CABINET

DATE	15 November 2023
REPORT OF	Councillor Stephen Harness Portfolio Holder for Finance, Resources and Assets
RESPONSIBLE OFFICER	Sharon Wroot, Executive Director, Place & Resources
SUBJECT	Treasury H1 Outturn 2023-24
STATUS	Open
FORWARD PLAN REF NO.	CB 11/23/02

CONTRIBUTION TO OUR AIMS

Effective treasury management will provide support towards the achievement of Council Plan aims and objectives. Treasury management is an integral part of the Council's finances providing for cash flow management and financing of capital schemes. It therefore underpins all the Council's aims.

EXECUTIVE SUMMARY

The report contains details of treasury management arrangements, activity and performance during the 2023/24 financial year.

During the period covered, the Council complied with its legislative and regulatory requirements.

The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Prudential and Treasury Indicators	**2023-24 Approved Budget £'m**	**H1 2023-24 £'m**	**Revised 2023-24 Estimate £'m**
Capital Expenditure	**77.2**	**14.0**	**74.9**
Capital Financing Requirement	**239.6**	**208.9**	**222.5**
Authorised Borrowing Limit	**250.0**	**250.0**	**250.0**
Operational Boundary	**220.0**	**220.0**	**220.0**
External Borrowing	**186.1**	**165.3**	**183.4**
Investments >365 days	**21.0**	**0.0**	**21.0**

RECOMMENDATIONS

It is recommended that Cabinet:

1) Receives the report and notes the treasury management activity during the first half of 2023-24.

REASONS FOR DECISION

The Council's treasury management activity is guided by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year with interim updates on performance against Prudential Indicators reported quarterly. We therefore report in full after Quarter 2 and year end with Prudential Indicators being reported additionally after Quarters 1 and 3 in the Commissioning and Resource Report.

1. BACKGROUND AND ISSUES

1.1. CIPFA has defined treasury management as:

The management of the organisation's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

1.2. The Treasury Management Strategy Statement (TMSS) for 2023-24 was developed in consultation with our treasury management advisors, Link Treasury Services Ltd. This statement also incorporates the Investment Strategy.

1.3 Whilst the Council has appointed advisors to support effective treasury management arrangements, the Council is ultimately responsible for its treasury decisions and activity. No treasury activity is without risk. The successful identification, monitoring and control of risk is therefore an important and integral element of treasury management activities.

1.4 The Council has nominated the Audit & Governance Committee as responsible for ensuring effective scrutiny of the treasury management arrangements.

1.5 Key points to note with specific regard to Treasury activity:

- The first half of 2023/24 saw:
    - Interest rates rise by a further 100bps, taking Bank Rate from 4.25% to 5.25% and, possibly, the peak in the tightening cycle.

- Short, medium and long-dated gilts (and therefore our borrowing rates) remain elevated as inflation continually surprised to the upside.
- A 0.5% m/m decline in real GDP in July, mainly due to more strikes.
- CPI inflation falling from 8.7% in April to 6.7% in August, its lowest rate since February 2022, but still the highest in the G7.
- A cooling in labour market conditions, but no evidence yet that it has led to an easing in wage growth (as the of average earnings rose to 7.8% year-on-year in August, excluding bonuses).

- The continuing rapid rises in interest rates by the Bank of England as it sought to contain inflation, led to increased investment returns (aided by our preference for short duration investments) but also meant that borrowing became progressively more expensive. As a result, a strategy of deferring long-term commitment through use of reserves and short-term borrowing arrangements was adopted.

- Higher investment returns, even with our cautious approach, has generated surplus income (above budget) of £0.472m during the period, and we are on course to generate in excess of £1m of income during the full financial year which is available to fund frontline services.

- The Treasury Management Strategy covers the Council's treasury aims and principles. The Council also considers direct 'commercial' investments from time-to-time with the aim of generating financial return. Although reference is made to these types of investments in the TMSS' these transactions are guided and limited by the Capital Strategy document.

2. RISKS AND OPPORTUNITIES

2.1 No Treasury activity is without risk. Specific risks include, but are not limited to, Counterparty Credit Risk (the risk of an investment not being repaid), liquidity risk (the risk that the Authority does not have its funds in the right place, at the right time and in the right amount to make it's payments as they fall due), interest rate risk (the risk that future rate movements have a revenue implication for the Authority) and reputational risk (see Section 4 below).

2.2 The attached Appendices define our approach toward mitigating these risks.

2.3 Treasury is an Authority-wide function and therefore its environmental sustainability and equalities implications are the same as for the Council itself.

2.4 The Authority will have regard to the environmental and equality activities of its Counterparties (where reported) but

- Prioritises Security, Liquidity and Yield,
- Recognises that as large, global institutions our high-quality counterparties operate across the full range of marketplaces in which they are legally able

to, and such exposures are small parts of their overall business.

- Excluding any one counterparty will likely mean others will similarly have to be avoided and thus impact the Authority's capacity to mitigate risk through diversification.

2.5 **General Data Protection Regulation 2018** – Relationships with external providers covered by the Treasury management Practices are governed by and operated in accordance with the Act.

3. OTHER OPTIONS CONSIDERED

These were set out on Page 28 of the Treasury Management Strategy Statement.

4. REPUTATION AND COMMUNICATIONS CONSIDERATIONS

As you would expect, with large sums of public money involved, any treasury activity carries a high degree of reputational risk. Any losses have not just financial but also significant, ongoing resource implications for the Council.

