Cheltenham Borough Council

Cabinet – 5th December 2023/Council 11th December

2023/24 Treasury Mid-term Report – position at 30th September 2023

Accountable member:

Cllr Peter Jeffries – Cabinet Member for Finance and Assets

Accountable officer:

Gemma Bell - Director of Finance and Assets (Deputy Section 151 Officer)

Accountable scrutiny committee:

Treasury Management Panel

Ward(s) affected:

All

Key/Significant Decision:

No

Executive summary:

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities for the first six months of this financial year and highlights compliance with the Council's policies previously approved by members in March 2023. The Treasury Management Strategy for 2023/24 has been determined by the adoption of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the council to approve treasury management semi-annual and annual

reports.

Recommendations: That Council:

- **considers and notes the contents of this summary report of the treasury management activity during the first six months of 2023/24.**

---

1. Main Points

1.1. On 20 March 2023, Council approved the Authority's treasury management strategy for 2023/24. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Council's treasury management strategy.

1.2. General Fund borrowing costs in the first 6 months to 30th September 2023 are higher than forecast in 2023/24 budget, showing an expected overspend for the year £516,809 due to the Bank Rate being 1% higher than predicted in November 2022.

1.3. Investment interest is expected to be slightly down by £38,000 against the estimated budget for 2023/24. The capital value of pooled funds continues to be affected by prevailing economic conditions in the world markets. Overall pooled funds have an unrealised capital loss of £959,669 or 13.71%. A breakdown of the fund's performance is shown in section 5.7 table 5.

1.4. The Council complied with all the Prudential Indicators for 2023/24 as set in the budget by Council in March 2023.

2. Economic Background

2.1. The 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.

2.2. Inflation continued to fall from its peak as annual headline CPI declined to 6.7% in August 2023, remaining the same 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%.

2.3. 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.

2.4. 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.

2.5. 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.

2.6. July data showed the unemployment rate increased to 4.3% (3mth/year). 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.

3. Credit review

3.1. 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 2023, 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 being reported on.

3.2. 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.

3.3. Arlingclose continued to monitor and assess credit default swap levels for signs of credit stress but made no changes to the counterparty list or recommended durations. 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.

4. Treasury Management Summary position as of 31st March 2023

4.1. On 31st March 2023, the Authority had net borrowing of £166.328m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.23 Actual £m
General Fund CFR	125.425
HRA CFR	66.715
Total CFR	**192.140**
External borrowing	179.111
Less : Internal borrowing	(12.000)
Less: Usable reserves	(13.003)
Less: Working capital	(0.680)
Add: Treasury Investments	12.900
Net borrowing	**166.328**

Borrowing

4.2. CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the Authority.

4.3. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield and this Authority intends to avoid this activity in order to retain its access to PWLB loans.

4.4. As outlined in the treasury strategy, the Authority's chief objective when borrowing has been 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.

4.5. UK gilt yields were volatile, mainly facing upward pressure since early April following signs that UK growth had been more resilient, inflation stickier than expected, and that the Bank of England saw persistently higher rates through 2023/24 as key to dampening domestic demand.

4.6. There was a substantial rise in the cost of both short- and long-term borrowing over the last 18 months. Bank Rate rose by 1% from 4.25% at the beginning of April to 5.25% at the end of September.

4.7. PWLB borrowing rates, rose and broadly remained at elevated levels. On 30th September 2023, the PWLB certainty rates for 50-year loans were at 5.43%. Their equivalents on 31st March 2023 were 4.41% respectively.

