Report to:	**Senior Leadership Team**
Date:	Tuesday, 14 November 2023
Reporting Officer:	Ashley Hughes – Director of Resources
Subject:	**Treasury Management Mid-Year Update**
Report Summary:	This report provides a mid-year review of the Council's Treasury Management activities for 2023/24. Treasury Management is a critical activity to ensure Value for Money in the use of public funds. It is concerned with safely managing the working capital of an organisation, managing its cash flows, investments, money markets and banking. It ensures that public funds work for us, and are safely maximised, without undertaking high-risk investments. It is unrelated to the Revenue Budget of the Council. This report provides an overview of the Treasury Management activities of the organisation over the first 6 months of the year. At 30 September, the total investment balance was £139.550m and total long term borrowing was £139.269m. The current strategy is designed to ensure that borrowing costs are kept low over the longer term, rather than subject to volatility that a high risk strategy might deliver. Where investments are involved, the policy is to ensure the security of the asset rather than pursue the highest returns available. The Council has been able to take advantage of rising interest rates in year and interest earned on day-to-day investments is forecast to be £5.309m against a budget of £2.685m, an over performance of £2.624m. This additional investment income can now be invested in Council activities.
Recommendations:	That the Treasury Management activity and performance is noted.
Corporate Plan:	The Treasury Management function of the Council underpins the ability to deliver the Council's priorities.
Policy Implications:	In line with Council Policies.
Financial Implications: (Authorised by the statutory Section 151 Officer & Chief Finance Officer)	The achievement of savings on the cost of financing the Council's debt through repayment, conversion and rescheduling, together with interest earned by investing short term cash surpluses, is a crucial part of the Council's medium term financial strategy. This has to be carefully balanced against the level of risk incurred. The Council held £139.550m of investments as at 30 September 2023 and for the first 6 months of the year earned interest of £3.007m. The Council is projecting that, by the end of financial year, this will have increased to £5.309m, significantly greater than budget.
Legal Implications: (Authorised by the Borough Solicitor)	There is a statutory duty for the Council deliver a balanced budget and sound treasury management is a key tool in managing this. Demonstration of sound treasury management will in turn provide confidence to the Council that it is complying with its fiduciary duty

to the public purse, and in turn allows the Council to better plan and fulfil its key priorities for the coming year.

Members should ensure that they take the opportunity when considering this report to ensure that they are content with all of the analysis set out in the main body of the report.

Risk Management:	Failure to properly manage and monitor the Council's loans and investments could lead to service failure and loss of public confidence.
Background Information:	The background papers relating to this report can be inspected by contacting Gemma McNamara, Interim Assistant Director of Finance (Deputy 151 Officer):

e-mail: gemma.mncamara@tameside.gov.uk

1. INTRODUCTION

1.1. The Council has adopted 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, as a minimum, treasury management semi-annual and annual outturn reports.

1.2. This report provides an additional update and includes the new requirement in the 2021 Code, mandatory from 1 April 2023, of quarterly reporting of the treasury management prudential indicators.

1.3. The Treasury Management Strategy for 2023/24 was approved by Council on 28 February 2023. The Council has substantial levels of both investments and borrowing, 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.

2. EXTERNAL CONTEXT

2.1. The following economic update is provided by the Council's advisors, Arlingclose:
Economic background: *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.*

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.

July data showed the unemployment rate increased to 4.3% (3mth/year) while the employment rate rose to 75.5%. 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.

Inflation continued to fall from its peak as annual headline CPI declined to 6.7% in July 2023 from 6.8% 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%.

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.

Financial market Bank Rate expectations moderated over the period as falling inflation and weakening data gave some indication that higher interest rates were working. Expectations fell from predicting a peak of over 6% in June to 5.5% just ahead of the September MPC meeting, and to then expecting 5.25% to be the peak by the end of the period.

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.*

The lagged effect of monetary policy together with the staggered fixed term mortgage maturities over the next 12-24 months means the full impact from Bank Rate rises are still yet to be felt by households. As such, while consumer confidence continued to improve over the period, the GfK measure hit -21 in September, it is likely this will reverse at some point. Higher rates will also impact business and according to S&P/CIPS survey data, the UK manufacturing and services sector contracted during the quarter with all measures scoring under 50, indicating contraction in the sectors.

