ANNEX 5.1

TREASURY MANAGEMENT STRATEGY 2023/24

Mid-year

1. Introduction

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.

This report satisfies the new requirement in the 2021 Code, mandatory from 1 April 2023, of quarterly reporting of the treasury management prudential indicators.

The non-treasury prudential indicators are incorporated in the Council's quarterly revenue and capital monitoring update.

The Treasury Management Strategy for 2023/24 was approved by Council on 20 July 2023.

The Council has invested significant sums 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 therefore remains central to the Council's treasury management strategy.

2. External Context

(provided by the Council's Treasury Management Advisor, 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

On 31 March 2023, the Council had net investments of £9.0 million arising from its revenue and capital income and expenditure.

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying resources available for investment.

These factors are summarised in the table below.

Table 1: Balance Sheet Summary	**31/03/2023 Actual £000**	**31/03/2024 Forecast £000**
General Fund CFR	94,300	70,100
External borrowing[1]	(7,000)	-
Internal borrowing	**87,300**	**70,100**
Less: Balance sheet resources	103,294	73,300
Investments/ (borrowing)	**15,994**	**3,200**

NOTE 1: Loans to which the Council is committed; excludes optional refinancing.

The treasury management position at 30th September and the change over the six months is shown in Table 2 below.

Table 2: Treasury Management Summary	**31/03/2023 Balance £000**	**Movement £000**	**30/09/2023 Balance £000**	**30/09/2023 Rate %**
Short term Borrowing	(7,000)	7,000	-	-
Cash and cash equivalents	15,994	28,030	44,024	4.65%
Net investments	**8,994**	**35,030**	**44,024**	**4.65%**

The increase in investment movement is due to expected capital receipts during this period.

Borrowing

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.

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.

Borrowing Strategy and Activity

At 30 September 2023 the Council held no loans.

The Council has historically been largely debt free and has borrowed on a temporary basis to fund short term cash flow shortfalls. This strategy is likely to remain the most effective in future.

Loans outstanding as at 30 September 2023 are summarised in the table below.

Table 3: Borrowing Position	31/03/2023 Balance £000	Net Movement £000	30/09/2023 Balance £000	30/09/2023 Weighted Average Rate %	30/09/2023 Weighted Average Maturity (months)
Other Lenders[1]	(7,000)	7,000	-	-	-
Total borrowing	**(7,000)**	**7,000**	**-**	**-**	**-**

NOTE 1: Housing Association

The chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should long-term plans change being a secondary objective.

The borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

Treasury Investment Activity

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

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held.

During the year, investment balances ranged between £11.8 million and £65.9 million due to timing differences between income and expenditure.

The investment position is set out in the table below:

Table 4: Treasury Investment Position	31/03/2023 Balance £000	Net Movement £000	30/09/2023 Balance £000	30/09/2023 Income Return %	30/09/2023 Weighted Average Maturity (Days)
Banks & building societies (unsecured)	8,994	30	9,024	0.95%	1
Government – Debt Management Office (DMO)	-	15,000	15,000	3.98%	117
Money Market Funds	7,000	13,000	20,000	5.30%	1
Total investments	**15,994**	**28,030**	**44,024**	**4.65%**[1]	**25**[1]

NOTE 1: Weighted Average

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 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.

Bank Rate increased by 1%, from 4.25% at the beginning of April to 5.25% by the end of September.

Short-dated cash rates rose commensurately, with 3-month rates rising to around 5.25% and 12-month rates to nearly 6%.

The rates on DMADF deposits also rose, ranging between 5.2% and 5.3% by the end of September and Money Market Rates from 4.16% and 5.30%.

The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in the table below.

Table 5: Investment Benchmarking – Treasury investments managed in-house	**Credit Score**	**Credit Rating**	**Bail-in Exposure**	**Weighted Average Maturity (days)**	**Rate of Return %**
Reigate & Banstead Borough Council 31/03/2023 30/09/2023	 4.90 4.29	 A+ AA-	 100% 66%	 1 25	 4.01% 4.65%
Similar Local Authorities	4.43	AA-	56%	63	4.71%
All Local Authorities	4.47	AA-	59%	13	4.79%

Non-Treasury Investments

The definition of investments in the Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).

Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) and Welsh Government also includes within the definition of investments all such assets held partially or wholly for financial return.

The Council held:

- £1.1m shares in Pathway For Care Limited;
- £0.652m shared in Greensand Holdings Limited; and
- Loans of £13.258m to Greensand Holdings Limited
- Horley Business Park development LLP is in the process of being liquidated.

