Appendix 1

Treasury Management Mid-Year Review 2023/24

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1. INTRODUCTION AND BACKGROUND

The Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management 2009 was adopted by this Council in February 2010 and this Council fully complies with its requirements. The Code was revised in 2011 and further revised in 2017.

The primary requirements of the Code are as follows:

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

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

3. Receipt by the Council of an annual treasury management strategy report (including the annual investment strategy and minimum revenue provision report) for the year ahead, a mid-year review and an annual review report of the previous year.

4. 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, which in this Council is the Chief Officer Resources.

5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specified named body which in this Council is the Corporate Overview & Performance Scrutiny Committee.

Treasury management in this context is defined as:

"The management of the local authority's 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."

The purpose of this report is to meet one of the above requirements of the CIPFA Code, namely the mid-year review report of treasury management activities, for the financial year 2023/24

This Treasury Management Mid-Year Review Report Covers

- Economic Background during the period
- Interest Rate Forecast
- Treasury Advisors
- The Council's treasury position as of 30 September 2023;
- Borrowing and investment rates for the first half of 2023/24;
- Mid-year review of the borrowing strategy 2023/24;
- Borrowing outturn for the first half of 2023/24;
- Debt rescheduling for the first half of 2023/24;
- Compliance with treasury limits and Prudential Indicators for the first half of 2023/24;
- Mid-year review of the investment strategy for 2023/24;
- Investment outturn for the first half of 2023/24;
- Other treasury management issues.

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2. ECONOMICS UPDATE

The following information has been received from our Treasury Management advisors.

- The first half of 2023/24 saw:

  - 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.

  - Interest rates rise by a further 100 basis points (bps), taking Bank Rate from 4.25% to 5.25% and, possibly, the peak in the tightening cycle.

- As the growing drag from higher interest rates intensifies over the next six months, it seems likely thatthe 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. With CPI inflation past its peak and expected to decline further, the economy has got through the cost-of- living crisis without recession.

- 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.

- The tightness of the labour market began 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.

- Currently the central assumption is that inflation will drop to the 2.0% target only if the Bank of England (the Bank) keeps interest rates at the probable peak of 5.25% until the second half of 2024.

3. INTEREST RATES FORECAST

The Council has appointed Link Group as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. The Public Works Loan Board (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.

The latest forecast (25th September 2023) sets out a view that short, medium, and long-dated interest rates will be elevated until Summer 2024, as the Bank of England seeks to squeeze inflation out of the economy.

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The forecasts have levelled out during the quarter, 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.

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

- LIBOR and LIBID rates ceased at the end of 2021. In a continuation of previous views, money market yield forecasts are based on expected average earnings by local authorities for 3 to 12 months.

- The forecast for earnings are averages, actual rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short-term cash at any one point in time.

An Overview of the Future Path of Bank Rate

- The central forecast for interest rates reflected a view that the Monetary Policy Committee (MPC) wants the markets to believe in the higher for longer narrative. The statement did not say that rates have peaked and once again said if there was evidence of more persistent inflation pressures "further tightening in policy would be required". Governor Bailey stated, "we'll be watching closely to see if further increases are needed". The Bank also retained the hawkish guidance that rates will stay "sufficiently restrictive for sufficiently long".

- This narrative makes sense as the Bank of England does not want the markets to decide that a peak in rates will be soon followed by rate cuts, which would loosen financial conditions and undermine its attempts to quash inflation. The language also gives the Bank of England the flexibility to respond to new developments. A rebound in services inflation, another surge in wage growth and/or a further leap in oil prices could conceivably force it to raise rates at the next meeting on 2nd November, or even pause in November and raise rates in December.

- Moreover, it is still anticipated that the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures are behind us – but timing on this will remain one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged. Link's current judgment is that rates will have to stay at their peak until the second quarter of 2024 as a minimum.

- In the upcoming months, the forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but also international factors such as policy development in the US and Europe, the provision of fresh support packages to support the faltering recovery in China as well as the on-going conflict in Israel.

