Annex 5.1

TREASURY MANAGEMENT STRATEGY 2023/24

Quarter 3

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 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 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 rates finally started to decline, mirroring the sharp but earlier drop seen in the Eurozone and US. Despite the fall, the Consumer Price Index (CPI) remained substantially in excess in the Bank of England's (BoE) 2% target, at 3.9% for November 2023. Market expectations for further rises in Bank Rate fell from October through to year end, indicating that the 5.25% level reached in August 2023 was indeed the peak for Bank Rate.*

Economic growth in the UK remained weak over the period, edging into recessionary territory. In calendar Q3 2023, the economy contracted by 0.1%, following no change in Q2. Monthly GDP data showed a 0.3% contraction in October, following a 0.2%

rise in September. While other indicators have suggested a pickup in activity in the subsequent months, Q4 GDP growth is likely to continue the weak trend.

July data showed the unemployment rate increased to 4.2% (3mth/year) while the employment rate rose to 75.7%. Pay growth edged lower as the previous strong pay rates waned; total pay (including bonuses) growth was 7.2% over the three months to October 2023, while regular pay growth was 7.3%. Adjusting for inflation, pay growth in real terms were positive at 1.3% and 1.4% for total pay and regular pay respectively.

Inflation continued to fall from its peak as annual headline CPI declined to 3.9% (down from 4.6%) in November 2023. The largest downward contribution came from energy and food prices. The core rate also surprised on the downside, falling to 5.1% from 5.7%.

The BoE's Monetary Policy Committee held Bank Rate at 5.25% throughout the period, although a substantial minority continued to vote for a 25 basis point rate rise. The Bank continues to tighten monetary policy through asset sales, as it reduces the size of its balance sheet. Financial market Bank Rate expectations moderated over the period as falling inflation and weakening data showed that higher interest rates were working in the UK, US, and Eurozone.

Following the December MPC meeting, Arlingclose, the authority's treasury adviser, maintained its central view that 5.25% is the peak in Bank Rate. Short term risks are broadly balanced, 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, it is likely this will reverse at some point and spending will struggle. Higher rates will also impact exposed businesses; according to S&P/CIPS survey data, the UK manufacturing and construction sectors contracted during the quarter. The services sector recovered, however, with the PMI rising strongly in December, possibly due to improving consumer confidence.

The US Federal Reserve held its key interest rate at 5.25-5.50% over the period. While policymakers continued to talk up the risks to inflation and therefore interest rates, this stance ebbed over the quarter culminating in a relatively dovish outcome from the December FOMC meeting.

The European Central Bank continues to resist market policy loosening expectations, but the Eurozone CPI rate has fallen sharply as GDP growth as markedly slowed, hitting 2.4% in November (although rising to 2.9% on energy-related base effects).

Financial markets: *Financial market sentiment and bond yields remained volatile, but the latter rapidly trended downwards towards the end of 2023 on signs of sharply moderating inflation and economic growth.*

Gilt yields fell towards the end of the period. The 10-year UK benchmark gilt yield rose from 4.57% to peak at 4.67% in October before dropping to 3.54% by the end of December 2023. The Sterling Overnight Rate (SONIA) averaged 5.19% over the period.

Credit review: *Arlingclose maintained the advised maximum duration limit for all banks on its recommended counterparty list to 35 days over the period.*

In October, Moody's revised the outlook on the UK's Aa3 sovereign rating to stable from negative. This led to similar rating actions on entities that include an element of government support in their own credit ratings, including banks and housing associations. Local authorities were, however, downgraded on expectations of lower government funding.

Following the issue of a Section 114 notice, in November Arlingclose advised against undertaking new lending to Nottingham City Council. After reducing its recommended duration on Warrington Borough Council to a maximum of 100 days in September, the local authority was subsequently suspended from the Arlingclose recommended list following a credit rating downgrade by Moody's to Baa1.

Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress, but no changes were made to recommended durations over the period.

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 £9.0million 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	62,900
External borrowing[1]	(7,000)	-
Internal borrowing	**87,300**	**62,900**
Less: Balance sheet resources	103,294	66,500
Investments/ (borrowing)	**15,994**	**3,600**

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

The treasury management position at 31rst December and the change since 1 April is set out in the table below.