5. FINANCIAL CONSIDERATIONS

The report confirms that all investment and borrowing transactions were in line with the Approved 2023-24 Treasury Management Strategy. No changes to the Strategy were necessary during the 2023-24 financial year.

6. CHILDREN AND YOUNG PEOPLE IMPLICATIONS

As an Authority-wide corporate function, the immediate impacts of day-to-day Treasury operations on children and young people are the same as for the Council as a whole. However, certain Treasury decisions, most notably those relating to Long-Term Borrowing transactions, will place a greater burden on young residents, over time, relevant to other demographics.

7. CLIMATE CHANGE AND ENVIRONMENTAL IMPLICATIONS

In line with the Authority's declaration of a Climate Emergency, the S151 Officer will aim to assess and monitor, not just Environmental but all, Environmental, Social and Governance (ESG) factors when selecting investment options. Full assessment is however restricted by the fact that, at the time of writing, there is no consistent rating framework with which to measure and benchmark specific counterparty ESG metrics. Until this market data gap is fully resolved, our approach to managing the risks associated with the Environmental activities of our Counterparties is as follows:-

- As the Ratings Agencies headline ratings on our Counterparties now incorporate ESG risk assessments alongside more traditional financial risk metrics and so provide both an holistic risk measure and a proxy for ESG ‘scoring’ in the absence of anything more robust

- The Council will continue to Prioritise Security, Liquidity and Yield, in that order

- The Council recognises that as large, global institutions our high-quality counterparties operate across the full range of marketplaces in which they are legally able to, and as a result climate change considerations are an increasingly important and heavily-scrutinised part of their overall business.

- Excluding any one counterparty will likely mean others will similarly have to be avoided and thus impact the Authority’s capacity to mitigate risk through diversification.

- The Council notes that bonds issued by Supranational institutions offer strong ESG credentials, combined with the explicit underwriting support of all major developed countries. This results in excellent ratings (typically AA+ - AAA) being applied. As such, the Council actively seeks exposure to these assets (commensurate with its investment horizon) and in doing so, contributes to market liquidity and therefore capital raising abilities of these bodies who then deploy that capital in ESG positive schemes.

8. CONSULTATION WITH SCRUTINY

This Report was taken to Audit and Governance Committee on 9 November 2023 and duly recommended to Cabinet.

9. FINANCIAL IMPLICATIONS

As set out in the appendix.

10. LEGAL IMPLICATIONS

There are no direct legal implications arising from the recommendations in this report which are not covered in the body of the report. The Council has complied with its statutory obligations arising from the Local Government Act, the Local Government Finance Act and all relevant CIPFA guidance.

11. HUMAN RESOURCES IMPLICATIONS

There are no immediate HR implications arising from the recommendations contained in this report.

12. WARD IMPLICATIONS

All wards indirectly affected

13. BACKGROUND PAPERS

CIPFA Treasury Management Code and Guidance Notes
Treasury Management Strategy Statement 2023-24
Capital Strategy Statement 2023-24

14. CONTACT OFFICER(S)

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Councillor Stephen Harness
Portfolio Holder for Finance, Resources and Assets

Appendix 1

Treasury Half-year Report 2023/24

Contents

Abbreviations Used In This Report

- **CFR:** capital financing requirement - the council's annual underlying borrowing need to finance capital expenditure and a measure of the council's total outstanding indebtedness.
- **CIPFA:** Chartered Institute of Public Finance and Accountancy – the professional accounting body that oversees and sets standards in local authority finance and treasury management.
- **ESG:** environmental, social, and governance. A set of aspects considered when investing with counterparties
- **Gilts:** gilts are bonds issued by the UK Government to borrow money on the financial markets. The yields on Gilts change inversely to the price of gilts i.e. a rise in the price of a gilt will mean that its yield falls.
- **LOBO:** a loan carrying provision for the lender to periodically amend the interest rate applicable. If the lender chooses to exercise this option the borrow then receives the secondary option to choose to repay the loan without penalty.
- **DLUHC:** the Department for Levelling Up, Housing and Communities - the Government department that directs local authorities in England.
- **MRP:** minimum revenue provision - a statutory annual minimum revenue charge to reduce the total outstanding CFR, (the total indebtedness of a local authority).
- **PWLB:** Public Works Loan Board – the section within H.M. Treasury which provides loans to local authorities to finance capital expenditure.
- **S151 Officer:** an Officer appointed under section 151 of the Local Government Act to carry out the duties of 'Responsible Financial Officer' as defined by CIPFA
- **SONIA:** Sterling Overnight Index Average, the 'risk-free' rate for market transactions.
- **TMSS:** the annual treasury management strategy statement reports that all local authorities are required to submit for approval by the full council before the start of each financial year.

Key Messages:

All investment and borrowing transactions were in line with the Approved 2023-24 Treasury Strategy.

There are no necessary in-year policy changes to the TMSS; the details in this report update the half-year position against the updated economic environment and budgetary changes already approved.

Our revised central case for rates is now for interest rates to peak around 5.25% before pausing and then reducing, albeit slowly over the next 3 years. Uncertainty remains however and the implications for both investment income and borrowing cost will be closely monitored.

S151 Officer Overview

The Council operates a balanced budget, which broadly means cash raised during the year will meet its non-capital expenditure, however there will always be timing differences in how funds are received, and expenses settled. A fundamental element of treasury management is to ensure this cash flow is adequately planned, with surplus monies being invested in low-risk counterparties, whilst retaining adequate liquidity and finally seeking appropriate investment return, consistent with those two primary objectives.

