Full Council

12th December 2023

Report of: Service Director: Finance

Title: Treasury Management Mid-Year Report 2023/24

Ward: City Wide

Officer Presenting Report: Deputy Mayor – Finance, Governance and Performance

Recommendation
That the Mid-Year Treasury Management report for 2023/24 is noted.

Summary
This report meets the treasury management regulatory requirement that the Council receive a Mid-Year Treasury review report. It also incorporates the needs of the Prudential Code to ensure adequate monitoring of the capital expenditure plans.

The significant issues in the report are:
There are no policy changes to the Treasury Management Strategy Statement; the details in this report update the position in light of the updated economic position and budgetary changes. The authority has a net borrowing requirement of £641m over the next five years and is planning on undertaking £60m of new borrowing during the financial year to support the financing of the capital programme and to ensure there are adequate treasury resources to meet the liquidity requirements of the Council.

However, the Council will undertake further borrowing should market opportunities arise to borrow at fixed rates lower than forecasts to reduce the interest rate risk exposure to the authority due to the significant borrowing needed over the medium term to support the financing of the Council's current capital programme.

Policy

1. There are no policy implications as a direct result of this report.

Consultation

Internal

2. Audit Committee, Strategic & Service Directors.

External

3. The Council's Treasury Management advisers

Purpose / Context of the report:

4. This report meets the treasury management regulatory requirement that the Council receive a mid-year treasury review report. It also incorporates the needs of the Prudential Code to ensure adequate monitoring of the capital expenditure plans and the Council’s prudential indicators (PIs).

5. That the mid-year report is structured to highlight:

   - The economic outlook;
   - The actual and proposed treasury management activity (borrowing and investment);
   - The key changes to the Council’s capital activity (the prudential indicators {PIs}).

Background

6. 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.”

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

8. The second main function of the treasury management service 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. The 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.

Introduction

9. The Chartered Institute of Public Finance and Accountancy’s (CIPFA) Code of Practice on Treasury Management (revised in 2021) has been adopted by this Council. The primary requirements of the Code are:

   - Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council’s treasury management activities;
   - Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives;

- Receipt by the Full Council of an annual Treasury Management Strategy Statement (TMSS) - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a **Mid-year Review Report** and an Annual Report (stewardship report) covering activities during the previous year;
- 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;
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For Bristol City Council the delegated body is Audit Committee.

10. 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 2023/24 financial year to 30 September 2023;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- 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 or planned during 2023/24;
- The Council's capital expenditure and prudential indicators;
- A review of compliance with Treasury and Prudential Limits for 2023/24.

Key Changes and updates to the Treasury and Capital Strategies

11. There are no policy changes to the TMSS; the details in this report update the position in light of the latest economic position and budgetary changes.

    The 2023–2028 Treasury Strategy (approved 21st February 2023) identified a medium term net borrowing requirement of £641m to support the existing and future Capital Programme with the debt servicing costs met from revenue savings from capital investment and the economic development fund. The approved Strategy indicated a net borrowing need of £100m for 2023/24 though the Council's policy is to defer borrowing while adequate levels of treasury resources are available to support the liquidity requirements of the Council. The Council has not borrowed any external funds to date as the Council held treasury cash balances of £88m at the end of September 2023. The Council is planning to borrow £60m on a short term basis during the remainder of the year as treasury balances fall to support the financing of the capital programme while maintaining adequate liquidity to meet the Councils ongoing obligations. It is estimated that the Council will hold circa £50m in Treasury resources as at the end of March 2024.