Table 2: Treasury Management Summary	**31/03/2023 Balance £000**	**Movement £000**	**30/12/2023 Balance £000**	**30/12/2023 Rate %**
Short term Borrowing	(7,000)	7,000	-	-
Cash and cash equivalents	15,994	34,737	50,731	5.02%
Net investments	**8,994**	**41,737**	**50,731**	**5.02%**

The increase in investment movement is due to 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 31 December 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 31 December 2023 are summarised in the table below.

Table 3: Borrowing Position	**31/03/2023 Balance £000**	**Net Movement £000**	**30/12/2023 Balance £000**	**30/12/2023 Weighted Average Rate %**	**30/12/2023 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**	**30/12/2023 Balance £000**	**30/12/2023 Income Return %**	**30/12/2023 Weighted Average Maturity (Days)**
Banks & building societies (unsecured)	8,994	(4,263)	4,731	2.11%	1
Government – Debt Management Office (DMO)	-	10,000	10,000	5.33%	132
Money Market Funds	7,000	29,000	36,000	5.30%	1
Total investments	**15,994**	**34,737**	**50,731**	**5.02%**[1]	**9**[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.

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

Short-dated cash rates peaked at 5.6% for 3-month rates and 12-month rates to nearly 6.6% during the period.

The rates on deposits with the Government's Debt Management Account Deposit Facility (DMADF) also rose, ranging between 5.2% and 5.3% by the end of December and Money Market Rates from 4.16% and 5.35%.

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	4.90	A+	100%	1	4.01%
30/12/2023	4.62	AA-	80%	9	5.02%
Similar Local Authorities	4.81	AA-	57%	54	5.00%
All Local Authorities	4.80	AA-	60%	11	5.04%

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.

At 31 December the Council held:

- £1.1m shares in Pathway For Care Limited;
- £0.652m shares in Greensand Holdings Limited; and
- Loans of £13.258m advanced to Greensand Holdings Limited
- Note: excludes funds provided to Horley Business Park Development LLP which is in the process of being liquidated.

Treasury Performance

Treasury investments generated an average rate of return 5.02% in the nine months 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**	**30/12/2023 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	**-**	**-**	10,000	Yes
Negotiable instruments held in a broker's nominee account	-	**-**	13,000	Yes
Limit per non-UK country	**-**	**-**	5,000	Yes
The UK Government	25,000	10,000	n/a	Yes
Local authorities & other government entities	**-**	**-**	Unlimited	Yes
Secured investments	**-**	**-**	Unlimited	Yes
Banks (unsecured) (Excluding the Councils Operational bank accounts)	10	**10**	Unlimited	Yes

Table 6: Investment Limits	2023/24 Maximum £000	30/12/2023 Actual £000	2023/24 Limit £000	Complied?
Building societies (unsecured)	-	-	10,000	Yes
Registered providers (unsecured)	-	-	13,000	Yes
Money market funds	£41m sector (£10m per counterparty)	£36m sector (£7m per counterparty)	Unlimited (£10m per counterparty)	Yes
Strategic pooled funds	-	-	25,000	Yes
Real estate investment trusts	-	-	13,000	Yes
Other investments	-	-	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

