Northumberland County Council

AUDIT COMMITTEE

29 NOVEMBER 2023

Treasury Management Mid-Year Review Report for the Period 1 April to 30 September 2023

Report of Councillor(s) Richard Wearmouth – Deputy Leader and Portfolio Holder for Corporate Services

Responsible Officer(s): Jan Willis, Executive Director of Transformation and Resources.

1. Purpose of the Report

This report provides a mid-year review of the activities of the Treasury Management function for the period 1 April to 30 September 2023, and performance against the Treasury Management Strategy Statement (TMSS) 2023-24 - as approved by the County Council on 22 February 2023. The report provides a review of borrowing and investment performance for the period set in the context of the general economic conditions prevailing so far during the year. It also reviews specific Treasury Management prudential indicators defined by the (CIPFA) Treasury Management Code of Practice and CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code), and approved by Council in the TMSS.

2. Recommendations

It is recommended that Members:

- Receive the report and note the performance of the Treasury Management function from 1 April to 30 September 2023.
- Present the report to County Council.

3. Link to the Corporate Plan

This report is aligned to the priorities outlined in the Corporate Plan 2023-2026, being ‘Achieving Value for Money’, ‘Tackling Inequalities’ and ‘Driving Economic Growth’.

4. Key Issues

The Local Government Act 2003 (the Act) and supporting regulations require the Council to produce a mid-year review of treasury management activities and actual performance against prudential and treasury indicators. This report meets the requirements of both the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

The report provides a review of the Treasury Management activities for the six-month period from 1 April to 30 September 2023 and sets out performance against the Treasury Management Strategy Statement for 2023-24.

TREASURY MANAGEMENT MID-YEAR REVIEW REPORT FOR THE PERIOD 1 APRIL TO 30 SEPTEMBER 2023

1. INTRODUCTION

1.1. Background

This Treasury Management mid-year report provides a review of the activities of the Treasury Management function for the period 1 April to 30 September 2023, and performance against the Treasury Management Strategy Statement (TMSS) for 2023-24. Its production and submission to Council is a requirement of the CIPFA Code of Practice on Treasury Management.

Treasury management is defined as:

“The management of the local authority’s 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.”

The Council operates a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure this cash flow is adequately planned, with surplus monies being invested in low-risk counterparties, with a main aim of providing sufficient liquidity, ahead of the achievement of the best possible investment returns.

The second main function of the treasury management service is to arrange the funding of the Council’s capital programme. The capital programme provides a guide to the borrowing need of the Council, and there needs to be longer term cash flow planning to ensure capital spending requirements can be met. The management of longer-term cash may involve arranging long or short-term loans, utilising longer term cash flow surpluses and, occasionally, debt restructuring to meet Council risk or cost objective.

1.2. Statutory and Regulatory Requirements

The Local Government Act 2003 (the Act) and supporting Regulations requires the Council to produce a mid-year review of treasury management activities and the actual performance against prudential and treasury indicators. This report meets the requirements of both the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important as it provides details of the performance of the treasury management activities and highlights compliance with the Council’s policies previously approved by Members.

1.3. Basis and Content of Treasury Management Mid-Year Review Report for 2023-24

The report covers:

- Overview of the Treasury Management Strategy for the financial year 2023-24.

- Economic conditions and interest rates for the period 1 April to 30 September 2023.
- Overview of the treasury position on 30 September 2023.
- Borrowing activity.
- Investment activity; and,
- Treasury management limits and prudential indicators position.

2. BACKGROUND - TREASURY MANAGEMENT STRATEGY FOR 2023-24

2.1. Overview of the 2023-24 Strategy (prepared in November 2022)

The expectation for interest rates within the Treasury Management Strategy Statement for 2023-24 was for UK Bank Rate (often referred to as Base Rate) to remain at 4.50% for most of year and decrease to 4.00% in the final quarter (January 2024 – March 2024). Longer term borrowing rates were forecast to decrease each quarter by 0.10% to 0.20% throughout the year.