Our 2023-24 Treasury Strategy was tailored to allow the Council to manage risks related to cash investments and has, once again, stood up well to the ongoing pressures seen as a result of persistent inflation and rapidly rising interest rates, even though both surpassed our default expectations going into the period. Managing circumstances a standard deviation or two beyond that expected is a key determinant of successful Treasury Management delivery. Rare or 'once in a generation/lifetime' events happen all the time. The role of Treasury Management at North East Lincolnshire Council is to ensure those occurrences do not endanger the larger mission of the Authority.

To deliver that high level brief, the main functions of Treasury are divided into 4 main elements:-

1. The arrangement of funding for the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its capital spending plans as they fall due. This management of longer-term cash may involve arranging long or short-term loans or using longer-term cash flow surpluses. Occasionally, debt previously drawn may be restructured to meet Council risk or cost objectives.
2. Safeguarding surplus funds – investing the Council's funds in line with the principles of Security, Liquidity and Yield priority.
3. Day-to-day cash flow management – ensuring the Authority has funds available in the right place, at the right time, in the right size to meet its payment obligations as they fall due.
4. Horizon scanning of financial data and market intelligence and sharing this with the wider organisation as appropriate.

In a rising rate environment, such as that seen over the last two years, we have predominantly opted for shorter term borrowing, hoping to 'ride out' the cycle before locking in loans for the long-term. Our long-held preference for liquidity over yield has also meant that we have been able to capture rate rises promptly as they have occurred, boosting our in-year return. Higher return that is now available to support services. At the time of writing, rates were expected to be close to peaking but we continue to monitor rate paths and develop a borrowing strategy that best meets the requirements of the Authority's plans.

Sharon Wroot, S151 Officer

Oct 2023

Key Messages:

No Treasury activity is without risk. These risks include, but are not limited to, Credit Risk, Liquidity Risk, Interest Rate Risk, Inflation Risk and Reputational Risk.

The Council uses in-house knowledge, advisors (Link Treasury Services), treasury management software (Treasury Live) and the CIPFA Treasury Management Code to manage these risks.

Scrutiny of Treasury activity is undertaken by Audit and Governance Committee and reported twice-yearly to Full Council. Updates on Prudential Indicators are also provided as part of quarterly budget updates Reports.

Introduction and External Context

This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2021) to provide a review of treasury management activities and the actual prudential and treasury indicators for 2023/24. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

This report covers the following:

- An economic update for the 2023/24 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of the Council's investment portfolio in 2023/24;
- A review of the Council's borrowing strategy for 2023/24;
- A review of any debt rescheduling undertaken during 2023/24;
- A review of compliance with Treasury and Prudential Limits for 2023/24.

The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides an updated position for treasury activities and highlights compliance with the Council's policies previously approved by members.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to the above treasury management report by the Audit Committee before they were reported to the full Council. Member training on treasury management issues was undertaken during 2022/23 to support members' scrutiny role.

Introduction and External Context

Key Messages:

The Council has taken a cautious approach to investing but is also fully appreciative that the external risk environment is very much shaped by developments around inflationary pressures and economic outlooks.

As of September 2023 our advisors, Link Group are forecasting that Bank Rate has now reached a peak in the cycle of 5.25%. Central Banks globally remain committed to taming inflation but have now also shifted to maintaining a close watch on growth slowdowns which, were they to materialise, would likely precipitate a reversal in rates. In summary, the picture for rates over the next 12 months remains uncertain.

Having moved away from historic lows in the latter months of 2021/22 rates have continued to move higher with the Bank of England voting for 14 consecutive increases until finally pausing in September 2023 at 5.25%.

Our advisors' expectation for interest rates within the treasury management strategy for 2023/24 was that Bank Rate would advance to only 4.5% by September 2023. Although we have seen faster increases (Bank Rate is now 5.25%) we have been able to capture some lower rate forward borrowing (see p11), have seen welcome additional return on investments (p12), and slower than anticipated Capital Programme spend means budgets for debt cost remain achievable as at the time of writing for 2023/24. If rates remain elevated, a revision to budgets and/or Capital Plans may be necessary for future years.

Key economic data during the period saw:-

- Interest rates rise by a further 100bps, taking Bank Rate from 4.25% to 5.25% and, possibly, the peak in the tightening cycle.
- Short, medium and long-dated gilts remain elevated as inflation continually surprised to the upside.
- A 0.5% month-on-month decline in real GDP in July, mainly due to more strikes.
- CPI inflation falling from 8.7% in April to 6.7% in August, its lowest rate since February 2022, but still the highest in the G7.
- A cooling in labour market conditions, but no evidence yet that it has led to an easing in wage growth (as average earnings rose at an annual rate of 7.8% in August, excluding bonuses).

The Council has appointed Link Group as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. Their September forecast set out a view that both short and long-dated interest rates will be elevated for some time, with Bank Rate at 5.25% until summer 2024 before falling back steadily as the economy contracts. Rates for a typical 25yr PWLB loan are expected to be slightly lower (5.2%) but with falling slowly from Q1 2024 to bottom out around 3.8% in 2026. Even this is well above our existing average cost of debt and so the Authorities borrowing costs are expected to rise sharply over the next 3 years as capital spend is committed and existing debt matures and is replaced.

The Authority does not typically have sufficient surplus cash balances to be able to place deposits for more than around six months so as to earn higher rates from longer deposits. In a rising rate environment this has the beneficial effect of being able to capture uplifts in rates sooner, however.

