Government's fiscal event on 23rd September 2022, both S&P and Fitch have 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 the economic outlook. Nothing further has evoved in the first half of 2023/24.

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

It is noted that sentiment in the current economic climate can easily shift, so it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances.

The average level of funds available for investment purposes over the six-month period was **£32.9M**. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept and business rate related payments, the receipt of grants and progress on the Capital Programme.

In terms of performance against external benchmarks, the return on investments compared to the SONIA (average) and bank rates at the end of the period is as follows. This is viewed as reasonable performance, given the need to prioritise security of investments, and liquidity (i.e. making sure that the Council's cashflow meets its needs):

Base Rate	5.25%
SONIA (average)	4.74%
Lancaster City Council investments	5.07%

Investment Balances – quarter ended 30 September 2023

At the start of the year investments totalled £24.0M rising to £29.9M by 30 September. Fixed term investments rose from £20M to £23M whilst Money Market Fund balances rose from £4M to £6.9M

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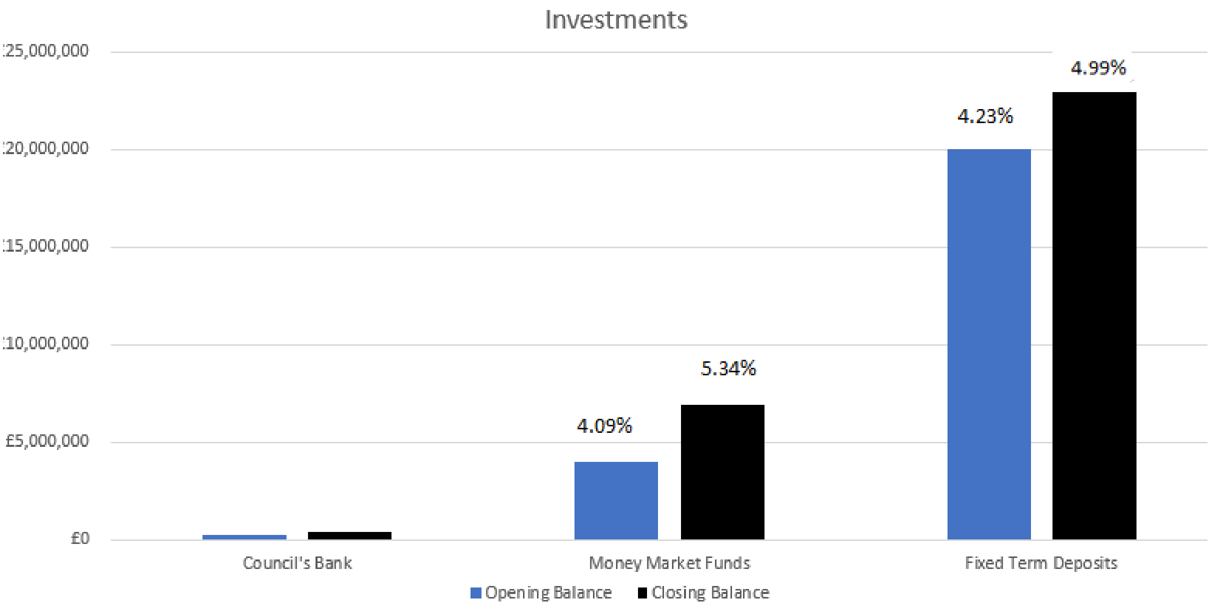
Other Investments	Term	Maturity Date	Opening 1.4.23 £	Closing 3.09.23 £	Indicative Rate (YTD)	Current Fixed Rate	Interest to Date £
Call Accounts							
Natwest (Cash Manager Plus)			244,000	396,500	0.12%		3,797
Money Market Funds							
Aberdeen Life Investments			0	900,000	5.28%		105,515
Blackrock Sterling Liquidity First Fund			4,000,000	0	4.09%		51,739
LGIM			0	6,000,000	5.35%		106,022
Insight			0	0	5.14%		34,512
Goldman Sachs			0	0	5.14%		7,045
Lancashire County Council			0	0	5.00%		2,147
Fixed Term Deposits							
London Borough of Newham	233 days	26/05/2023	5,000,000	0		3.50%	26,370
West Dunbartonshire	184 days	22/11/2023	5,000,000	5,000,000		4.55%	104,979
Halton Borough Council	186 days	20/11/2023	5,000,000	5,000,000		4.50%	104,438
Aberdeen City Council	92 days	03/08/2023	5,000,000	0		4.35%	68,849
Birmingham City Council	213 days	19/01/2024	0	5,000,000		5.05%	71,253
Bradford City Council	184 days	31/01/2024	0	5,000,000		5.50%	46,712
London Borough of Barking & Dagenham	153 days	30/01/2024	0	3,000,000		5.60%	14,729
Sub-total			**24,244,000**	**30,296,500**			**748,107**
						Budgeted income	**433,000**
							315,107



Investment Counterparty criteria

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

Approved Limits

Officers can confirm that, with one exception where funds held in the Council's bank account overnight exceeded the £1.5M specified limit, the approved limits within the Annual Investment Strategy were not breached during the period ended 30th September 2023.