Following the inflation and subsequent interest rate increases experienced in 2022-23 it was anticipated that the Bank Rate would not surpass 4.50% and that the Bank of England would be keen to loosen monetary policy when the worst of the inflationary pressures had lessened. However, the timing was uncertain due to the cost-of-living squeeze and wage increases running at 5.70%.

Against this backdrop of market volatility and high interest rates, along with the risks in the economic forecast, the proposed strategy for 2023-24 was to continue to operate with an under borrowing position - i.e., use investments in lieu of external borrowing – and to meet the remaining external borrowing requirement for the year primarily from medium and shorter term / temporary borrowing (up to 2 years). At that time, the external borrowing requirement for the year was estimated at £170.000 million, after taking into consideration maturing loans of £51.552 million.

2.2. Compliance

All treasury activities met the Treasury indicators set out in the TMSS, and borrowing was within the borrowing limits set by the Council. Throughout the period, all treasury activities have been conducted within the parameters of the TMSS 2023-24, alongside best practice suggested by the CIPFA Treasury Management Code and Central Government.

3. ECONOMIC CONDITIONS AND INTEREST RATES FOR PERIOD 1 APRIL TO 30 SEPTEMBER 2023

3.1. Economy - At 04 October 2023

At the end of 2022-23 inflation in the UK was at 10.4%, this figure dropped to 6.7% by August 2023. This is as a result of a combination of statistical effects, falling energy prices and other factors like easing global cost pressures. Whilst there has been a cooling in the labour market this has still not fed through to an easing in wage growth.

The three-month average of annual pay growth was 8.5% in July 2023 which is still well above the Bank of England's prediction for it to fall to 6.9% by September 2023.

It is expected that the economy will dip into a mild recession due to the delayed impact of the increased Bank Rate and the phasing out of financial support packages provided by the government during the energy crisis.

UK GDP increased by 0.2% in the period April – June and is estimated to contract in the second quarter of the year by up to 1%.

Bank Rate

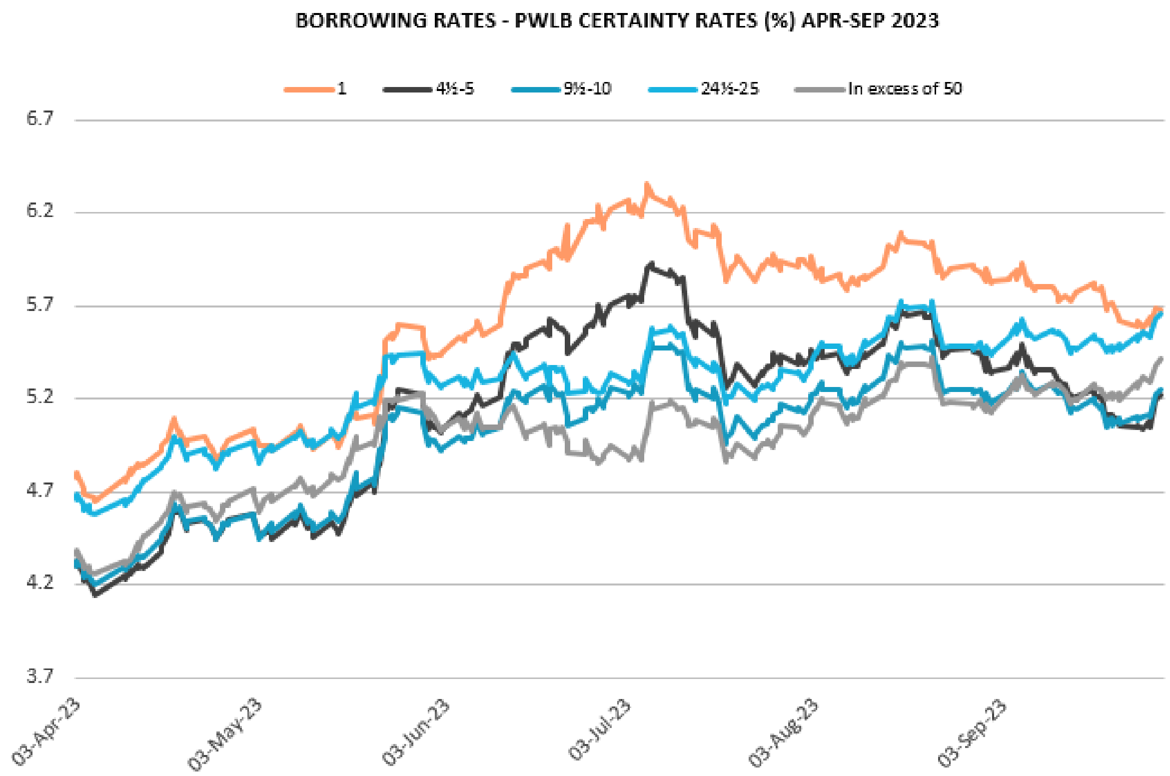
Following the weak August CPI inflation release, the recent loosening of the labour market and the downbeat activity surveys, the Bank of England left interest rates unchanged at 5.25% in September. It is estimated that the Bank Rate will remain at 5.25% until Quarter Ending September 2024 when it will begin to drop.