The US Federal Reserve increased its key interest rate to 5.25-5.50% over the period, pausing in September following a 0.25% rise the month before, and indicating that it may have not quite completed its monetary tightening cycle.

Having fallen throughout 2023, annual US inflation started to pick up again in July 2023, rising from 3% in June, which represented the lowest level since March 2021, to 3.2% in July and then jumping again to 3.7% in August, beating expectations for a rise to 3.6%. Rising oil prices were the main cause of the increase. US GDP growth registered 2.1% annualised in the second calendar quarter of 2023, down from the initial estimate of 2.4% but above the 2% expansion seen in the first quarter.

The European Central Bank increased its key deposit, main refinancing, and marginal lending interest rates to 4.00%, 4.50% and 4.75% respectively in September, and hinted these levels may represent the peak in rates but also emphasising rates would stay high for as long as required to bring inflation down to target.

Although continuing to decline steadily, inflation has been sticky, Eurozone annual headline CPI fell to 5.2% in August while annual core inflation eased to 5.3% having stuck at 5.5% in the previous two months. GDP growth remains weak, with recent data showing the region expanded by only 0.1% in the three months to June 2023, the rate as the previous quarter.

***Financial markets:** Financial market sentiment and bond yields remained volatile, with the latter generally trending downwards as there were signs inflation, while still high, was moderating and interest rates were at a peak.*

Gilt yields fell towards the end of the period. The 5-year UK benchmark gilt yield rose from 3.30% to peak at 4.91% in July before trending downwards to 4.29%, the 10-year gilt yield rose from 3.43% to 4.75% in August before declining to 4.45%, and the 20-year yield from 3.75% to 4.97% in August and then fell back to 4.84%. The Sterling Overnight Rate (SONIA) averaged 4.73% over the period.

***Credit review:** 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 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.*

During the second quarter of the period, Moody's revised the outlook on Svenska Handelsbanken to negative from stable, citing concerns around the Swedish real estate sector.

Having put the US sovereign rating on Rating Watch Negative earlier in the period, Fitch took further action in August, downgrading the long-term rating to AA+, partly around ongoing debt *ceiling concerns but also an expected fiscal deterioration over the next couple of years.*

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.

Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress and although no changes were made to recommended durations over the period, Northern Trust Corporation was added to the counterparty list.

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.

3. LOCAL CONTEXT

3.1. On 31 March 2023, the Council had investments of £124.610m and borrowing of £139.471m. The treasury management position at 30 September and the change over the year to date is shown in Table 1 below.

Table 1: Treasury Management Summary

	31.3.23 Balance £m	Movement £m	30.9.23 Balance £m
Long-term borrowing			
- PWLB	99.227	(0.202)	99.025
- Market Loans	40.000	-	40,000
- Other	0.244	-	0.244
Total borrowing	**139.471**	**(0.202)**	**139.269**
Long-term investments	-	-	-
Short-term investments	100.700	(75.700)	25.000
Cash and cash equivalents	23.910	90.640	114.550
Total investments	**124.610**	**14.940**	**139.550**
Net Borrowing	**14.861**	**(15.142)**	**(0.281)**

3.2. The borrowing position has remained consistent as the majority of the Council's loans are maturity loans with long durations. As is illustrated in the Prudential Indicators at the end of this report, 93% of these loans do not mature for at least ten years. Further to this no additional borrowing has been taken up in year to date and none is planned for the remainder of the year due to the current high interest rate environment and the Council's already strong cash position. Any loans taken up would incur a cost of carry due to the interest rates on borrowing being higher than those available for investment. Further borrowing, and the resultant increase in cash balances, would also have the adverse effect of increasing the Council's exposure to credit risk.

3.3. Investment balances have increased over the year to date by £14.940m. This is largely as a result of the timing differences between the receipts of grants versus subsequent expenditure, as many grants are received earlier in the year whilst expenditure is spread more evenly. It is anticipated that investment levels will return to similar to the opening levels by the end of the financial year.

4. BORROWING

4.1. 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 Council. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield unless these loans are for refinancing purposes.

4.2. The Council has not invested in assets primarily for financial return or that are not primarily related to the functions of the Council. It has no plans to do so in future.