Analysis of Debt and Investments

12. A summary of the of the Council's debt and Investment position as at 30th September 2023 (including forecast at 31st March 2024) compared with 31st March 2023 is shown in the table below:

Debt & Investments	31st March 2023		30th September 2023		31st March 2024	
	Actual		Actual		Forecast	
	£m	Rate%*b	£m	Rate%*b	£m	Rate%*b
Long Term Debt – PWLB Fixed	326	4.63	326	4.59	326	4.59
Long Term Debt – Market LOBO*a	70	4.09	70	4.09	70	4.09
Long Term Debt – Market Fixed	50	4.04	50	4.04	50	4.04
Estimated "New" Short Term Borrowing	-	-	-	-	60	5.50
Total Debt	**446**	**4.45**	**446**	**4.45**	**526**	**4.49**
Investment	116	1.90	88	4.72	50	5.25
Net Borrowing Position	**330**	**-**	**358**	**-**	**476**	

*a Lender option Borrower option, *b reflects the average rate for the year taking account of new loans and repayments.

We are currently achieving a return of 4.72% on our investments for the period to 30 September 2023. The return for the year is expected to rise to, circa 5.25% with base rate not anticipated to rise any further.

The authority's advisors are forecasting the base rate to remain at 5.25% until June 2024 before falling back in gradual rate cuts to 3.00% over the medium term. Long term interest rates (PWLB) are expected to fall from their levels in September of 5.5% to circa 3.50% over the medium term.

Economic Update

13. 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 continues.
- A 0.5% m/m 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 cooling in labour market conditions, but no evidence yet that it has led to an easing in wage growth (as the 3myy growth of average earnings rose to 7.8% in August, excluding bonuses).

14. The 0.5% m/m 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 weakness.

The 0.4% m/m rebound in retail sales volumes in August is not as good as it looks as it partly reflected a pickup in sales after the unusually wet weather in July. Sales volumes in August were 0.2% below their level in May, suggesting much of the resilience in retail activity in the first half of the year has faded.

As the drag from higher interest rates intensifies over the next six months, it is believed that 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. With CPI inflation past its peak and expected to decline further, the economy is passing the cost-of- living crisis without recession. With the worst of the falls in real household disposable incomes 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 be felt too. It is expected that the Bank of England will keep interest rates at the probable peak of 5.25% until the second half of 2024 with mortgage rates being 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. That is the first time it has fallen below 1m since July 2021. The job vacancy rate has fallen from 3.0% in July, to circa 2.9% in August and moving closer to 2.5%, which would be consistent with slower wage growth.

The cooling in labour market conditions has not yet fed through to an easing in wage growth. The headline 3myy rate rose from 8.4% (revised up from 8.2%) to 8.5%, which meant UK wage growth remains much faster than in the US and in the Euro-zone. Moreover, while the Bank of England's closely watched measure of regular private sector wage growth eased a touch in July, from 8.2% 3myy in June to 8.1% 3myy, it is still well above the Bank of England's prediction for it to fall to 6.9% in September.

CPI inflation declined from 6.8% in July to 6.7% in August, the lowest rate since February 2022.

In the 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 indicated to the Bank of England that it has raised rates sufficiently. The minutes show the decision was "finely balanced". Five MPC members voted for no change and the other four voted for a 25bps hike.

Similar to the US, the Bank of England want 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".

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.

The pound weakened from its cycle high of $1.30 in the middle of July to $1.21 in late

September. In the first half of the year this driven by the upward shift in UK interest rate expectations, however, over the past couple of months interest rate expectations have dropped as inflation started to come down, growth faltered, and the Bank of England paused its increases to base rate.

The FTSE 100 gained more than 2% since the end of August, from around 7,440 on 31st August to 7,608 on 29th September. The rebound was primarily driven by higher energy prices which boosted the valuations of energy companies. The FTSE 100's relatively high concentration of energy companies explain why UK equities outperformed both US and Euro-zone equities in September. Nonetheless, as recently as 21st April the FTSE 100 stood at 7,914

Interest rate forecasts

15. The Council's treasury advisor, Link Asset Services, has provided the following forecast:

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

PWLB rates are certainty rates, gilt yields plus 180bps

The latest forecast on 25th September sets out a view that short, medium and long-dated interest rates will be elevated for some time as the Bank of England seeks to reduce inflation.