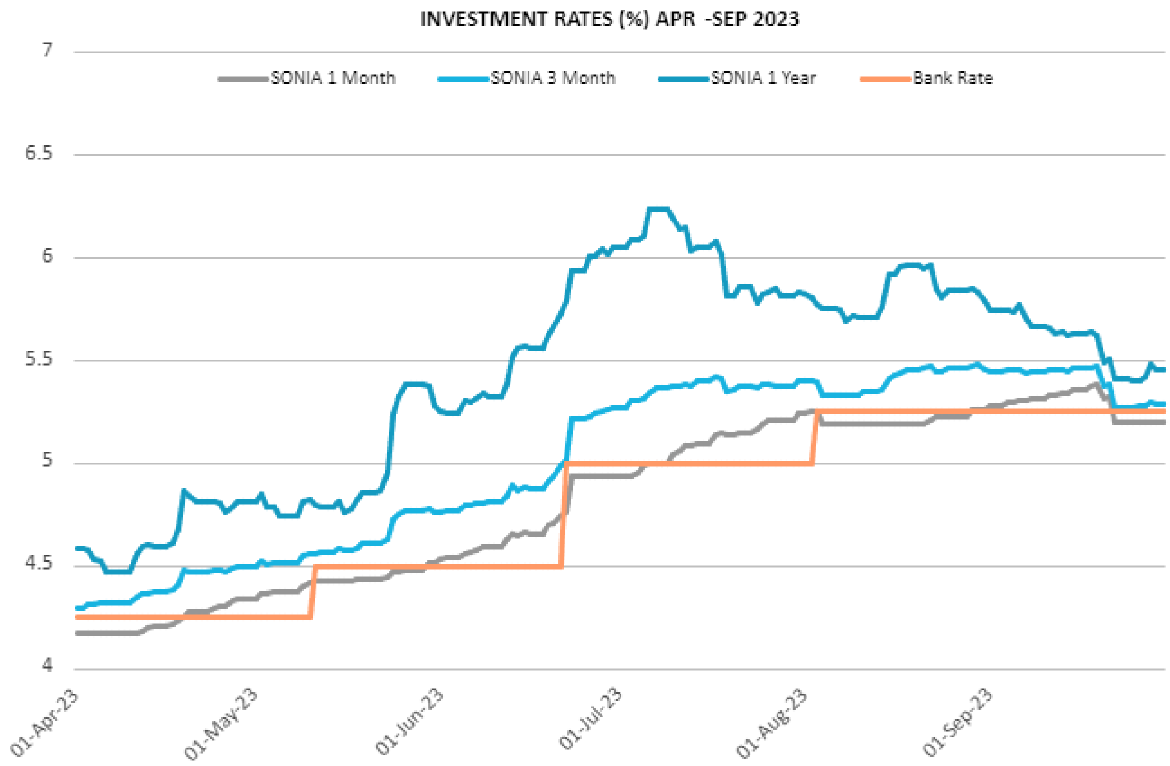
Bond/Gilt Yields and PWLB Rates

The Yield on 10-year Gilts fell from a peak of 4.74% on 17 august to 4.44% on 29 September. This is mainly on the back of investors revising down their interest rate expectations. Even after the recent pullback, the rise in Gilt Yields has exceeded the rise in most other Developed Market Government Yields since the start of the year. The estimate is that once inflation reduces Gilt Yields will reduce.