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- On the positive side, consumers are still estimated to be sitting on excess savings left over from the pandemic, which could cushion some of the impact of the above challenges and may be the reason why the economy is performing somewhat better at this stage of the economic cycle than may have been expected. However, most of those excess savings are held by more affluent people whereas lower income families already spend nearly all their income on essentials such as food, energy, and rent/mortgage payments.

PWLB Rates

- The yield on 10-year Gilts fell from a peak of 4.74% on 17th August to 4.44% on 29th September, mainly on the back of investors revising down their interest rate expectations.

- PWLB 5 to 50 years Certainty Rates are, generally, in the range of 5.10% to 5.30%.

- Looking forward, once inflation falls back, Gilt yields are set to reduce further. A (mild) recession over the next couple of quarters will support this outlook if it helps to loosen the labour market (higher unemployment/lower wage increases).

The balance of risks to the UK economy: -

- The overall balance of risks to economic growth in the UK is to the downside.

Downside risks to current forecasts for UK gilt yields and PWLB rates include:

- Labour and supply shortages prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, the rising gilt yields we have seen of late).

- The Bank of England increases Bank Rate too fast and too far over the coming months, and subsequently brings about a deeper and longer UK recession than we currently anticipate.

- UK / EU trade arrangements – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.

- Geopolitical risks, for example in Ukraine/Russia, Israel, China/Taiwan/US, Iran, North Korea, and Middle Eastern countries, which could lead to increasing safe-haven flows.

- A broadening of banking sector fragilities, which have been successfully addressed in the near-term by central banks and the market generally, but which may require further intervention if short-term interest rates stay elevated for longer than is anticipated.

Upside risks to current forecasts for UK gilt yields and PWLB rates:

- Despite the recent tightening by 1%, the Bank of England proves too timid in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to remain elevated for a longer period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project.

- The pound weakens because of a lack of confidence in the UK Government's fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.

- Longer-term US treasury yields rise strongly if inflation remains more stubborn than the market currently anticipates, pulling gilt yields up higher consequently.

- Projected gilt issuance, inclusive of natural maturities and Quantitative Tightening (QT), could be too much for the markets to comfortably digest without higher yields compensating.

4. TREASURY ADVISORS

The Council uses external treasury management advisors. The Council recognizes that responsibility for Treasury Management decisions always remains with the Authority and will ensure that undue reliance is not placed upon our external service providers.

It also recognizes that there is value in employing external providers of treasury management services to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented and subjected to regular review.

The Council retendered for the provision of Treasury Management advisory services during 2022. This resulted in the appointment of Link Asset Services for a period of two years from 1st May 2022 until 30th April 2024, with an option to extend for a further two years at 12-month intervals.

5. TREASURY POSITION AS AT 30 SEPTEMBER 2023

The Council's debt and investment position at the beginning of the year and the end of the half year was as follows:

The table illustrates that the total debt outstanding as of 30 September 2023 was £193.8 million, comprising of long-term debt of £162.4 million and short-term debt of £31.4 million.

	31March 2023 Principal	Average Rate/ Return	30Sept 2023 Principal	Average Rate/ Return	Increase/ (Decrease) in Borrowing
	£000		£000		£000
Fixed Rate Funding:					
- PWLB	71,147	4.02%	70,388	4.02%	(759)
- Market Loans	18,000	1.26%	12,000	1.26%	(6,000)
Variable Rate Funding:					

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- Market (LOBO *)	4,000	4.50%	4,000	4.50%	0
Interest Free Loans:					
Welsh Government	75,970	0.00%	75,970	0.00%	0
Total Long-Term Debt	***169,117***	***3.53%***	***162,358***	***3.53%***	***(6,759)***
Short Term Loans (<365 days)	48,365	1.67%	31,400	2.96%	(16,965)
Total Debt	**217,482**	**2.42%**	***193,758***	***3.69%***	***(23,724)***
Investments:					
- Short Term	66,000	1.22%	38,000	4.49%	(28,000)
Total Investments	***66,000***		***38,000***		***(28,000)***

** LOBO – Lenders Option Borrowers Option. This loan has a fixed rate for the first two years of 3.85%. The remaining period of the loan (which we are now in) has a rate of 4.5%, but the lender can increase this rate at six-month intervals.*

The Rail and Town Centre Loans have not been included in the average interest rate calculation as they are interest free loans from the Welsh Government.