Key Messages:

The Treasury Management Strategy Statement, (TMSS), for 2023/24 was approved by this Council in February 2023. No changes are considered necessary during the year despite the continued uncertainty around inflation and rate forecasts.

The Authority has an increasing CFR over the next three years due to the capital programme, and with reduced investments will therefore need to borrow up to £61m over the next few years. An additional £49m will be required to replace maturing loans.

Over the last decade or so, the Authority has adopted a cautious approach whereby investments are framed by low counterparty risk considerations, the trade-off being lower overall returns.

Local Context

The Treasury Management Strategy Statement, (TMSS), for 2023/24 was approved by this Council on 23 February 2023.

No in-year policy changes to the TMSS are necessary – pleasing to note in the face of volatile economic circumstances; the Strategy did its job in protecting public funds whilst allowing sufficient flexibility to cope with exceptional operational demands.

Gross borrowing and the Capital Financing Requirement (CFR) - to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council must ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This means that the Council is not borrowing to support revenue expenditure.

The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator and we are on target to achieve the original forecast.

	31 March 2023 Principal	Rate/ Return	Average Life yrs		30 September 2023 Principal	Rate/ Return	Average Life yrs
Total debt	*£169.5m*	*3.48%*	*24.3*		*£165.3m*	*3.71%*	*24.6*
Capital Financing Requirement (CFR)	*£203.1m*				*£208.9m*		
Over / (under) borrowing	*(£33.6m)*				*(£43.6m)*		
Total investments	*£15.5m*	*4.04%*	*0.1*		*£23.7m*	*5.25%*	*0.1*
Net debt	£154.0m				£141.7m		

The overall level of investment balances remained close to pre-pandemic levels as the Authority utilised internal borrowing to both defer more expensive long-term borrowing and minimise its credit risk exposure.

Key Messages:

When undertaking new borrowing the Council will review both the source and tenure of loans it seeks to take.

At 30/09/2023 the Authority held £165m of loans, (down £4m in the period) as a consequence of funding previous years' capital programmes.

The Council's current borrowing portfolio is predominantly of a long-term and fixed nature. Whilst this provides certainty of cost it can restrict flexibility to restructure debt as plans and finances change.

Borrowing Strategy

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

	2023/24 Outturn Original Estimate £m	Mid-year Position 30/09/2023 £m	Revised 2023/24 Final Position £m
Borrowing	186.1	165.3	165.3
Other Long Term liabilities	0.0	0.0	0.0
Total debt	186.1	165.3	183.4
CFR (year end position)	239.6	208.9 (est)	222.5 (est)

The structure of our debt portfolio as at 31.3.2022 is shown below

Type of Loan	Amount	% of Portfolio
PWLB Fixed	£76.2m	45%
LOBO	£21.0m	13%
Market Fixed	£43.0m	26%
Short-term Fixed	£25.0m	15%
Variable Rate	£0.1m	1%
Total	£165.3m	

*Figures are rounded so may not aggregate to total shown

Key Messages:

Affordability and the "cost of carry" remained strong influences on the Authority's borrowing strategy. As interest rates rose, we arranged £20m of new loans over several start dates and periods of up to a year secure sufficient funding to meet the Council's cash flow needs whilst deferring long-term borrowing until a peak in the cycle passes. At which point we will look to term out debt.

It remains true though that future borrowing will now be more expensive (at current rates/projections)

Borrowing short-term from other local authorities provides a useful source of funding below current long-term rates and with the ability to exit loans within a reasonable timeframe.

Borrowing Strategy (continued)

- During the period, the Council maintained an under-borrowed position. This means that the capital borrowing need, (the Capital Financing Requirement), was not fully drawn in loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as it minimises cost of carry. Reduced counterparty risk on investments is also a factor.

- The policy of delaying new borrowing by utilising spare cash balances, has served well in recent years. However, with long term rates now well elevated a secondary element of this strategy, namely the use of short-term borrowing to meet immediate need but avoid – as far as possible – committing to locking in higher rates for the long term, was utilised in the period. This tactical approach of using shorter term loans to manage the cost of debt while rates are rising and then potentially re-financing at a longer tenor once monetary policy shows signs of easing will be kept under review, particularly if the 'higher for longer' scenario looks engrained and/or liquidity for short-term loans looks like becoming an issue. £20m of fixed rate debt over various shorter periods and start dates was arranged in the period to lock in some lower rates as the market moved upwards (see P11 for details).

- It is anticipated that further borrowing will be undertaken during the 2023/24 financial year.

- Whatever the economic background there are risks within any forecast, so caution is adopted within treasury operations. The S151 Officer therefore monitors interest rates in financial markets and will adopt a pragmatic strategy based upon the following general principles to manage interest rate risks :

- where there was a significant perceived risk of a sharp FALL in long and short term rates, (e.g. due to a marked increased risk of recession or risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing may be considered.

- if it was felt that there was a significant risk of a sharp RISE in long and short term rates, perhaps arising from 'sticky' inflation or Sterling weakness, then the portfolio position would be re-appraised. Our starting point in such circumstances would be to shorten the length of any loans arranged and re-profile once rates showed signs of declining.

Key Messages:

The Authority's traditional source of long-term borrowing is the Public Works Loan Board (part of HM Treasury).

The rate at which the Authority can borrow is determined by the Gilt Market (the Government's own primary source of borrowing) and fluctuates with market conditions. On top of this 'core rate' PWLB apply a margin, typically 0.8% for NELC.