3.2. Actual Interest Rates 1 April to 30 September 2023

The following graphs show interest rate movements over the period, for various terms of borrowing and investment:





3.3. Forecast Interest Rates

The Council's treasury advisor, Link Asset Services, current interest forecast (dated 4 October 2023) is shown below:

	Quarter 3 2023-24 (Q/E Dec 2023)	Quarter 4 2023-24 (Q/E Mar 2024)	Quarter 1 2024-25 (Q/E Jun 2024)	Quarter 2 2024-25 (Q/E Sep 2024)
Bank Rate	5.25%	5.25%	5.25%	5.00%
5-year PWLB	5.10%	5.00%	4.90%	4.70%
10-year PWLB	5.00%	4.90%	4.80%	4.60%
25-year PWLB	5.40%	5.20%	5.10%	4.90%
50-year PWLB	5.20%	5.00%	4.90%	4.70%

This was accompanied with the following comments:

"The latest forecast on 25 September 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."

4. THE PORTFOLIO POSITION AT 30 SEPTEMBER 2023

4.1. Current Borrowing

The Council's debt at the beginning of the year and at 30 September 2023 is shown below:

TABLE 1: BORROWING	**Total Principal 1 Apr 2023 £m**	**Weighted Average Rate %**	**Total Principal 30 Sep 2023 £m**	**Weighted Average Rate %**
Public Works Loan Board Loans	449.745	2.66	448.725	2.65
LOBOs	176.500	3.95	154.500	3.90
Market / Local Authority (>1 year)*	79.100	3.69	79.100	3.69
Market / Local Authority (<1 year)*	40.000	4.00	40.000	4.00
Salix	0.033	0.00	0.028	0.00
TOTAL EXTERNAL BORROWING	**745.378**	**3.14**	**722.353**	**3.11**

* Note: above figures are based on the term of loans at their inception

4.2. Current Investments

The table below summarises the investment position at 30 September 2023:

TABLE 2: INVESTMENTS	**Total Outstanding 1 Apr 2023 £m**	**Weighted Average Rate %**	**Total Outstanding 30 Sep 2023 £m**	**Weighted Average Rate %**
Fixed Term Investments – Long Term (>1 year)*	0.000	0	0.000	0
Fixed Term Investments – Short Term (<1 year)*	35.000	4.32	62.000	5.45
Money Market Funds and Call Accounts	79.450	4.09	56.150	5.33
TOTAL INVESTMENTS (excl. Cash)	**114.450**	**4.16**	**118.150**	**5.39**

* Note: above figures are based on the term of investments at their inception

5. BORROWING ACTIVITY 2023-24

Cash balances have reduced in the first half of 2023-24, the balance of Money Market Funds at 30 September 2023 was £56.150 million. Interest rates remain high due to high inflation, as a result a decision was taken to minimise external borrowing and instead, wherever possible, increase the reliance on internal borrowing – i.e., use these additional investment balances to support the cash flows associated with the capital programme instead of borrowing externally. There has been no new borrowing taken out in the first half of 2023-24. It is estimated that by the end of Quarter 3 there will be a requirement for new borrowing.

Two reviews of the capital programme, one in June 2023 and another in September 2023, have identified that a sizeable proportion of the original budgeted capital expenditure for 2023-24 will not now be spent until later years (see 7.1 below). The anticipated net borrowing requirement for the year is expected to be lower than the anticipated £170.000 million outlined in the original strategy (see 2.1 above). This is because of reprofiling from 2023-24 into future years. However, this reprofiling has been partially offset by reprofiling from the previous year (2022-23). Based on the latest projections, it is currently estimated that at most a further £160.000 million of external borrowing may now be required within 2023-24. This means overall borrowing is down £32.001 million from the figure outlined in the original strategy (see paragraph 7.3 below). It is expected that the £160.000 million requirement for the year will be covered by shorter term / temporary borrowing.