Investment Portfolio 2023/24

16. In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in the "Economic Update" interest rates are anticipated to rise and peak at 5.25% at which point will fall back over the medium term to 2.75%.

    Given this environment and the likelihood that Bank Rate will fall gradually over the medium term the Council will 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 quality financial institutions

17. The Council held £88m of Treasury investments as at 30th September 2023 (£116m at 31 March 2023) with an average maturity of 30 days. These investments are predominately with local authorities, money market funds and UK banks. The investment portfolio yield for the first six months of the year was 4.72%. The standard comparator for investment performance is the benchmark SONIA[1], which for the period was 4.73%.

    1SONIA – Sterling Over Night Index Average rate is a recognised reference rate to benchmark short-term investment interest rates.

18. The Chief Financial Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2023/24.

19. The current investment counterparty criteria selection approved in the TMSS is the method by which treasury management investment are chosen.

Borrowing

20. The Capital Financing Requirement (CFR) denotes the Council's underlying need to borrow for capital purposes. The Council's CFR at 31 March 2024 is estimated to be £940m. 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).

21. The balance of borrowing between external and internal is generally driven by market conditions and forecasts of future cash flows and interest rates. At the 31st March 2023 the Council had external borrowings of £564m and has utilised £412m of internal cash in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require on-going monitoring in the event that upside risk to gilt yields prevails.

22. However, internal borrowing is a temporary measure that takes advantage of lower interest rates and will ultimately be replaced by more expensive external borrowing as the cash used is required elsewhere. The timing and amount of new external borrowing is therefore dependent on capital spending decisions, future cash flows and forecasts of interest rates.

23. The Council does have an underlying need to borrow for capital expenditure requirements, along with the council utilising treasury balances to support services. The Council is therefore planning on taking £60m of external borrowing during the remainder of the year that will increase the net financing costs of the authority that will be contained within the current Capital Financing budget.

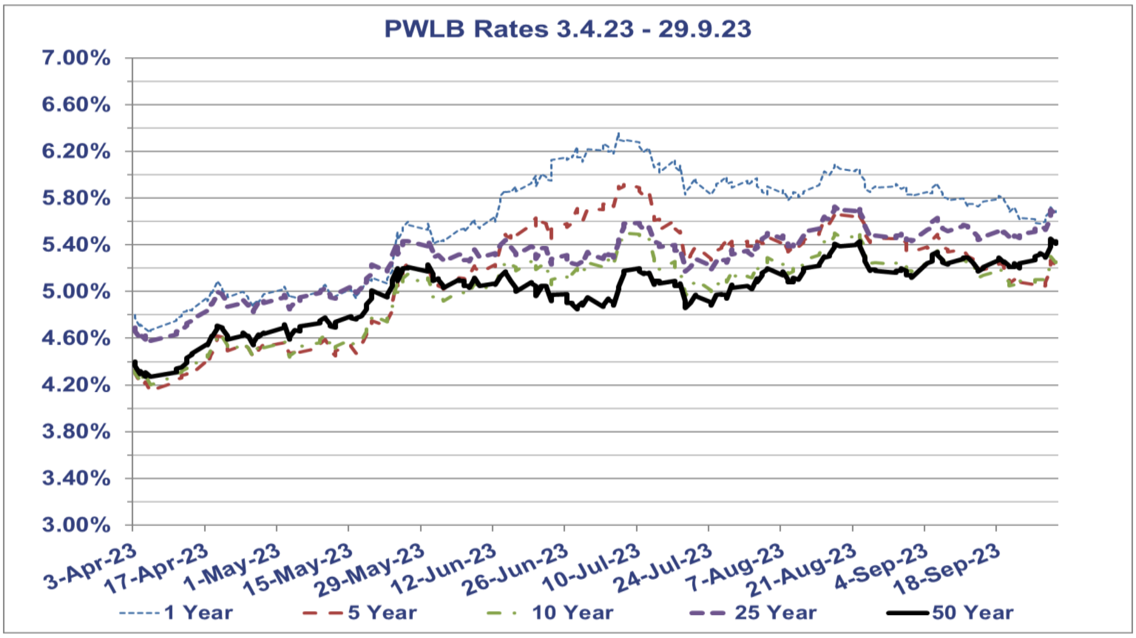
    However, should there be a risk that borrowing costs will rise quicker and remain elevated for longer than expected then the Council will consider borrowing to reduce the Council's internal borrowing position and reduce its interest rate risk exposure.