5. BORROWING STRATEGY AND ACTIVITY

5.1. As outlined in the treasury strategy, the Council'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. The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

5.2. There has been a substantial rise in the cost of both short- and long-term borrowing over the last 18 months. In the year to date, Bank Rate has risen from 4.25% at the beginning of April to 5.25% at the end of September and was also 2% higher than its level at the end of September 2022. However, due to the Council's portfolio of fixed rate loans, there has been no adverse impact on interest costs.

5.3. 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. Gilt yields, and consequently PWLB borrowing rates, rose and broadly remained at elevated levels. On 30th September, the PWLB certainty rates for maturity loans were 5.26% for 10 year loans, 5.64% for 20-year loans and 5.43% for 50-year loans. Their equivalents on 31st March 2023 were 4.33%, 4.70% and 4.41% respectively.

5.4. At 30 September the Council held £139.471m of loans, a minor reduction from 31st March 2023, as part of its strategy for funding previous years' capital programmes. No Further borrowing is planned in year.

Loans restructuring

5.5 The sharp rise in gilt yields over the past 18 months has now resulted in some of the Council's loans being in or close to a discount position if repaid early. However, as the prepaid loans would potentially need to be replaced by new loans at higher interest rates, this isn't a cost-effective option for the Council.

LOBO loans

5.6 The Council continues to hold £30m 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 Council has the option to either accept the new rate and terms or to repay the loan at no additional cost.

5.7 With market interest rates having risen, the probability of LOBOs being called has been higher than in the recent past. The £30m of LOBO loans have semi-annual call options, however no lender exercised their option to date. If any option is exercised and an increased rate proposed, the Council will evaluate whether to accept the new rate if it is judged to be a fair rate given the continued existence of future options and the prevailing interest rate at the or repay the loan at no additional cost. If required, the Council will repay the LOBO loans with available cash or by borrowing from other local authorities or the PWLB.

6. INVESTMENT ACTIVITY

6.1. CIPFA published a revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes on 20 December 2021. These define treasury management investments as investments that arise from the organisation's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

6.2. The Council held £139.550m of invested funds as at 30 September, representing income received in advance of expenditure plus balances and reserves held. The investment position is shown in Table 2 below and a full breakdown is included in **Appendix 1**.

Table 2: Treasury Investment Position

	31.3.23 Balance £m	Net Movement £m	30.9.23 Balance £m	30.9.23 Weighted Average Return %	30.9.23 Weighted Average Maturity Days
Local Authorities	70.700	(55.700)	15.000	4.25	57
Banks	30.000	(20.000)	10.000	4.60	10
Money Market Funds	23.910	90.640	114.550	5.31	n/a
Total Investments	**124.610**	**14.940**	**139.550**		

6.3. 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 income.

6.4. 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 around 5.6%. Money Market Rates are around 5.3%. The Council still has a small number of older investments which are shown with returns below base rate in table 2. However, as these mature they will be replaced with low risk investments with higher returns.

6.5. The Council's advisors, Arlingclose, are recommending only shorter duration deposits when using banks, and an increasing number of local authorities have issued Section 114 notices or suggested they are in danger of having to do so. Against this backdrop there has been a move towards using more Money Market Funds (MMFs) which are highly secure and offer daily liquidity. The Council will still look to place fixed deposits when satisfied with both the level of security and return.

6.6. Based on the current investment portfolio and anticipated market conditions for the remainder of the year, interest income of £5.309m is forecast against a budget of £2.685m, a favourable variation of £2.624m.

7. MANCHESTER AIRPORT

7.1. The Council has an historic 3.22% shareholding in Manchester Airport Group. This shareholding has been valued at £20.1m as at 31 March 2023. Prior to the COVID-19 pandemic, the Council was receiving significant dividend income from this investment (£6.4m in 2019) which was a key item in the Council's Medium Term Financial Strategy. No dividends have been received since 2020/21.

7.2. In recent years, further additional investment in Manchester Airport has been approved:

7.3. A capital investment of £11.3m in Manchester Airport was approved by Executive Cabinet in February 2018. The investment takes the form of a shareholder loan which was funded from reserves. Interest will be paid at a rate of 10% per annum, which generates a revenue stream for the Council of approximately £1m (after allowing for the loss of interest earned on cash used to fund the investment) which will support the revenue budget.