The forecast reduction in the borrowing requirement of £32.001 million is a temporary position, as some of the capital spend has been reprofiled into later years and will instead impact on future years' borrowing requirements. In addition, the reliance on internal borrowing is becoming unsustainable as the reserves and balances supporting this position have reduced. Therefore, at some point further external loans may be required to replace the reduction in cash. Added to which, the notional saving of borrowing internally, in the form of the foregone investment compared to cost of borrowing externally, is also subject to the volatility of the interest rate environment.

As shown in the table above, total external borrowing has decreased by £23.025 million, from £745.378 million at the start of year to £722.353 million at 30 September 2023. This is due to maturing existing loans and a LOBO loan being recalled. The loan maturities in 2023-24 are estimated to be £73.552 million and due to 2022-23 reprofiling the capital spend funded by borrowing is £16.000 million higher than originally estimated for 2023-24. As a result, it is forecast that additional borrowing of around £160.000 million will be required in the second half of 2023-24 resulting in an overall borrowing position at 31 March 2024 of around £831.825 million.

It should be noted that savings resulting from the reduced levels of borrowing will be partly offset by the higher than expected interest rates payable on those new loans taken out within the year. As a result, is expected to generate an overall saving of around £1.802 million compared to the original interest payable budget for 2023-24 of £27.096 million.

6. INVESTMENT ACTIVITY 2023-24

The Council's investment policy (as set out in the Treasury Management Strategy Statement for 2023-24) is governed by the Communities and Local Government's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by two of the main credit rating agencies (Moody's and Fitch Group), supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.).

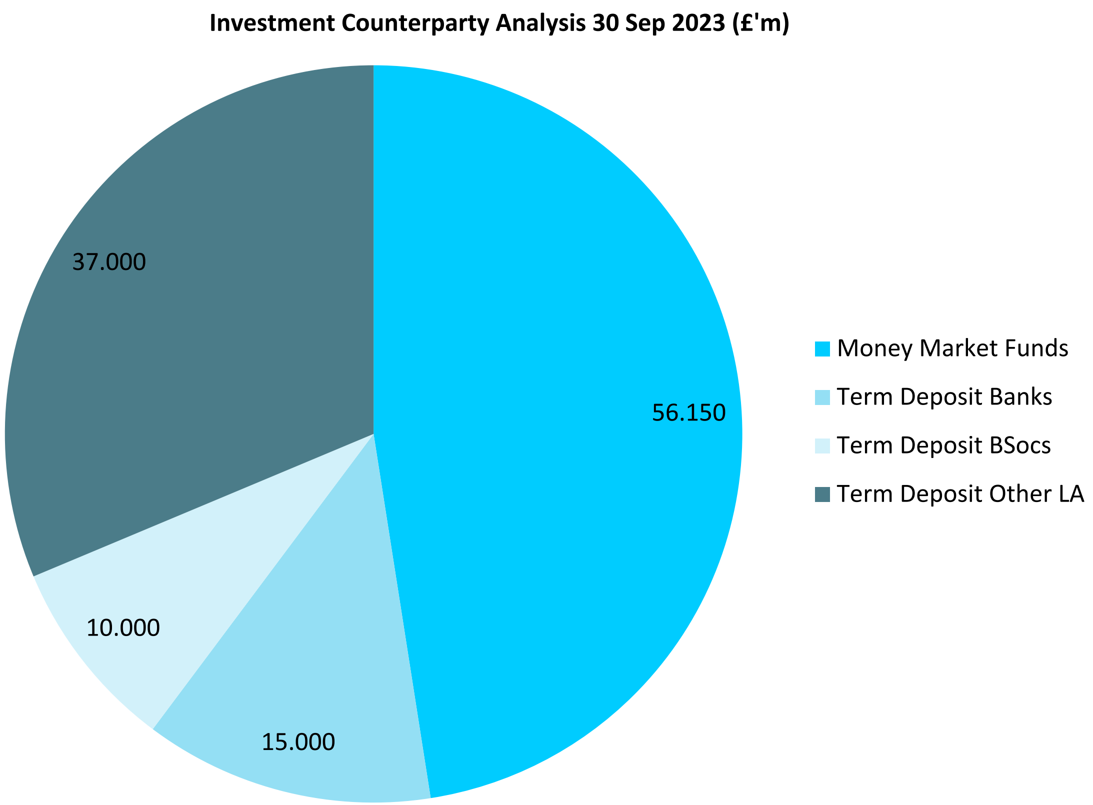
All investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