Table 2: Treasury Management Summary

			31.3.23 Balance £m	Movement £m	30.9.23 Balance £m	30.9.23 Rate %
Long-term borrowing Short-term borrowing			116.111 63.000	(0.779) 3.100	115.332 66.100	3.15 5.20
Total borrowing			**179.111**	**2.321**	**181.432**	**3.90**
Long-term investments Short-term investments Cash and cash equivalents			7.878 0.000 4.905	6.868 0.000 0.335	14.746 0.000 5.240	5.28 - 5.24
Total investments			**12.783**	**7.203**	**19.986**	**5.02**
Net borrowing			**166.328**	**(4.882)**	**161.446**	

4.7. The balance as can be seen in Table 2 shows a reduced figure of £161.446m as of 30th September 2023 compared with the balance held on 1st April 2023 due to further investment loans to the airport, during 2023. Short-term borrowing costs have risen significantly due to the higher interest rates than what was expected back in November 2022, and are now expected to be £843k higher than budgeted. The Housing Revenue Account (HRA) will re-imburse the General Fund £326,879 for their share of the debt costs, which will see a re-alignment to the revised budget for 2023/24.

4.8. Current temporary borrowing of £66.1m has been used over several years to fund capital expenditure as an alternative to taking out longer term borrowing which was much more expensive at the time. Although temporary borrowing is much more expensive now, long-term borrowing is still 60-80 basis points more expensive. In time we believe rates will start to fall next year, and the Council will liaise with Arlingclose first before any changes in strategy are required.

4.9. The outstanding loans on 30th September 2023 are summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.23 Balance £m	2023/24 Movement £m	30.9.23 Balance £m	30.9.23 Rate %
Public Works Loan Board	102.211	(0.779)	101.432	3.06
Banks (LOBO)	7.000	(2.000)	5.000	3.95
Banks (fixed-term)	8.900	0	8.900	3.82
Local authorities (short-term)	61.000	5.100	66.100	5.20
Total borrowing	**179.111**	**2.321**	**181.432**	**3.90**

4.10. LOBO loans: The Authority currently holds £5m 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 or to repay the loan at no additional cost. Bayerische Landesbank loan of £2m was repaid in September 2023 when it opted to raise the rate on the loan from 4.99% to 6.99%. The council exercised its rights to repay the loan early without any premiums due.

5. Investments

5.1. The CIPFA Treasury Management Code now defines treasury management investments as those investments which arise from the Authority's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use during business.

5.2. The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the six-month period the council's investment balance ranged between £14m and £25m due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.23 Balance £m	Net Movement £m	30.9.23 Balance £m	30.9.23 Rate of Return %
Money Market Funds/ Call Accounts	4.905	(9.405)	3.704	1.76
Pooled Funds	7.000	-	7.000	4.40
Other investments	8.886	3.225	9.282	5.39
Total Investments	**20.791**	**(6.180)**	**19.986**	**5.02**

5.3. Both the CIPFA Code and Government Guidance require the Council 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 Council'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.

5.4. As demonstrated by the liability benchmark in this report, the Authority expects to be a long-term investor and treasury investments therefore include both short-term low risk instruments to manage day-to-day cash flows and longer-term instruments where limited additional risk is accepted in return for higher investment income to support local public services.

5.5. 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%. Investment income was budgeted to be £1.176m in the Council's 2023/24 budget, set in February 2023. The Council has reviewed its expectations for investment income in 2023/24 and has assumed after looking at the returns over the first 6 months that the income could be lower by £16k, so the revised budget will be amended in line with the expected fall. This was due to investment balances being lower than expected as the treasury team were using cash balances to reduce day to day borrowing for cashflow purposes.

5.6. £7m of the Authority's investments are held in externally managed strategic pooled equity, multi-asset and property funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds have generated an average total return of 4.40% for the first 6 months of this financial year which is used to support services in year. Because the Council's externally managed funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives are regularly reviewed. 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 rate.