Treasury Performance

Treasury investments generated an average rate of return 4.65% in the first half of the financial year.

The Council's treasury investment income for the year is likely to be above the budget due to the higher interest rates and anticipated capital receipts during the second quarter of the year.

Compliance

The Chief Finance Officer 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.

Compliance with specific investment limits is demonstrated in the table below.

Table 6: Investment Limits	2023/24 Maximum £000	30/09/2023 Actual £000	2023/24 Limit £000	Complied?
Any single organisation, except the UK Government	10,000	5,000	10,000	Yes
Any group of pooled funds under the same management	0	0	10,000	Yes
Negotiable instruments held in a broker's nominee account	0	0	13,000	Yes
Limit per non-UK country	0	0	5,000	Yes
The UK Government	25,000	15,000	n/a	Yes
Local authorities & other government entities	0	0	Unlimited	Yes
Secured investments	0	0	Unlimited	Yes
Banks (unsecured) (Excluding the Councils Operational bank accounts)	10	10	Unlimited	Yes
Building societies (unsecured)	0	0	10,000	Yes
Registered providers (unsecured)	0	0	13,000	Yes
Money market funds	£41m sector (£10m counterparty)	£20m sector (£5m counterparty)	Unlimited (£10m per counterparty)	Yes
Strategic pooled funds	0	0	25,000	Yes
Real estate investment trusts	0	0	13,000	Yes
Other investments	0	0	5,000	Yes

Treasury Management Prudential Indicators

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

1. Liability Benchmark

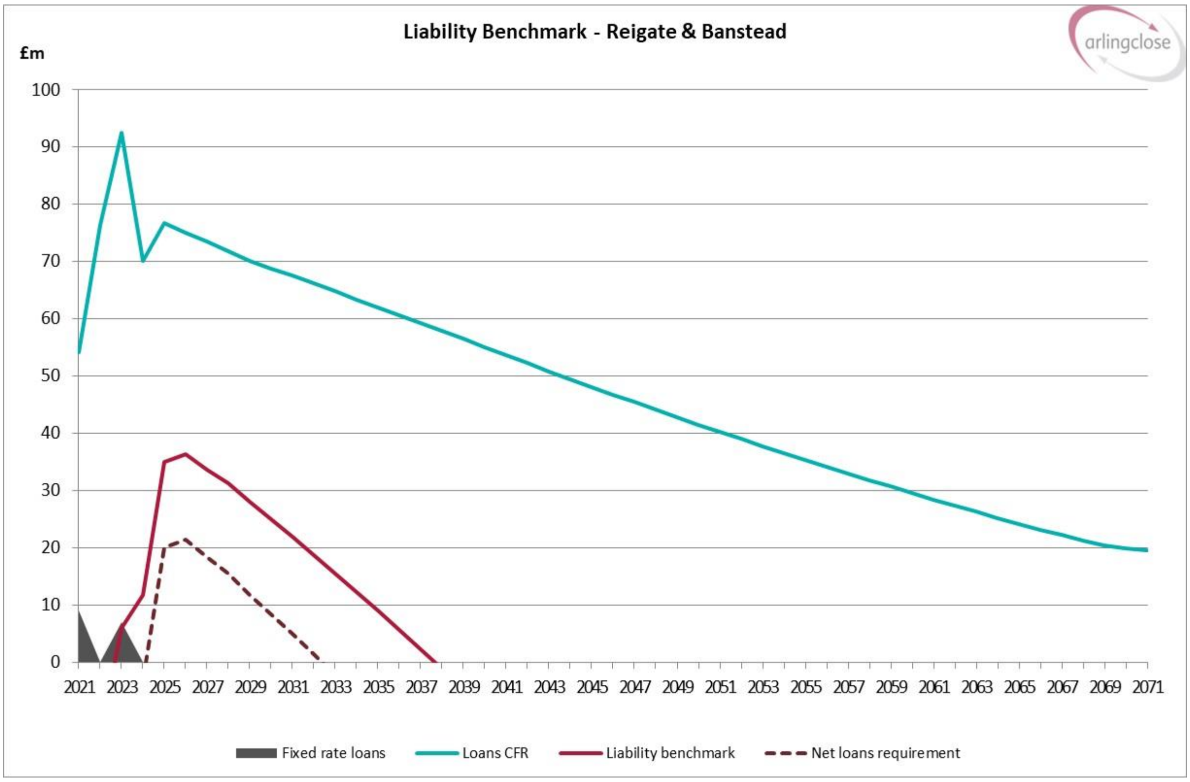
This new indicator compares the Council's actual existing borrowing against a liability benchmark that has been calculated to show the lowest risk level of borrowing.