As identified above, the current policy is to use a significant proportion of available investment balances as ‘internal borrowing’ to support the financing of the Capital Financing Requirement (CFR).

Overall external investments (excluding cash) have increased slightly during the first six months of the year from £114.450 million to £118.150 million.

Based on the forecast revised capital spend and change in borrowing for the year, investment balances are anticipated to reduce to around £42.686 million by 31 March 2024 - due to the increased utilisation of investment balances to cover the Capital Financing Requirement (CFR) in lieu of borrowing externally.

An analysis of the mid-year investment balance (excluding cash) by counterparty is shown in the following chart:



The internally managed funds earned an overall average rate of return of 5.39% during the first 6 months of 2023-24. Taking into consideration that a significant proportion of funds are being kept liquid to support cash flow and facilitate future internal borrowing requirements, the returns are good compared against the average Sterling Overnight Index Average (SONIA) benchmark indicators of:

- SONIA overnight 4.73%
- SONIA 1 month 4.83%

- SONIA 3 month 5.02%
- SONIA 1 Year 5.44%

The Council's budgeted investment return for 2023-24 was originally £2.800 million (excluding interest of loans to thirds parties). Due to the higher than anticipated interest rates in 2023-24, along with higher than budgeted balances available for investment, returns are estimated to exceed the original budget by £2.477 million.

The above figures are exclusive of interest received on loans from third parties, such as the facilities to Advance Northumberland and Northumbria Healthcare NHS Foundation Trust etc. These loans are made for policy/service reasons, and not day-to-day treasury undertakings in relation to the investment of cash flows.

7. PRUDENTIAL INDICATORS AND TREASURY LIMITS 2023-24

The Prudential Code has been developed by CIPFA. The Code has a central role in capital finance decisions, including borrowing for capital investment. Its key objectives are to provide a framework for local authority finance that will ensure individual authorities' capital expenditure plans are affordable; all external borrowing is within prudent and sustainable levels; and, that treasury management decisions are taken in accordance with good professional practice.

Performance against the approved prudential indicators, as set out in the 2023-24 Treasury Management Strategy Statement, is outlined below. None of the indicators have been exceeded during the year to 30 September 2023.

7.1. Capital Expenditure

This table shows the original approved capital programme (as agreed as part of the MTFP), current expenditure and forecast outturn for the year:

Capital Expenditure	2023-24 Original Estimate £m	2023-24 Current Budget £m	Position 30 Sept 2023 £m	2023-24 Forecast Outturn £m
Adults, Ageing and Wellbeing	4.427	5.380	0.884	3.429
Chief Executive	2.016	2.516	0.994	2.516
Children, Young People & Education	32.622	39.767	5.522	26.778
Place and Regeneration	166.270	250.658	63.069	211.399
Public Health, Inequalities and Stronger Communities	0.800	2.185	1.548	2.085
Transformation and Resources	16.814	23.955	5.941	21.503
TOTAL EXPENDITURE	**222.949**	**324.461**	**77.958**	**267.710**

7.2. Authorised Limit and Operational Boundary

The authorised limit - is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level.

The operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

The table below demonstrates that during 2023-24 the Council has maintained gross borrowing within its authorised limit and operational Boundary.