5.7. Table 5: Pooled Funds

FUND NAME	Initial Investment	1 April 2023 Fund Value	30th Sept 23 Fund Value	Dividends paid out in 2023/24 as at 30 Sept	Gain / (Loss) for 2023/24	Gain / (Loss) to Initial Principal
	£	£	£	£	£	£
CCLA Property Fund	3,000,000	2,704,632	2,673,658	67,650	(30,974)	(326,342)
Schroders Income Maximiser Fund *	2,000,000	1,528,554	1,488,630	68,731	(39,924)	(511,370)
CCLA Diversified Income Fund	2,000,000	1,884,988	1,878,043	36,778	(6,945)	(121,957)
Total	**7,000,000**	**6,118,174**	**6,040,331**	**173,159**	**(77,843)**	**(959,669)**

* The Schroders Income Maximiser Fund has purchased shares within the oil and gas industry, which accounts 6.01% of the total amount invested in the fund (8.65% Sept 2022). This equates to £120,200 of the original £2m invested into the fund by this council (£173,000 Sept 2022). The Fund Manager is looking to ease out of investing within the oil and gas industries which has reduced from 14% in September 2021. The dividend returns are currently returning over 6.8%. There are no plans at present to sell this investment as the fund is valued below the initial investment, which would need to be funded by revenue. As opportunities to support the climate ambitions of the Council arise, they will be considered. However, the treasury management function is controlled by statute and by professional guidelines and the first priorities of treasury must remain security, liquidity, and yield.

Economic Outlook for the rest of 2022/2023

5.8. Table 7: Interest rate 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
Arlingclose 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

Arlingclose now expects Bank Rate to have peaked at 5.25% but near-term rate cuts are unlikely, although downside risks will increase as the UK economy likely slides into recession and inflation falls more quickly.

5.9. The much-repeated message from the MPC is that monetary policy will remain tight as inflation is expected to moderate to target only slowly. In the Bank's forecast, wage and services inflation, in particular, will the keep CPI above the 2% target until 2026.

5.10. Inflation is expected to fall over the next 12 months. The path to the target will not be smooth, with higher energy prices and base effects interrupting the downtrend at times. The MPC's attention will remain on underlying inflation measures and wage data. Arlingclose believe policy rates will remain at the peak for another 10 months, or until the MPC is comfortable the risk of further 'second-round' effects has diminished.

5.11. Arlingclose expects long-term gilt yields to eventually fall from current levels (amid continued volatility) reflecting the lower medium-term path for Bank Rate. However, yields will remain relatively higher than in the past, due to quantitative tightening and significant bond supply. This will have an impact on long-term PWLB rates and other lenders going forward, and after consulting with Arlingclose, the council may look to take out long-term borrowing if the time and rates fit within the business plans.

6. Compliance

6.1. The Director of Finance and Assets reports that all treasury management activities undertaken during the first six months of 2023/24 complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy.

Table 8: Debt Limits

	30.9.23 Actual £m	2023/24 Operational Boundary £m	2023/24 Authorised Limit £m	Complied? Yes/No
Total debt	**181.432**	***262.000***	**274.000**	Yes

Council approved in March 2023 the authorised borrowing limit and operational boundary limit are increased to the new levels as shown above in table 8. 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.

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	2022/23 Target	Complied?
Portfolio average credit rating	A+	A-	Yes

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. This indicator covers the risk of replacement loans being unavailable, not interest rate risk. The upper and lower limits on the maturity structure of all borrowing were:

	30.9.23 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	38.53%	50%	0%	YES
12 months and within 24 months	0.78%	50%	0%	YES
24 months and within 5 years	0.79%	100%	0%	YES
5 years and within 10 years	7.45%	100%	0%	YES
10 years and above	52.45%	100%	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.

Liability Benchmark - This new indicator compares the Council'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 £10m required to manage day-to-day cash flow.

	31.3.23 Actual £m	31.3.24 Forecast £m	31.3.25 Forecast £m	31.3.26 Forecast £m
Loans CFR	192.140	211.700	233.100	257.000
External borrowing	179.111	117.600	116.100	114.700
Internal (over) borrowing	13.029	94.100	117.000	142.300
Less: Balance sheet resources	(25.683)	(25.683)	(25.683)	(25.683)
Investments (new borrowing)	12.900	(68.417)	(91.317)	(116.617)
Net loans requirement	167.328	186.017	207.417	231.317
Plus: Liquidity allowance	10.000	10.000	10.000	10.000
Liability benchmark	**177.328**	**196.017**	**217.417**	**241.317**
Existing Net Borrowing	**161.446**			

7. Consultation

7.1. Arlingclose the Council's treasury advisors have supported officers in preparing the treasury activities over the first 6 months of this financial year.