Borrowing

The Council’s capital financing requirement (CFR) for 2023/24 was forecast as £105.97M as set out in **Annex A**. The current forecast CFR at quarter 2 is, however, £108.14M. this is principally due to the impact of the change in the Council’s MRP policy during 2022/23. The CFR denotes the Council’s underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing), or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The Council currently has borrowings of £59.01m and has utilised £49.13m of cash flow funds in lieu of borrowing. This is a prudent and cost-effective approach in the current economic climate but will require ongoing monitoring in the event that any upside risk to gilt yields prevails.

No new external borrowing has, to date, been undertaken. The capital programme is being kept under regular review due to the effects of inflationary pressures, shortages of materials and labour. Our borrowing strategy will, therefore, also be regularly reviewed and then revised, if necessary, in order to achieve optimum value and risk exposure in the long-term.

Gilt yields and PWLB certainty rates were on a generally rising trend throughout the first half of 2023/24. 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.

Rates are forecast to fall back over the next two to three years as inflation dampens and 50 year rates are forecast to stand at 3.9% by the end of September 2025, however, there is a high degree of uncertainty as to whether rates will fall that far.

It is anticipated that further borrowing will need to be undertaken during this financial year. This is currently in the region of £15.5M, however, the potential for slippage & uncertainty regarding the progress of some schemes under development make this difficult to quantify with certainty and the actual amount of borrowing may be lower. Consideration also needs to be given to the recent volatility in the markets leading to PWLB interest rates being in excess of 5% at the time of writing. In light of this it may be prudent to delay borrowing or consider the use of short-term borrowing as an interim measure.

7. Debt Rescheduling

Debt rescheduling opportunities have increased over the course of the past six months and will be considered if giving rise to long-term savings. However, no debt rescheduling has been undertaken to date in the current financial year.

8. Compliance with Treasury and Prudential Limits

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the half year ended 30th September 2023, the Council has operated within the treasury and prudential indicators set out in the Council’s Treasury Management Strategy Statement for 2023/24. The amendments to the Treasury Management Strategy for 2023/24 are reflected in the quarter 2 position set out at Annex A and will be passed on the Budget & Performance panel for consideration and comment then presented to Dull Council for approval. The Chief Finance Officer reports that no difficulties are envisaged for the current or future years in complying with these indicators.

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

9. Other Issues

Changes in risk appetite

The 2021 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or to other types of investment instruments this change in risk appetite and policy should be brought to members' attention in treasury management update reports. There are no such changes to report.

ANNEX A

PRUDENTIAL INDICATORS - MID YEAR REVIEW

Prudential Indicator for Capital Expenditure

This table shows the current estimates for the General Fund and Housing Revenue Account capital programmes, compared to the original estimates.

Capital Expenditure by Fund	2023/24 Original Estimate £m	2023/24 Quarter 2 Position £m
General Fund	19.61	23.97
Council Housing (HRA)	6.20	7.22
Total Capital Expenditure	**25.81**	**31.19**

Changes to the Financing of the Capital Programmes

This table shows the changes in the financing of the capital programme and the level of borrowing required.

Capital Expenditure	2023/24 Original Estimate £m	2023/24 Quarter 2 Position £m
Total capital expenditure	**25.81**	**31.19**
Financed by:		
Capital receipts	1.52	1.53
Capital grants	8.25	10.54
Reserves	2.77	4.77
Revenue	2.21	2.55
Total Financing	**14.75**	**19.39**
Borrowing Requirement	**11.06**	**11.80**

Changes to the Capital Financing Requirement

Capital Financing Requirement	2023/24 Original Estimate £m	2023/24 Quarter 2 Position £m
General Fund	71.87	74.05
HRA	34.10	34.09
Total Capital Financing Requirement	**105.97**	**108.14**
Net movement in CFR	**3.47**	**2.17**

Limits to Borrowing Activity

A key control over treasury management activity is to ensure that over the medium term, net borrowing (borrowings less investments) will only be for capital purposes. Gross external borrowing should not, except in the short term, exceed the total capital financing requirement.