In the first half of 2023-24 rates continued to rise as future hikes in Bank Rates were anticipated by markets. By period end rates were deemed at/close to peak but the timing of reductions was far from certain and volatility is expected to remain a feature across the majority of financial markets for some time.

Borrowing Strategy (continued)

PWLB rates are based on gilt (UK Government bonds) yields through H.M.Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields, as well as Defined Benefit Pension Scheme liabilities.

The current margins over gilt yields are as follows: -.

- PWLB Standard Rate is gilt plus 100 basis points (G+100bps)
- PWLB Certainty Rate is gilt plus 80 basis points (G+80bps)
- Local Infrastructure Rate is gilt plus 60bps (G+60bps)
- UK Infrastructure Bank is gilt plus 40bps (G+40bps) – subject to scheme criteria being met

with rates being revised twice daily.

At the close of the day on 30 September 2023, all PWLB Maturity Certainty Rate loans from 1 to 5 years were between 5.22% – 5.69% while the 10-year and 25-year yields were at 5.15% and 5.62% and the market had remained more volatile than in previous years.

At period end a 'goldilocks' scenario was priced into yields, whereby there was an expectation that the Bank of England had delivered *just* the right amount of tightening to deal with inflation but not too much so as to eliminate growth. Any negative news on the latter front going forward could therefore lead to emergent recession fears and suppress PWLB rates over the coming months. Clearly, this is just one possible outcome, and the opposite could be true i.e. inflation remains above target and therefore the Bank of England needs to do more but, after such rapid rises in rates over the last 18 months, it feels like the risk is not symmetrical and former view is slightly more likely. Our core strategy, therefore, remains to defer long-term borrowing as far as possible, with a keen eye on any data/rates that could signal a meaningful move in either direction. If rates do move higher, long-term borrowing will be limited to essential cash flow requirements that cannot be covered off from other sources.

Borrowing in advance of need

The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed, so expects to retain access to PWLB. The forward starting loans recently arranged were secured to meet a portion of the anticipated requirement over the next year, while lower rates remained accessible.

Key Messages:

Several loans were agreed during 2023-24 to support the Council's Capital Plans and refresh maturing loans.

Debt rescheduling opportunities have increased as rates have risen . An exercise was undertaken to review the economic value present in our portfolio but this was judged to be insufficient to warrant the longer-term cost. Debt rescheduling will continue to be considered if it can deliver (net) long-term savings. No debt rescheduling has been undertaken to date in the current financial year however.

Borrowing Strategy (continued)

Borrowing – the following loans were arranged during the period:

Counterparty	Start Date	Maturity Date	Amount	Rate
West Midlands Combined Authority	28/04/2023	26/04/2024	£5,000,000	4.85%
West Yorkshire Combined Authority	25/05/2023	22/05/2024	£5,000,000	4.58%
West of England Combined Authority	17/08/223	15/08/2024	£5,000,000	4.65%
Renfrewshire Council	06/09/2023	06/04/2024	£5,000,000	5.60%

No longer-term loans were taken during the period as rates remained well above 5%. For the time being we are arranging loans to meet cash flow need as it arises out to 12-month tenors.

Debt rescheduling

Opportunities to reschedule debt have increased as rates have risen and an exercise was recently undertaken to review the economic value present in our debt portfolio, but this was found insufficient to warrant the longer term cost. We continue to keep opportunities under review in conjunction with our Advisors.

Our expectation for interest rates going forward

Whilst rates are currently expected to peak at around 5.25% (at the time of writing), it is not our current base case that they then begin to revert to the ultra-low levels seen in the past decade or so. Indeed, the current view is that higher rates are here for the foreseeable future as the Bank of England battles sticky core inflation and rising oil prices. Clarity should be forthcoming in the coming months, including the Bank's next update to its own forecasts in November. Barring a sharp deterioration in economic conditions, it is likely that the Bank will stick to its view that policy will remain at elevated levels for some time. History suggests that the average period between Bank Rate peak and the first subsequent cut is around 10 months. In addition we do not expect the downward slope of the cycle curve to be as steep as the pre-peak trajectory. Certainly, cuts meeting-after-meeting are unlikely unless it becomes very clear that higher rates have caused the economy to cool much more quickly than desired, and the Bank of England then must act to stimulate growth again (i.e. reduce rates). In short, our default view is that higher rates are here for the time being but we are ready to react to a reducing rates trajectory to secure long-term certainty of debt cost, should that opportunity present itself.

Key Messages:

The Authority has held significant invested funds, representing income received in advance of expenditure plus balances and reserves held. These funds are temporarily invested to generate a return until they are needed.

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

All other things being equal we would expect to see balances fall each year by the amount of corporately funded capital expenditure less any new borrowing.

The Authority is on course to generate £1m of income from its investments during 2023-24.

Investment Activity

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. These funds are temporarily invested to generate a return until they are needed.

During 2023/24 total investment balances ranged between £15.5m and £48.3 million. The average balance maintained was £34m with a weighted average maturity of 15 days. During the period our target rate of 7-day SONIA was 5.09%. We under-performed the benchmark (achieving an average return of 4.71%). This is representative of the rapid rises in rates during the period which emphasises the maturity lag of our investments before we can capture those higher yields. By period end we had caught up however and were earning an average yield of 5.25% vs 7-day SONIA at 5.19%

Our investments generated £0.697m of income during the first half of 2023/24 and are on target to generate £1m of income for the Authority in the full year to 31 March 2024.