7.4. In February 2019, Executive Cabinet approved an equity investment of £5.6m in Manchester Airport funded by prudential borrowing. The investment is expected to generate revenue income through returns of around 3.25% (after taking account of borrowing costs and debt repayment). It was originally envisaged that this income would begin to be received from 2021/22 onwards, although no amounts are yet assumed in the Medium Term Financial Plan (MTFP). The economic impact of COVID-19 is likely to mean that income from this investment will not be generated for a number of years and will be dependent on the speed and scale of recovery in the Aviation Sector. This additional shareholding has been valued at £4.3m as at 31 March 2023.

7.5. In April 2020, Executive Cabinet approved a further investment of £9.7m in Manchester Airport in the form of an equity loan, funded by prudential borrowing. The loan intended to provide financial stability to Manchester Airport Group and ensure it was best placed to react and rebuild business operations as Covid restrictions were lifted. The investment completed in June 2020 and generates income through interest earned of 10% per annum

7.6. The COVID-19 pandemic has had a significant impact on the Aviation Industry. Whilst the expectation is that interest on loans and investments will continue to be accrued, the annual dividend is not expected to be payable for a number of years, placing a £6.4m pressure on the revenue budget.

8. COMPLIANCE

8.1. The Director of Resources reports that all treasury management activities undertaken during the quarter complied fully with the principles in the Treasury Management Code and the Council's approved Treasury Management Strategy.

9. PRUDENTIAL INDICATORS

9.1. As required by the 2021 CIPFA Treasury Management Code, the Council monitors and measures the following treasury management prudential indicators.

Ratio of Financing Costs to Net Revenue Stream

Limit/Indicator	Limit %	Estimate %
Ratio of financing costs to net revenue stream	4.5	4.5

This ratio represents the total of all financing costs e.g. interest payable and minimum revenue provision (MRP) that are charged to the revenue budget as a percentage of the amount to be met from Government grants and taxpayers (net revenue stream).

Capital Financing Requirement (CFR)

Limit/Indicator	Limit £m	Actual £m
Capital Financing Requirement	194.637	193.962

The Capital Financing Requirement is aimed to represent the underlying need to borrow for a capital purpose and is calculated from the aggregate of specified items on the balance sheet.

The CFR increases by the value of capital expenditure not immediately financed (i.e. borrowing) and is reduced by the annual MRP repayment.

Capital Expenditure

Limit/Indicator	Limit £m	Estimate £m
Capital expenditure	118.794	47.100

This is the total capital expenditure incurred (from all funding sources).

Incremental Impact of Capital Investment Decisions

Limit/Indicator	Limit £	Actual £
For the Band D Council Tax	0.27	0.01

This is the estimate of the net incremental impact of the capital investment decisions, based on the level of borrowing set out in the report and reflects the total cost of this additional borrowing (interest payments and minimum revenue provision), as a cost on Council Tax.

The actual cost will depend on final funding. For every £1 increase on Band D properties, approximately £0.066m would be raised.

Operational Boundary and Authorised Limit on External Debt and Other Long Term Liabilities

Limit/Indicator	Limit £m	Actual £m
Operational Boundary for external debt	206.110	139.269
Authorised Limit for external debt	226.110	139.269

The Authorised Limit for External Debt sets the maximum level of external borrowing on a gross basis (i.e. excluding investments) for the Council.

The operational boundary for External Debt comprises the Council's existing debt plus the most likely estimate of capital expenditure/financing for the year. It excludes any projections for cash flow movements. Unlike the authorised limit, breaches of the operational boundary (due to cash flow movements) are allowed during the year as long as they are not sustained over a period of time.

These limits include provision for borrowing in advance of the Council's requirement for future capital expenditure. This may be carried out if it is thought to be financially advantageous to the Council.