	Authorised Limit for External Debt £m	Operational Boundary for External Debt £m	Actual 30 September 2023 £m
Borrowing	1,156.913	964.094	722.353
Other Long-Term Liabilities (PFI)	72.813	60.678	62.106
TOTAL EXTERNAL DEBT	**1,229.726**	**1,024.772**	**784.459**

7.3. Limits to Borrowing Activity

One of the key controls 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 Capital Financing Requirement (CFR) [i.e., the underlying need to borrow] in the preceding year plus the estimates of any additional CFR for 2023-24 and next two financial years.

CFR vs Borrowing	2023-24 Original Estimate £m	Position at 30 Sept 2023 £m	2023-24 Forecast Outturn £m
Borrowing	863.826	722.353	831.825
Other Long-Term Liabilities (PFI)	61.187	62.106	62.887
TOTAL EXTERNAL DEBT	**925.013**	**784.459**	**894.712**
CFR	**1,172.380**	**N/A**	**1,157.743**

The Executive Director of Transformation and Resources reports that no difficulties are envisaged for the current or future years in complying with this indicator.

The purpose of the following limit is to restrain the activity of the treasury function within certain limits; thereby managing risk; and reducing the impact of any adverse movement in interest rates.

Interest Rate Exposure	Limit for 2023-24	Actual 30 Sep 2023
Fixed Rate Exposure	0% - 100%	89.20%
Variable Rate Exposure	0% - 100%	10.80%

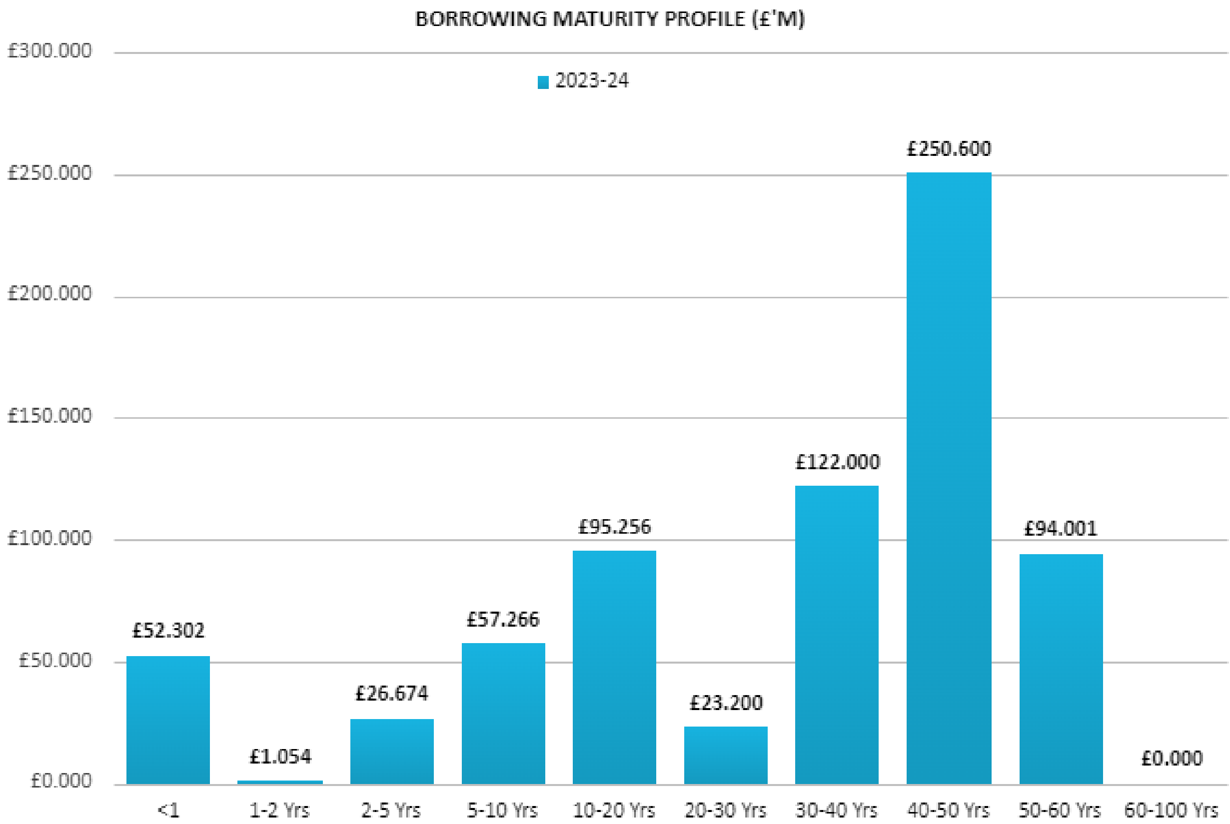
Lender option, borrower option loans (LOBOs) callable within 12 months are classed as variable; if the rate is fixed for a longer period they are classed as fixed. At 30 September 2023 the total of variable rate loans was £78.000 million and is within the set limit.