Investment Policy – the Council's investment policy is governed by DLUHC guidance, which has been implemented in the annual investment strategy approved by the Council. Investment activity during the year conformed to the Investment Strategy for 2023/24 which aimed to reduce risk by;

- Setting value and term limits for counterparties based on Credit rating, available collateral and sector.
- Utilising data tools available via Treasury Live and Link Treasury Services to monitor risk.
- Ensuring a minimum level of liquidity was maintained to allow payments to be made as they fell due

The Council aims to achieve an adequate return (yield) on its investments commensurate with robust levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs using our suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

Creditworthiness – Credit metrics for the financial institutions we interact with improved slightly during the period following volatility seen on the back of the US Regional Bank and Credit Suisse failures just prior to the period start. No changes to TMSS limits, or indeed (more restrictive) operational limits were necessary during the period. Even so in a post 'Bail-in' regulatory environment NELC seeks to largely avoid direct bank exposure.

Key Messages:

Counterparty credit quality is assessed and monitored with reference to credit ratings (the Authority's minimum long-term counterparty rating for institutions defined as having "high credit quality" is A-); credit default swap prices, financial statements, and reports from quality financial news feeds.

Investment Activity

Investments	Balance on 31/03/2023 £m	Investments Made £m	Maturities/ Investments Sold £m	Balance on 31/09/2023 £m	Avg Rate/Yield (%) and Avg Life (years)
UK Government: - DMADF - Treasury Bills/Gilts	13.1 0.0	397.9 9.9	(403.7) (6.9)	7.3 3.0	4.60% 7 days 4.74% 60 days
Bonds issued by Multilateral Development Banks	2.0	4.9	(2.0)	4.9	4.85% 131 days
Direct Unsecured Investments (call accounts, deposits) with financial institutions - rated A- or higher - rated below A-	0.3 -	20.7	(20.4)	0.6	3.93% at Call
Tradable Investments with Financial institutions Corporates (CDs) rated A- or higher	0.0	-	-	0.0	N/A
Money Market Funds	0.3	14.8	(7.0)	7.9	5.03% at Call
TOTAL INVESTMENTS	15.6	453.5	(472.3)	23.7	4.71% 28 days
Increase/ (Decrease) in Investments £m				8.1	

Given the increased risk and continued low returns from short-term unsecured bank investments, but having no funds available for longer-term investment, the Authority is unable to simply diversify into more secure and/or higher yielding asset classes such as repurchase agreements or covered bonds which are secured on financial assets. Eliminating Credit Risk by running lower balances whilst still maintaining adequate liquidity therefore remains a key strand of operational activity. It also reduces 'cost of carry' i.e. the spread on rates between those we can obtain from investments versus those payable on borrowing.

Key Messages:

Figuratively the Authority's risk profile remained steady during the period, (with a narrow set of counterparties our risk profile primarily moves with UK sovereign rating where there were no changes during the period).

An active strategy during the period has been to hold short-term Multi-lateral Bank Bonds. These instruments are typically AAA-rated thanks to their callable capital claims on the World's major developed countries. They have the additional positive characteristic of possessing strong ESG credentials.

Investment Activity (contd.)

Credit Risk

Counterparty credit quality as measured by credit ratings is summarised below:

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating
31/03/2023	3.61	AA-
30/06/2023	3.56	AA-
30/09/2023	2.41	AA+

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 26
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

Credit risk (as defined by Credit Swap premia) settled slightly lower during the period after it became clear that contagion from the US Regional Banking crisis and failure of Credit Suisse earlier in the year had been contained. The table above suggests that our own average risk remained very low and even improved slightly. Several factors contributed to this:-

- The scores above reflect Credit Rating Agencies ratings. These are far less 'agile' than CDS rates, so there is likely to be some lag present and there may be Outlook changes and even downgrades in the remainder of the financial year, particularly if the UK Sovereign Rating is revised downward should a recession look likely.
- An active strategy during the period has been to hold short-term Multi-lateral Bank Bonds. These instruments are typically AAA-rated thanks to their callable capital claims on the World's major developed countries. They have the additional positive characteristic of possessing strong ESG credentials.
- NELC largely seeks to avoid direct bank exposure and where we do invest it is generally on a call/tradeable basis.

Key Messages:

In an environment where direct unsecured bank deposits present increased risk but low return NELC has sought to avoid this imbalance by utilising UK Government based investments and diversified funds.

Ultimately, we seek to minimise counterparty risk by limiting our cash levels whilst still maintaining adequate liquidity.

There were no operational breaches of the limits set in the TMSS during the period.

Investment Activity (contd.)

Benchmarking

- Comparisons are made to other Authorities using the Treasury Live database which looks at over £8Bn of local Authority investments. As at the outturn date this shows that other Authorities:-
  - Hold more cash than NELC. Average balance £103m (estimated) vs £23m at NELC
  - Invest for longer periods. 118 days on average vs only 32 days at NELC
  - Take more risk than us collectively.
  - Deliver lower return than us. 4.52% vs 5.25%

- The above shows how the Council has been able to take advantage of rising rates more quickly due to its shorter average investment term. NELC is of the view that, in a post Bail-in environment elimination of credit risk through lower balances is worth potential lower overall return. To ensure this strategy does not replace credit risk with liquidity risk NELC maintains a liquid balance at least £10m.