External Debt v Borrowing Need (CFR)	2023/24 Original Estimate £m	2023/24 Quarter 2 Position £m
External Debt	59.01	59.01
Expected Change in Other long term liabilities	14.46	14.46
Total Debt	**73.47**	**73.47**
Compared to current :		
Capital Financing Requirement	**105.97**	**108.14**
Operational Boundary:-		
Debt	**106.96**	**109.14**
Authorised Limit:-		
Debt	**122.00**	**124.00**

Definitions:

Operational Boundary

The limit beyond which external debt is not normally expected to exceed is known as the operational boundary.

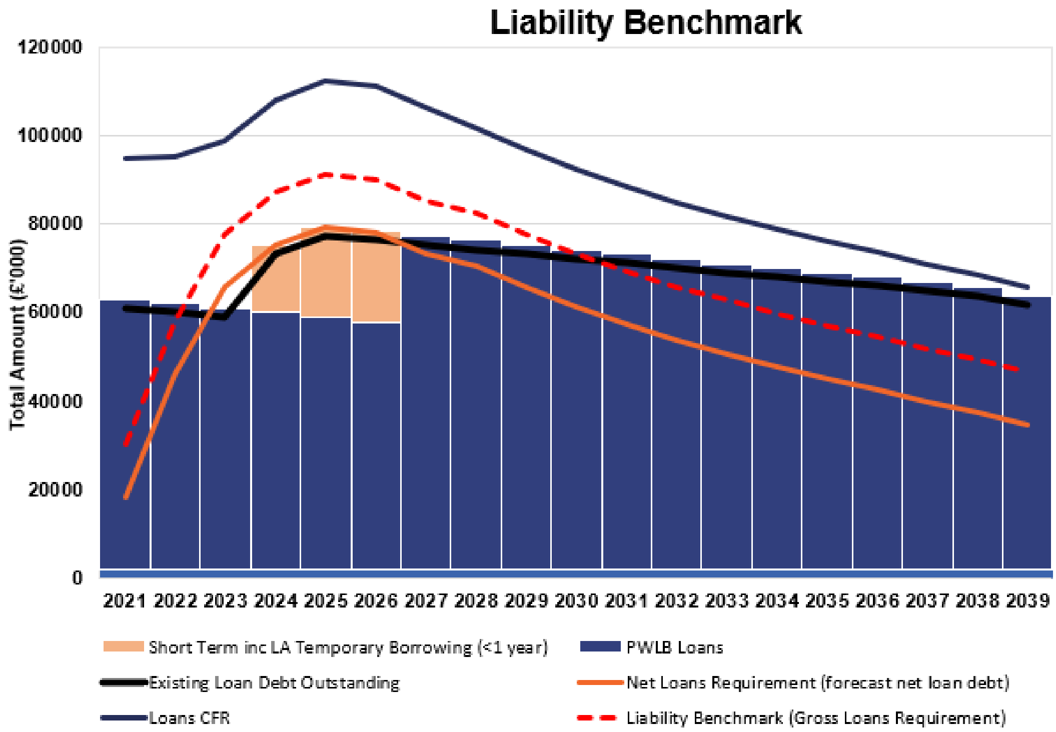
Authorised Limit for External Debt

A further prudential indicator controls the overall level of borrowing. This is the authorised limit which represents the limit beyond which borrowing is prohibited. It reflects the level of borrowing which, whilst not desired, could be afforded in the short term, but it is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements.

Liability Benchmark

The Council's liability benchmark reflecting the mid-year position is set out below. This charts the following four key components:

1. **Existing loan debt outstanding**: the Authority's existing loans that are still outstanding in future years.
2. **Loans CFR**: this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned MRP.
3. **Net loans requirement**: this will show the Authority's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned MRP and any other major cash flows forecast.
4. **Liability benchmark** (or gross loans requirement): this equals net loans requirement plus short-term liquidity allowance.



Liability Benchmark
120000
100000
80000
60000
40000
20000
0
Total Amount (£'000)
2021 2022 2023 2024 2025 2026 2027 2028 2029 2030 2031 2032 2033 2034 2035 2036 2037 2038 2039
Short Term inc LA Temporary Borrowing (<1 year)
PWLB Loans
Existing Loan Debt Outstanding
Net Loans Requirement (forecast net loan debt)
Loans CFR
Liability Benchmark (Gross Loans Requirement)