The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making.

It represents an estimate of the cumulative amount of external borrowing the Council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level of £15.0 million required to manage day-to-day cash flow.

Table 7: Liability Benchmark	**31/03/2023 Actual £000**	**31/03/2024 Forecast £000**	**31/03/2025 Forecast £000**	**31/03/2026 Forecast £000**
Loans CFR	94,300	70,100	76,700	75,000
Less: Balance sheet resources	103,300	73,300	56,700	53,700
Net loans requirement	**9,000**	**3,200**	**(20,000)**	**(21,300)**
Plus: Liquidity allowance	15,000	15,000	15,000	15,000
Liability benchmark	**6,000**	**11,800**	**35,000**	**36,300**
Existing borrowing	**(7,000)**	**-**	**-**	**-**

Following on from the medium-term forecast in the table above, the long-term liability benchmark assumes no capital expenditure will be funded by borrowing after 2023-24 and that reserves will increase by 2.5%. This illustrated in the chart below:



A borrowing requirement of £22.3 million is expected by 31 March 2024 and increasing by £35.2million and £36.6 million respectively for 31 March 2025 and 31 March 2026 and declining thereafter from 2027 onwards.

The net loans requirement on the graph is a lower figure and represents the borrowing that would be required if investment balances were kept at nil.

The graph represents only a snapshot in time at year end when balances are typically at their lowest and borrowing needs are highest. In year balances are expected to fluctuate to up to £65.3 million.

Borrowing is therefore in practice only likely to be required in the short term for some parts of the year.

2. Maturity Structure of Borrowing

This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

Table 8: Maturity Structure of Borrowing	Upper Limit	Lower Limit	30/09/2023 Actual	Complied?
Under 12 months	100%	0%	-	Yes
12 months and within 24 months	100%	0%	-	Yes
24 months and within 5 years	100%	0%	-	Yes
5 years and within 10 years	100%	0%	-	Yes
10 years and above	100%	0%	-	Yes

Time periods start on the first day of each financial year.

The maturity date of borrowing is the earliest date on which the lender can demand repayment.

As the Council has relatively modest and short term overall borrowing requirement there is no significant refinancing risk associated with having all loans maturating within the timescales shown above.

At present the Council would wish to retain maximum flexibility as to the periods in which it borrows over. If the debt portfolio becomes more extensive, then the indicator will be reviewed to ensure that it remains suitable.

3. Long-term Treasury Management Investments

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury management limits are:

Table 9: Long Term Investments	2023/24	2024/25	2025/26	No fixed date
Limit on principal invested beyond year end	£10.0m	£10.0m	£10.0m	£10.0m
Actual principal invested beyond year end	£0m	£0m	£0m	£0m
Complied?	Yes	Yes	Yes	Yes

Long-term investments with no fixed maturity date include strategic pooled funds, real estate investment trusts and directly held equity but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

Additional indicators

Security**:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average rating / credit score of its investment portfolio.

This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Table 10: Credit Risk	**2023/24 Target**	**30/09/2023 Actual**	**Complied?**
Portfolio average credit	A	AA-	Yes

Liquidity**:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period.

Table 11: Liquidity Risk	**2023/24 Target**	**30/09/2023 Actual**	**Complied?**
Total cash available within 3 months	£5.0 million	£29.024 million	Yes

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. Bank Rate rose by 1.00% from 4.25% on 1st April to 5.25% by 30th September 2023.

Table 12: Interest rate risk indicator	**2023/24 Target**	**30/09/2023 Actual[1]**	**Complied?**
Revenue impact of a 1% change in interest rates	£0.078 million pa	£0.369 million pa	No

Note 1 the figure is higher due to no loans taking out during this period and therefore figure is related to investment interest with no loan interest payable to the comparable target figure.

For context, the changes in interest rates during the quarter were:

	31/3/23	30/9/23
Bank Rate	4.25%	5.25%
1-year PWLB certainty rate, maturity loans	4.78%	5.69%
5-year PWLB certainty rate, maturity loans	4.31%	5.22%
10-year PWLB certainty rate, maturity loans	4.33%	5.26%
20-year PWLB certainty rate, maturity loans	4.70%	5.64%
50-year PWLB certainty rate, maturity loans	4.41%	5.43%

The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at new market rates.