- Whilst we regularly monitor performance against data on 80 other Authorities' activity (as summarised above), we have previously obtained some additional specific data on what Unitary Authorities (like NELC), were investing in, to ensure we are not 'missing out' on anything those 'peers' are doing. Data was shared with us (confidentially and anonymised) by our Advisors, Link Treasury Services. Against this narrower group we were 'in the bunch' with the only difference being those who lent (sometimes long-term) to other Authorities. We reviewed the data and considered LA lending but for the time being the S151 Officer has taken the decision not to do so.

Operational Breaches

- There was one (non-fault) operational breach during the period.

- On 17 August a lender omitted to send us an agreed loan sum as arranged, causing our bank account to go overdrawn. The position was corrected the following morning and the broker on the deal is arranging for our bank charges (£1.9k) relating to the missed settlement to be covered by the other party.

Key Messages:

The Authority confirms compliance with its Prudential Indicators for 2023/24, which were set in February 2023 as part of the Authority's Treasury Management Strategy Statement.

Compliance with Prudential Indicators

Treasury Management Indicators
The Authority measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

	2023/24	2024/25	2025/26
Upper limit on fixed interest rate exposure	£290m	£290m	£290m
Actual*	£140m	£215m (est)	£226m (est)
Upper limit on variable interest rate exposure	£90m	£90m	£90m
Actual*	£15m	£35m (est)	£35m (est)

*= Peak position for 2023/24

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing were:

	Upper	Lower	Actual
Under 12 months	70%	10%	29%
12 months and within 24 months	30%	0%	1%
24 months and within 5 years	30%	0%	8%
5 years and within 10 years	30%	0%	9%
10 years and within 20 years	30%	0%	9%
20 years and within 30 years	50%	0%	19%
Over 30 years	75%	10%	24%

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. Note: LOBO option dates are included as potential repayment dates.

Key Messages:

A minimum cash balance of £10m will be maintained to ensure forecast liquidity needs are met.

The gap between the red and black lines in the Liability Benchmark chart shown here depicts the additional borrowing need the Authority currently projects – a peak requirement of £110m new loans by the end of 2026-27 – including replacement of maturing debt.

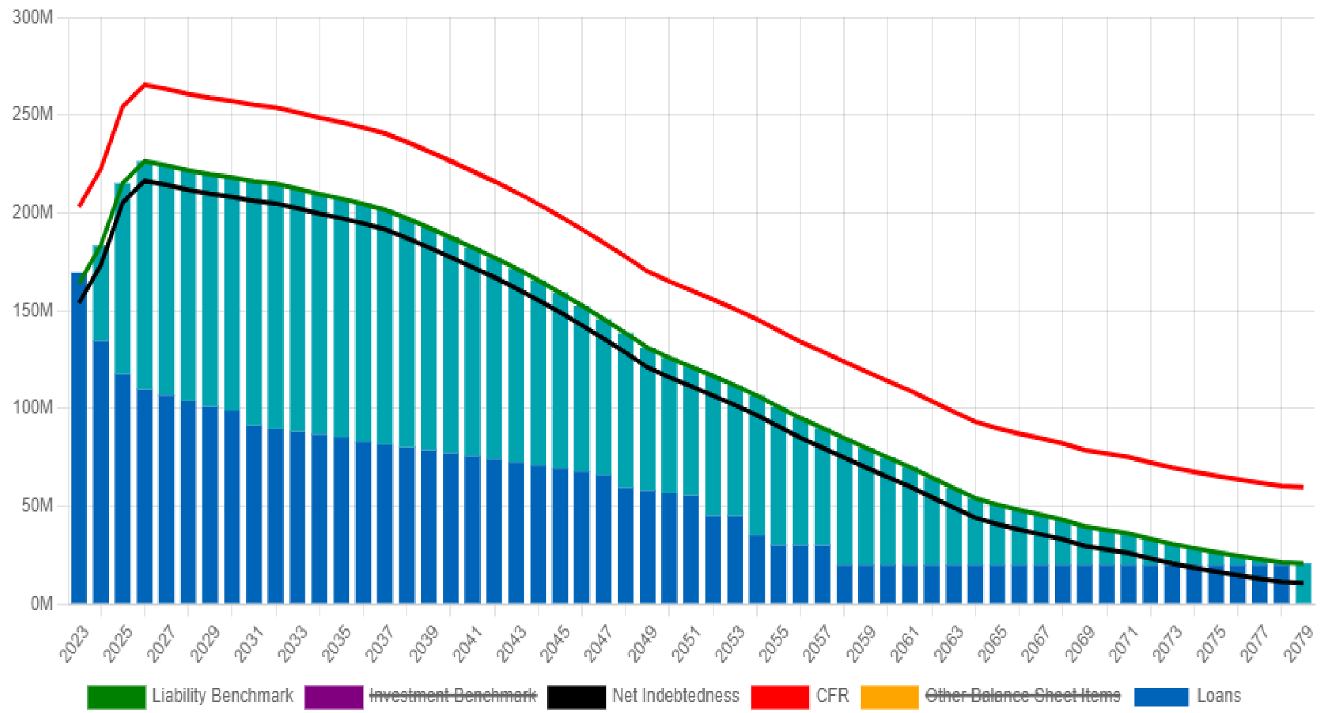
Before new long-term borrowing is entered into the Authority will have regard to the Liability Benchmark and its underlying assumptions will be assessed for their continuing prudency, with revisions made where necessary.

Prudential Indicators (The Liability Benchmark.)

For 2023/24 CIPFA revised their Guidance to require use of the **Liability Benchmark** tool as a formal Prudential Indicator. NELC have used, reported and provided Member training on this Benchmark for several years, so no change to current practice is necessary.