24. PWLB rates were on a generally rising trend throughout the year.

    In July short-dated rates peaked at their most expensive, the 1-year rate was 6.36% and the 5-year rate was 5.93%. Short dated rates then fell, though medium dates rose higher through August and the 10-year rate increased 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 over the next two to three years as inflation subsides. The CPI measure of inflation is expected to fall below 2% in the second half of 2024, and 50-year rates are forecast to be circa 3.90% by the end of September 2025. However, there is considerable gilt issuance over the next couple of years, so there is a high degree of uncertainty as to whether rates will fall that far.

    The graph and table below show the movement in PWLB certainty rates for the first six months of the year.



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	4.65%	4.14%	4.20%	4.58%	4.27%
Date	06/04/2023	06/04/2023	06/04/2023	06/04/2023	05/04/2023
High	6.36%	5.93%	5.51%	5.73%	5.45%
Date	06/07/2023	07/07/2023	22/08/2023	17/08/2023	28/09/2023
Average	5.62%	5.16%	5.01%	5.29%	5.00%
Spread	1.71%	1.79%	1.31%	1.15%	1.18%

Debt Rescheduling

25. Debt rescheduling opportunities have increased over the course of the past six months and will be considered if giving rise to long-term savings.

26. No debt rescheduling has been undertaken during the first six months of the year, however, now that the whole of the yield curve has shifted higher there may be better opportunities in the future, although only prudent and affordable debt rescheduling will be considered.

Ethical Equitable Investment Policy

27. An Ethical Investment Policy is incorporated within the Treasury Management Practice Statements (TMPS). The City Council currently invest surplus funds with Banks and Building Societies either directly or via the Money Markets in the form of instant access cash deposit accounts, money market funds or on fixed term deposit and with other local authorities. The City Council's ethical equitable investment policy is based on the premise that the City Council's choice of where to invest should reflect the ethical values it supports in public life. The City Council will not knowingly invest in organisations whose activities include practices which directly pose a risk of serious harm to individuals or groups, or whose activities are inconsistent with the mission and values of the City Council.

The Council's Capital Position (Prudential Indicators)

28. This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

Prudential Indicator for Capital Expenditure

There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

29. This table shows the latest estimates for capital expenditure:

Capital Expenditure by Service	2023/24 Approved Programme £m	2023/24 Period 6 Forecast £m
Non-HRA	165	164
HRA	133	120
Total	**298**	**284**

30. The latest capital monitoring report for the end of September 2023 sets out a capital forecast of £284m detailed within the period 6 monitoring report presented to Cabinet on 7th November 2023.

Financing of the Capital Programme

31. The table below draws together the capital expenditure plan and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2023/24 Approved Programme £m	2023/24 Period 6 Forecast £m
Total spend	**298**	**284**
Financed by:		
Capital receipts	50	35
Capital grants	118	126
Revenue / Reserves	48	43
HRA – Self Financing	30	31
Prudential Borrowing – Increase in Capital Financing Requirement	52	49
Total financing	**298**	**284**

Capital Financing Requirement (CFR) & Operational Boundary

32. The table below shows the CFR, which is the underlying external need to incur borrowing for a

capital purpose and it also shows the expected debt position over the period. This is termed the Operational Boundary.