6. BORROWING AND INVESTMENT RATES IN 2023/24

The following table displays a selection of interest rates prevailing as 1 April 2023 and 30 September 2023.

	01/04/2023	30/09/2023
Bank Base Rate	4.25%	5.25%
1 Month SONIA	4.17%	5.20%
PWLB 10-year Maturity	4.50%	5.45%
PWLB 15-year maturity	4.74%	5.70%
PWLB 25-year maturity	4.86%	5.86%

7. MID YEAR REVIEW OF THE BORROWING STRATEGY FOR 2023/24

The Treasury Management Strategy Statement for 2023/24 was approved by Council in March 2023. The Borrowing Strategy adopted as part of this was as follows:

To utilise the Authority's overdraft facility:
To fund unexpected daily cash deficits;
To fund temporary cash shortfalls where there are no other sources of funding available within the marketplace.

To borrow over the short term:
To fund temporary cash shortfalls;

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To maintain a suitably balanced maturity profile; to make short term savings required in order to meet budgetary constraints;
In anticipation of securing longer term loans at more attractive rates.

To borrow over the long term:
To reduce the Authority's average cost of borrowing;
To maintain a stable, longer-term portfolio;
To maximise the potential for future debt rescheduling.

If appropriate to avoid all new external borrowing:
To maximise savings in the short term;
To run down temporary investment levels;
To minimise exposure to interest rate and credit risk.

Borrowings undertaken during the period (see section 7 below) have been done so in accordance with this strategy and has focused on short term borrowings to minimize borrowing costs. Current short-term borrowing rates continue to be very low, however are likely to increase following the forecast increases to the Bank of England Base Rate. The Authority is therefore taking advantage of such rates and is predominantly borrowing short term where necessary to fund the remainder of its capital expenditure and maturing debt until such time the market indicates that long term rates are more advantageous. In March 2021 the Welsh Government awarded the Authority an interest free specific loan in relation to the Rail Track project, whilst this has resulted in an increase to the level of the Council's longer-term debt this resource has reduced the need to borrow externally in the first half of the 2023/24 financial year.
In the current economic climate, it is considered that the approved strategy is still fit for purpose and therefore no revisions are proposed.

8. BORROWING OUTTURN FOR THE FIRST HALF OF 2023/24

Long Term Borrowing

Definition

Long term borrowing relates to debt taken out for a period of greater than one year. It is taken out for periods of 1 year up to 50 years. This borrowing is required to finance capital expenditure undertaken in the year that is funded through:

- Borrowing approvals from Welsh Government, known as un-hypothecated supported borrowing (USB), for which revenue support for the borrowing costs is provided through the revenue support grant.
- Prudential borrowing, for which borrowing costs are funded through revenue savings.

Total outstanding as of 30th September 2023

The total long-term debt outstanding as of 30th September 2023 was £162.4 million. This is made up of debt taken from the Public Works Loan Board (PWLB), from other local authorities (through the marketplace), Specific Welsh Government Loans and from the market (LOBO). This debt is due to be repaid within the following years:

Maturing Within	£000s
1YR	2,909
1-2YRS	8,764
2-3YRS	15,451
3-4YRS	15,277
4-5YRS	12,609

5-6YRS	**6,037**
6-10YRS	**19,980**
10-15YRS	**9,570**
15+ YRS	**78,854**
Total	**162,358**

New borrowings for the First Half of 2023/24

No new long-term borrowing has been undertaken during this financial year. The Authority has repaid £6m of market loans during the first half year, however these have not been replaced with long term borrowing.