7.4. Maturity Structure of Borrowing

Measuring maturity structure of borrowing ensures a reasonable spread of maturing debt as a safety mechanism to ensure significant amounts of debt do not mature at a time when interest rates for refinancing the debt may be high.

Maturity Structure	Upper Limit for 2023-24	Actual 30 Sep 2023
Under 12 months	25%	7%
1 year - 2 years	40%	1%
2 years within 5 years	60%	3%
5 years within 10 years	80%	7%
10 years and above	100%	82%

The following graph shows maturity of loans by monetary value. LOBOs are shown as held to maturity. It should however be noted that, given the recent increase in interest rates, there is a possibility that some of these loans may be called.



7.5. Investments for periods longer than 365 days

These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment and are based on the availability of funds after each year-end.

	Limit 2023-2024 £m	Actual Highest £m	Actual 30 Sept 2023 £m
Principal sums invested > 364 days	120.000	0.000	0.000

Implications

Policy	The report provides a half-year review of the Treasury Management activities for 2023-24 and sets out performance against the Treasury Management Strategy Statement for 2023-24. It is aligned to the priorities outlined in the Corporate Plan 2023-26- being 'Achieving Value for Money', 'Tackling Inequalities' and 'Driving Economic Growth'
Finance and value for money	The financial implications of the 2023-24 investment and borrowing transactions have been taken into account within the revenue budget for 2023-24. Northumberland County Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management within the context of effective risk management, and to employing suitable performance measurement techniques, for example comparison with other members of the CIPFA and Capita benchmarking clubs.
Legal	Under Section 1 of the Local Government Act 2003 (the Act) the Council may borrow money for any purpose relevant to its functions under any enactment, or for the purpose of the prudent management of its financial affairs. The Act and supporting regulations also require the Council to 'have regard to' the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code and the CIPFA Treasury Management Code of Practice (which were adopted by Northumberland County Council in February 2010).
Procurement	There are no direct procurement implications for the County Council.
Human Resources	There are no direct staffing implications for the County Council.
Property	There are no direct property implications for the County Council.
Equalities (Impact Assessment attached) Yes ☐ No ☐ N/A ☐	There are no direct equalities implications for the County Council.

Risk Assessment	The report highlights the principal financial risks within the Treasury Management function. The identification, monitoring and control of risk are the prime criteria by which the effectiveness of the County Council's Treasury Management activities will be measured. Accordingly, the analysis and reporting of Treasury Management activities will focus on their risk implications for the Council. The investment priority is security and liquidity rather than yield, which is a secondary aim.
Crime & Disorder	There are no Crime and Disorder implications for the County Council.
Customer Consideration	There are no Customer Considerations for the County Council.
Carbon reduction	There are no carbon reduction implications for the County Council.
Health & Wellbeing	There are no health and wellbeing implications for the County Council.
Wards	All divisions.

Background Papers:

Treasury Management Strategy Statement for 2023-24 – County Council 22 February 2023

CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance notes (revised 2011)

CIPFA Prudential Code for Capital Finance in Local Authorities

Guidance on Local Government Investments The Local Government Act 2003

Local Authorities (Capital Finance and Accounting) Regulations 2012 (S.I.2012/265)

Author and Contact Details

Gemma Simpson – Technical Accountant
gemma.simpson@northumberland.gov.uk