The Benchmark forecasts our need to borrow over a 60 year period. This aids decision making when it comes to the quantum and term to be chosen, the aim being to avoid cost of carry revenue implications and avoid the trap of defaulting to ultra-long tenors just because the yield curve tail slopes downward. It represents the level of our anticipated borrowing and in the ordinary course of business would not be expected to be exceeded. It therefore should closely mirror the Operational Boundary. The benchmark assumes:

- future capital expenditure beyond the current programme funded by borrowing of c£8m a year on average
- minimum revenue provision on new capital expenditure based on an annuity profile of c30 years average
- No changes to Reserves beyond the current MTFP period (3 years)



Key Messages:

For 2023/24 a minimum cash level of £10m was targeted and there were no breaches of this, or other Indicators.

Compliance with Prudential Indicators (contd.)

Principal Sums Invested for Periods Longer than 365 days: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2023/24	2024/25	2025/26
Limit on principal invested beyond 365 days	£21m	£21m	£21m
Actual	£0m	£0m	£0m

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating 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.

	Target	Actual
Portfolio average credit rating	A	AA-

Liquidity: The Authority 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, without additional borrowing.

	Target	Actual (Low)
Total cash available within 1 month	£10m	£15m*

*includes residual Council Tax Energy Rebate Grant balances held during the period for the purpose of dispersal to local households.

Key Messages:

Borrowing remains comfortably below control levels as a result of continued internal borrowing support for the Capital Programme.

Borrowing levels were projected to be £196m at the end of 2022/23 when the TMSS was set in Feb 2023. Half-way through the year this outturn is now projected to be £183m due to changes in anticipated delivery of the Capital Programme.

Work is underway during 2023/24 to establish lease liabilities under IFRS16 Accounting Rules. Once confirmed these will be reflected in the 'Other Liabilities' figure in the tables across. For now, a 'placemarker figure' is quoted. It is currently expected that the actual figure will be lower.

Compliance with Prudential Indicators (contd.)

Other Prudential Indicators

The following prudential indicators are relevant to the treasury function as they concern limits on borrowing and the adoption of the CIPFA Treasury Management Code.

Operational Boundary for External Debt: The operational boundary is based on the Authority's estimate of most likely, i.e. prudent, but not worst-case scenario for external debt.

Operational Boundary	2023/24 £m	2024/25 £m	2025/26 £m
Borrowing	£220m	£230m	£240m
Other long-term liabilities	£30m	£30m	£25m
Boundary for Total Debt	£250m	£260m	£270m

Authorised Limit for External Debt: The authorised limit is "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 table below demonstrates that during 2023/24 the Council has maintained gross borrowing within its authorised limit.

Authorised Limit	2023/24 £m	2024/25 £m	2025/26 £m
Borrowing Limit	£260m	£265m	£275m
Other long-term liabilities	£40m	£40m	£40m
Total Debt Limit	£300m	£305m	£315m
Projected Peak Debt levels	£183m	£215m	£226m

Adoption of the CIPFA Treasury Management Code: The Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition in February 2023.

Key Messages:

The Local Government Act 2003 requires the Authority to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow.

The Authority confirms compliance with its Capital Finance Prudential Indicators for 2023/24, which were set in February 2022 as part of the Authority's Treasury Management Strategy Statement.

Changes to the 2023/24 and later programmes may occur as these are progressed in the coming months.

Compliance with Capital Finance Prudential Indicators

The Local Government Act 2003 requires the Authority to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure

The Authority's planned capital expenditure and financing as at 30.9.2023 may be summarised as follows.

Capital Expenditure and Financing	2023/24 Original £m	2023/24 Changes £m	2023/24 Draft Outturn £m	2024/25 Estimate £m	2025/26 Estimate £m
Total Expenditure	77.2	-2.3	74.9	103.9	30.2
Capital Receipts	5.0	-	5.0	4.0	-
External Grants	43.7	-2.3	41.4	59.0	9.4
Other External Funding (S106 etc)	2.0	-	2.0	0.7	-
Borrowing	26.6	0.0	26.6	40.2	20.8
Total Financing	77.2	-2.3	74.9	103.9	30.2

Key Messages:

The percentage of the Council's income required to service its debt came in below projections due to a combination of slippage in the capital programme and the effect of using short-term lenders which offered lower interest rates and delivered in-year cost-savings.

Future year projections on the other hand have been adversely affected by the sharp rise in rate expectations during the period. Maintaining debt costs within 10% of the Council's overall budget now presents a challenge with several factors being beyond the Authorities control (rates (cost of borrowing) and inflation (cost of schemes being financed)).

Compliance with Capital Finance Prudential Indicators (contd.)

Ratio of Financing Costs to Net Revenue Stream

This is a voluntary indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2023/24 Original Estimate %	2023/24 Revised Estimate %	2024/25 Revised Estimate %	2025/26 Revised Estimate %
General Fund	9.3%	8.3%	9.4%	10.6%

There are a range of factors that affect these future estimates, some internal such as what the capital investment delivers, and others which are external and largely out of the Authority's control such as the impact of interest rate changes. Any future borrowing must be in accordance with prudential borrowing principles. Borrowing must be affordable, sustainable and prudent.

Future year projections have been adversely affected by the sharp rise in rate expectations during the period. Maintaining debt costs within 10% of the Council's overall budget now presents a challenge while rates remaining elevated beyond those levels in the original forecast.