Due to the current elevated level of interest rates, the Council is not planning to undertake any long-term borrowing but will instead borrow in the short-term for re-financing of long-term debt or for cash flow purposes, due to the expectation that interest rates will begin to fall during 2024.

This situation will be monitored closely by the Treasury Management section, who will plan the future borrowing requirement of the Council in line with forecast interest rates.

Short Term Borrowing

Definition

Short term borrowing relates to debt taken out for a period of less than one year i.e. it will all be fully repaid within a year. These short-term loans are taken out to manage the Authority's short term cash flow i.e. to fund deficits in daily cash flow, pending receipt of income from grants or other sources, or pending the taking out of longer-term debt to fund capital expenditure whilst we wait for advantageous longer term borrowing opportunities. Current short-term borrowing rates are very low and are forecast to stay at these levels for the short term. The Authority is therefore taking advantage of such rates and is borrowing short term to fund its capital expenditure and maturing debt until such time the market indicates that long term rates are more advantageous.

Total outstanding as of 30th September 2023

The total short-term debt outstanding as of 30th September 2023 was £31.4 million. This is made up of debt taken from other local authorities through the marketplace.

New borrowings for the First Half Year of 2023/24

Appendix B lists the short-term loan activity during the year and shows that over the period a total of £48.365 million loans were brought forward from the previous year and £24 million of new short-term loans were raised. A total of £41 million of these loans have been repaid during the year (including the brought forward loans), leaving a balance outstanding as of 30 September 2023 of £31.4 million. The increase in short-term loans can be attributed to the repayment of a longer-term loan in July, subsequently re-financed with a short-term loan.

The following table gives a summary which shows that the average rate of interest paid was well within the benchmark. However, this is due to the Council entering into short-term borrowing when interest rates were low. With the current high level of interest rates, further borrowing will exceed the benchmark rate. This is still seen as the preferred option of borrowing, instead of entering long-term borrowing now when rates are expected to fall during 2024.

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	Total Value of Loans during the period	Average Loan	Interest due during the period	Average Interest Rate	Benchmark Interest Rate *
Short Term borrowing	£208.5m	£4m	£520,717	2.43%	4.50%

** Benchmark = budgeted interest rate for new borrowings 4.50%*

As shown in section 12, the Council has exceeded its investment returns target for the financial year. It is anticipated that any additional investment interest received will offset the increased cost of borrowing anticipated throughout the remainder of the financial year, due to the current and forecast interest rates above the benchmark rate.

9. DEBT RESCHEDULLING

Debt rescheduling opportunities have increased significantly in the first half year where gilt yields, which underpin PWLB rates and market loans, have risen materially. Members will be advised if there is value to be had by rescheduling or repaying a part of the debt portfolio.

No debt rescheduling has been undertaken during the financial year.

10. COMPLIANCE WITH TREASURY LIMITS

During the financial year the Council operates within the treasury limits and Prudential Indicators set out in the Treasury Strategy Statement 2023/24, approved by Council in March 2023.

Operational Boundary for external debt

The Council resolved that this limit be set at £225.8 million for 2023/24. The average level of borrowings to the 30th of September 2022 was £183.1 million, this is well below the limit.

The operational boundary can be exceeded on an occasional basis, and this is to be expected due to cash flow fluctuations. Sustained breaches, however, would indicate that either the limit has been set too low, or that the Authority is breaching its prudential boundaries, and that corrective action needs to be taken.

Monitoring of the operational boundary is undertaken daily, and any such continual breaches would be investigated, and a recommended course of action reported to Council.

Authorised Limit for external Debt

The Council resolved that this limit be set at £248.4million for 2023/24. The Authorised Limit is set having regard to the operational boundary above.

The average level of borrowings for the first half year to the 30th of September 2023 was £183.1 million, so well within the limit set.

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The Authorised Limit must not be breached.