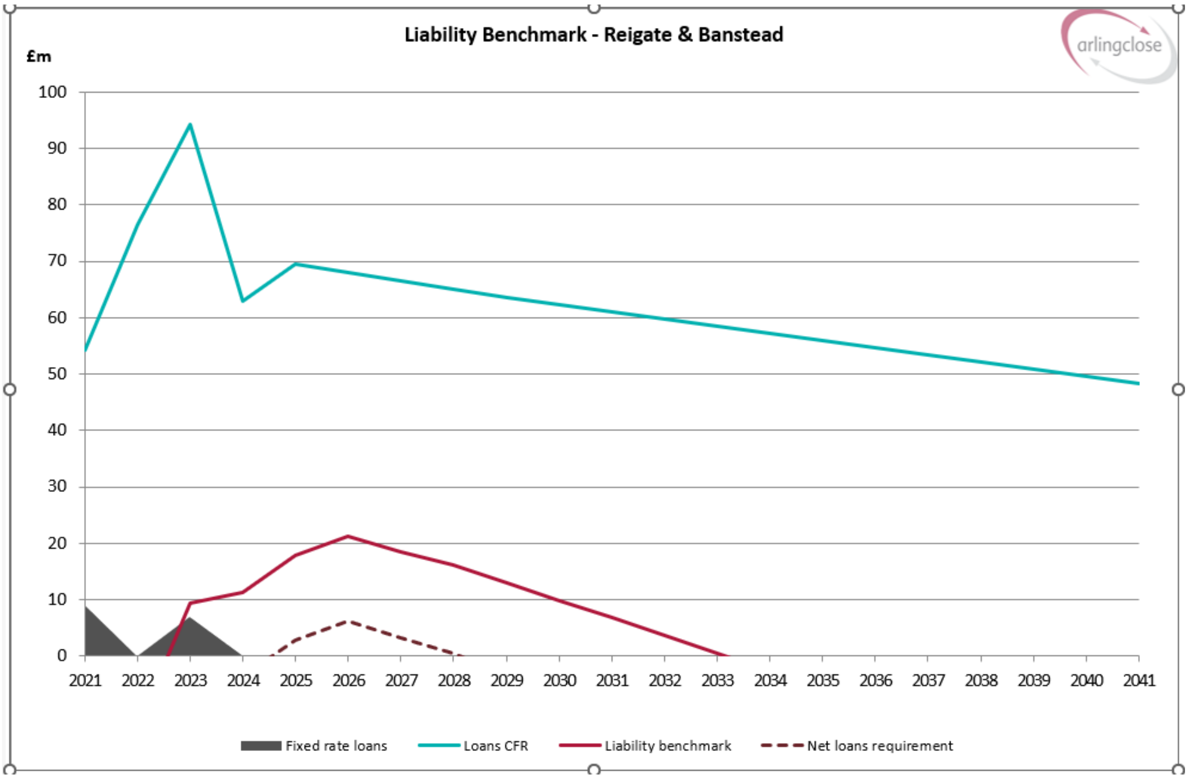
This indicator compares the Council's actual current borrowing against a liability benchmark that has been calculated to show the lowest risk level of borrowing.

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	62,900	69,600	68,100
Less: Balance sheet resources	103,300	66,500	66,700	61,800
Net loans requirement	**9,000**	**3,600**	**(2,900)**	**(6,300)**
Plus: Liquidity allowance	15,000	15,000	15,000	15,000
Liability benchmark	**6,000**	**11,400**	**17,900**	**21,300**
Current 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 is illustrated in the chart below:



A borrowing requirement of £11.4 million is expected by 31 March 2024 and increasing by £17.9million and £21.3 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 £65.9 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	30/12/2023 Actual Borrowing	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 requirements 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	30/12/2023 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	30/12/2023 Actual	Complied?
Total cash available within 3 months	£5.0m	£36.0m	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 31 December 2023.

Table 12: Interest rate risk indicator	2023/24 Target	30/12/2023 Actual	Complied?
Revenue impact of a 1% change in interest rates	£0.078m pa	£0.451m pa	No

The higher actuals figure is due to the fact that the target was set at a time when the authority had both short-term investments and short-term debt, mitigating the overall impact of a change of interest rates. At 31/12/2023 the authority had no short-term debt increasing the impact of a change in interest rates. This target will be reviewed for the next financial year so that it incorporates this eventuality.

For context, the changes in interest rates during the year to date were:

Interest Rates	31/3/23	30/12/23
Bank Rate	4.25%	5.25%
1-year PWLB certainty rate, maturity loans	4.78%	5.60%
5-year PWLB certainty rate, maturity loans	4.31%	4.92%
10-year PWLB certainty rate, maturity loans	4.33%	5.06%
20-year PWLB certainty rate, maturity loans	4.70%	5.55%
50-year PWLB certainty rate, maturity loans	4.41%	5.38%

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.