---

8. Implications

8.1. Financial implications

As detailed throughout this report.

Signed off by: Gemma Bell, Director of Finance and Assets (Deputy s151 Officer), 01242 264124

8.2. Legal implications

None arising from the report recommendations.

Signed off by: One Legal legalservices@onelegal.org.uk

8.3. HR implications

None arising from the report recommendations.

8.4. Environmental and climate change implications

The Council does have some exposure to investments in a pooled fund which has shares with oil and gas companies. This is detailed in Section 5.7 of the report. As a responsible investor, the Council is committed to considering environmental, social, and governance (ESG) issues, and has a particular interest in taking action against climate change and pursuing activities that have a positive social impact.

Signed off by: Louise Forey, Climate Emergency Programme Officer, 01242 264297

8.5. Property/asset implications

None specific directly arising from the recommendations.

Signed off by: Gemma Bell, Director of Finance and Assets, 01242 264124

8.6. Corporate policy framework implications

Taking action to ensure overspends are reduced as far as possible by the end of the financial year will help ensure that the council can continue to deliver its corporate objectives as set out in the 2019-2023 Corporate Plan.

Signed off by: Richard Gibson, Head of Communities, Wellbeing and Partnerships, 01242 264280

9. Performance management – monitoring and review

9.1. The budget position will continue to be monitored by the Finance team throughout the year and a revised budget will be presented to the December Cabinet with the 2024/25 draft budget proposal.

Report author:

Andrew Sherbourne, Capital and Treasury Management Accountant

Appendices:

1. Risk Assessment

Appendix 1: Risk Assessment

Risk ref	Risk description	Risk owner	Impact score (1-5)	Likelihood score (1-5)	Initial raw risk score (1 - 25)	Risk response	Controls / Mitigating actions	Control / Action owner	Deadline for controls/ actions
	LOBO Loans - If £5m of these loans is recalled by the banks if they choose to exercise their option then we would need to have the resources on the day to repay. Alternative borrowing arrangements at today's current rates would be favourable for the Council	Gemma Bell, Director of Finance and Assets	1	2	2	Accept and Monitor	If the loans are recalled the council could take out temporary borrowing/ new long term borrowing through the PWLB or sale of units held in Pooled Funds. Any capital receipts available could also be used to repay debt.	Gemma Bell, Director of Finance and Assets	Ongoing
	If the assumptions made within the strategies change, then the aspirations within the capital programme may become unaffordable	ED Finance and Assets	3	2	6	Accept and Monitor	The Treasury Management Strategy and Prudential and Treasury Indicators reflect various assumptions of future interest rate movements and Government support for capital expenditure. These will be continually monitored and any necessary amendments will be made in accordance with the Strategy	ED Finance and Assets	Ongoing
	If the assumptions made within the strategies change, then the projected returns and the return of the initial investments may not be	ED Finance and Assets	3	2	6	Accept and Monitor	The Treasury Management Strategy and Prudential and Treasury Indicators reflect various	ED Finance and Assets	Ongoing

Risk ref	Risk description	Risk owner	Impact score (1-5)	Likelihood score (1-5)	Initial raw risk score (1 - 25)	Risk response	Controls / Mitigating actions	Control / Action owner	Deadline for controls/ actions
	received.						assumptions of future interest rate movements and Government support for capital expenditure. These will be continually monitored and any necessary amendments will be made in accordance with the Strategy		
	If thorough due diligence is not undertaken when pursuing PRS schemes, the Council may not meet all of the criteria set out within its capital and investment strategies.	ED Finance and Assets	4	2	8	Accept & Monitor	Due diligence is of paramount importance. All of our investments have individual business cases that are subject to thorough risk assessment and stress testing and we also stress test the whole housing to ensure all risks are captured and properly controlled. Where appropriate to the size and scale of the project we also commission independent technical, legal, accounting, risk management, property, taxation advice	ED Finance and Assets	Ongoing