Maturity Structure of Fixed Rate Borrowing

The Council resolved the following limits for the maturity structure of fixed rate borrowings for 2022/23;

	Upper Limit	Lower Limit	Actual as at 30/09/2023
under 12 months	20%	0%	5.18%
12 months and within 24 months	20%	0%	9.14%
24 months and within 5 years	50%	0%	20.06%
5 years and within 10 years	75%	0%	14.16%
10 years and above	95%	25%	51.46%

The actual debt maturity profile as of 30^{th} September 2023 is well within the limits set.

Upper Limit on Variable Interest Exposure

Council resolved the upper limit on variable rate exposures for 2023/24 should be set at 30% of outstanding long-term debt. This strategy limits the proportion of interest which is subject to variable rate terms and hence protects the Council against increased costs in times of rising interest rates.

The actual level of variable borrowings is £4 million (LOBO) which equates to 2.4% of the outstanding long-term debt as of 30^{th} September 2023, so is well within the limit set.

The prudential and treasury Indicators are shown in Appendix 2.

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the first half year, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2023/24. The Chief Officer Resources 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

11. MID YEAR REVIEW OF INVESTMENT STRATEGY FOR 2023/24

The Annual Investment Strategy for 2023/24 adopted by Council in March 2023 was to maintain only temporary, short-term investments and to make those investments in accordance with anticipated cash flow requirements (including the investing of sums borrowed at prevailing low interest rates in anticipation of capital spending). The Council's investment priorities are:

a. the security of capital;
b. The liquidity of its investments.

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The Council also aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low to give priority to the security of its investments.

To ensure that the Authority's investments are secure, and that risk is minimised an investment matrix is used to determine investment counterparties, which factors in Fitch and Moody's credit ratings, credit default swap (CDS) spread data, and credit rating agency comments.

Currently, the approved investment counterparties available to the Authority are Barclays, the Authority's bank, Lloyds Bank, the Debt Management Account Deposit Facility (DMADF) other Local Authorities and the Public Sector Deposit Fund. To diversify its investment portfolio, the Authority has undertaken fixed term deposits with other banks in line with the counterparty list. Whilst interest rates receivable on these counterparties is low the security of the capital sum is high and there is no cost associated with placing cash there.

This strategy has been adhered to in determining the investments for the first half of 2023/24 outlined in section 12 below.

12. INVESTMENT OUTTURN FOR THE FIRST HALF OF 2023/24

Appendix A gives details of the investments made during the first half of the year, and the following table gives a summary, which shows the Authority's average rate of return was below the benchmark.

Investment balances

The Council has been able to invest a total of £208.5m during the first half of 2023/24, with an average investment value of £3.9m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of the Council's payments, receipt of grants and progress on the capital programme.

Appendix A gives details of the investments made during the year, and the following table gives a summary, which shows the Council's average rate of return was below the benchmark. This is in line with the Authority's risk averse policy whereby the security of the capital sum is the number one priority at the expense of more competitive investment returns.

	Total Value of Investments	Average Investment	Investment Returns	Average Rate of Return	Benchmark Return *
Internally Managed	£208.5m	£3.93m	£1.17m	4.49%	4.64%

** Benchmark = 1 month SONIA uncompounded 4.64%*

The above investment returns include £470,714 of interest received in relation to the ongoing investment of the funds received from the Welsh Government in respect of the Rail Infrastructure Loan. There is a condition of the funding approval that states any interest earned from holding the loan must be added to the works programme. Therefore, this income will be placed into a reserve until such time it is used to fund works or can be transferred to the Authority. The remaining £702,600 investment returns relates to interest due from the investment of the Council's own funds.

As illustrated, the Council underperformed the benchmark by 15 basis points. The Council's budgeted investment return for 2023/24 is £320,500. Due to the availability of funds to invest and the continued increases in bank rates above previous forecasts, the Council has exceeded this estimate.

Approved limits

Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the period ended 30th September 2023.

13. OTHER TREASURY MANAGEMENT ISSUES

None to report