Capital Financing Requirement	**2023/24 Original Estimate £m**	**2023/24 Latest Estimate £m**
CFR – non housing	732	722
CFR – housing	245	245
Total CFR	**977**	**967**

External Debt (Operational Boundary)	**2023/24 Approved Indicator £m**
Borrowing	546
Other long term liabilities*	116
Total debt 31 March	**662**

** On balance sheet PFI schemes and finance leases etc.*

33. The revised Capital Financing Requirement is based on the actual CFR as at 31 March 2023 (£940m) increased by in-year capital expenditure financed by borrowing (£49m) and reduced by the minimum revenue provision (MRP) for repayment of debt and the repayment of the debt facilities within other long term liabilities (£22m).

Limits to Borrowing Activity

34. The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2023/24 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

	2023/24 Original Estimate £m	**2023/24 Latest Estimate £m**
Gross borrowing	546	506
Plus other long term liabilities*	116	119
Gross borrowing & long term Liabilities	**662**	**625**
CFR* (year-end position)	977	967

** Includes on balance sheet PFI schemes and finance leases etc.*

35. The Chief Finance Officer reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

36. A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and

revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3(1) of the Local Government Act 2003.

Authorised limit for external debt	**2023/24 Approved Indicator £m**
Total Borrowing	**1,000**

Proposal

37. That the Mid-Year Treasury Management report for 2023/24 is noted.

Other Options Considered

38. None

Risk Assessment

39. Borrowing and lending activity is reported to the Mayor.
The principal risks associated with treasury management are:

Risk	**Mitigation**
Loss of investments as a result of failure of counterparties	Limiting the types of investment instruments used, setting lending criteria for counterparties, investing in only high quality low risk counterparties and limiting the extent of exposure to individual counterparties
Increase in the net financing costs of the authority due to borrowing at high rates of interest / lending at low rates of interest	Planning and undertaking borrowing and lending in light of assessments of future interest rate movements, and by undertaking most long term borrowing at fixed rates of interest (to reduce the volatility of capital financing costs)

Public Sector Equality Duties

40. a) Before making a decision, section 149 Equality Act 2010 requires that each decision-maker considers the need to promote equality for persons with the following “protected characteristics”: age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, sex, sexual orientation. Each decision-maker must, therefore, have due regard to the need to:

i) Eliminate discrimination, harassment, victimisation and any other conduct prohibited under the Equality Act 2010.

ii) Advance equality of opportunity between persons who share a relevant protected characteristic and those who do not share it. This involves having due regard, in particular, to the need to;

- remove or minimise disadvantage suffered by persons who share a relevant protected characteristic;

- take steps to meet the needs of persons who share a relevant protected characteristic that are different from the needs of people who do not share it (in relation to disabled people, this includes, in particular, steps to take account of disabled persons' disabilities);
- encourage persons who share a protected characteristic to participate in public life or in any other activity in which participation by such persons is disproportionately low.

iii) Foster good relations between persons who share a relevant protected characteristic and those who do not share it. This involves having due regard, in particular, to the need to –

- - tackle prejudice; and
- - promote understanding.

b) There are no proposals in this report, which require either a statement as to the relevance of public sector equality duties or an Equalities Impact Assessment.

Legal and Resource Implications

Legal

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.

(Legal advice provided by Tim O'Gara - Service Director - Legal and Democratic Services)

Financial

(a) Revenue

The financing costs arising from planned borrowing are provided for in the revenue budget and medium-term financial plan. Any additional operating costs will have to be contained within the revenue budget of the relevant department.

(Financial advice provided by Jon Clayton - Capital and Investments Manager)

(b) Capital

The latest economic forecasts and implementation of the Treasury management strategy indicate that sufficient funds will be available to fund capital expenditure over the medium term while adhering to prudential indicators.

Land

Not applicable

Personnel

Not applicable

Appendices:

None

LOCAL GOVERNMENT (ACCESS TO INFORMATION) ACT 1985
Background Papers:
None