Upper and lower limits on Interest Rate Exposures

Limit/Indicator	Limit £m	Actual £m
Upper limit for fixed interest rate exposure	194.637	84.221
Upper limit for variable interest rate exposure	64.879	(84.306)

These limits are in respect of our exposure to the effects of changes in interest rates.
The limits reflect the net amounts of fixed/variable rate debt (i.e. fixed/variable loans less fixed/variable investments. A negative value represents investments being higher than loans)

Upper Limit for Total Principal Sums Invested for Over 364 Days

Limit/Indicator	Limit £m	Actual £m
Upper limit for sums invested over 364 days	30.000	nil

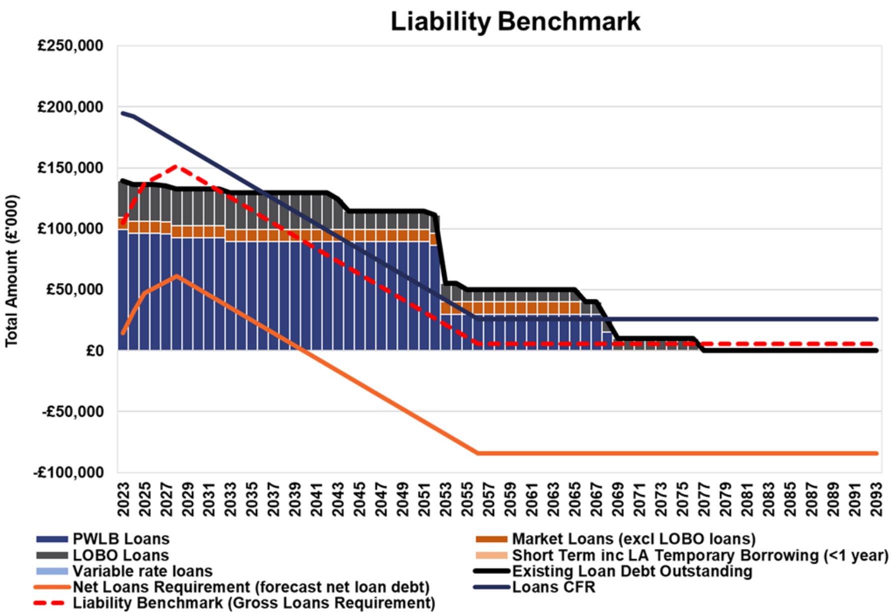
This limit is in respect of treasury investments made for a duration longer than one year.

Maturity structure for fixed rate borrowing

Indicator	Limit	Actual
Under 12 months	0% to 15%	2.16%
12 months and within 24 months	0% to 15%	-
24 months and within 5 years	0% to 30%	2.55%
5 years and within 10 years	0% to 40%	2.16%
10 years and above	50% to 100%	93.13%

This indicator is in respect of all of the Council's fixed rate borrowing with PWLB or other market lenders.

Liability Benchmark



The liability benchmark is a new prudential indicator introduced by CIPFA for 2023/24. This gives a long term view of the Council's borrowing needs based on current commitments. This demonstrates that there is currently no borrowing need and the Council currently has a significant level of surplus cash, which makes up its investment portfolio. If further schemes to be funded by borrowing are added to the Capital Programme in future then the benchmark will increase and more borrowing could potentially be required.

APPENDIX 1

Investments

The below table shows all of the Council's treasury investments as at 30 September 2023.

	Amount £m	Rate	Start	End
Fixed Deposits - Local Authorities				
Cheshire West and Chester Council	5.000	4.05%	28-Oct-22	23-Oct-23
Woking Borough Council	5.000	4.50%	14-Nov-22	13-Nov-23
Eastbourne BC	5.000	4.20%	13-Feb-23	15-Jan-24
	15.000			
Fixed Deposits - Banks				
Goldman Sachs	5.000	4.710%	11-Apr-23	11-Oct-23
Landesbank Hessen Thuringen Girozentrale (Helaba)	5.000	4.480%	11-Apr-23	11-Oct-23
	10.000			
Money Market Funds				
Invesco	15.000	5.33%	n/a	
Insight	15.000	5.30%	n/a	
SSGA	14.200	5.28%	n/a	
Federated	14.500	5.35%	n/a	
DB Advisors	10.940	5.23%	n/a	
AAM	15.000	5.29%	n/a	
Legal & General	15.000	5.35%	n/a	
Morgan Stanley	14.910	5.36%	n/a	
	114.550			
Total Investments	**139.550**			