Treasury Management Activity 2023/24: April to November 2023

The council's treasury management activity is underpinned by the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management ("the Code"). The Code recommends that members are informed of treasury management activities. This report provides an update on treasury management activity between 1 April and 30 November 2023 and a brief commentary on the economic context in which treasury management decisions were taken.

Economic Context

The key themes during the period were the impact on the UK from higher interest rates and inflation, a weakening economic outlook, an uncertain political climate due to an upcoming general election, and together with war in Ukraine and the Middle East.

The year has seen a steady increase in the Bank Rate. At 1 April it was at 4.25% with the Bank of England 's Monetary Policy Committee (MPC) increasing the rate at its meetings in May, June and August to reach a level of 5.25%. This rate was maintained in September and then again in November.

In the Bank of England's (BoE) November quarterly Monetary Policy Report (MPR) included a forecast of a prolonged period of weak Gross Domestic Product (GDP) growth with the potential for a mild contraction due to ongoing weak economic activity. The outlook for CPI inflation was deemed to be highly uncertain, with near-term risks to CPI falling to the target of 2% coming from potential energy price increases, strong domestic wage growth and persistence in price-setting.

The UK economy grew by 0.2% between April and June 2023. The BoE forecasts GDP will likely stagnate in Q3 but increase modestly by 0.1% in Q4, a deterioration in the outlook compared to the August MPR. The BoE forecasts that higher interest rates will constrain GDP growth, which will remain weak over the entire forecast horizon.

Office for National Statistics (ONS) figures showed CPI inflation was 6.7% in September 2023, unchanged from the previous month but this is still high relative to the Bank of England target of 2%. Looking ahead, using the interest rate path implied by financial markets the BoE expects CPI inflation to continue falling, declining to around 4% by the end of calendar 2023 but taking until early 2025 to reach the 2% target and then falling below target during the second half 2025 and into 2026.The October CPI did subsequently show a sharp fall with CPI falling to 4.6%.

Arlingclose Forecast

The Authority's treasury management adviser Arlingclose forecasts that although UK inflation and wage growth remain elevated, that Bank Rate has peaked at 5.25%.

The Bank of England's Monetary Policy Committee will cut rates in the medium term to stimulate the UK economy but will be reluctant to do so until it is sure there will be no lingering second-round effects. Arlingclose sees rate cuts from Q3 2024 to a low of around 3% by early/mid 2026.

Arlingclose expects long-term gilt yields to eventually fall from current levels (amid continued volatility) reflecting the lower medium-term path for Bank Rate. However, yields will remain relatively higher than in the past, due to quantitative tightening and significant bond supply. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.

Like the BoE, the Federal Reserve and other central banks see persistently high policy rates through 2023 and 2024 as key to dampening domestic inflationary pressure. Bond markets will need to absorb significant new supply, particularly from the US government.

Investment Activity

Investments at 30 November 2023 totalled £767m and consisted of £27m in bank and local authority deposits and £740m in corporate and government bonds. The following table shows the investment activity between 1 April and 30 November 2023.

Bank and Local Authority	**Call**	**Fixed**	**Total**
Deposits	**£m**	**£m**	**£m**
Balance 1 April 2023	**41.1**	**10.0**	**51.1**
Maturities	-115.1	0.0	-115.1
New Investments	91.1	0.0	91.1
Balance 30 November 2023	**17.1**	**10.0**	**27.1**

Bonds	**LA Bonds £m**	**Gilts £m**	**Liquidity £m**	**Corporate £m**	**Total £m**
Balance 1 April 2023	**25.3**	**323.8**	**252.7**	**203.1**	**804.9**
Maturities	-5.3	-214.5	-2,384.4	-0.7	-2,604.9
New Investments	0.2	235.9	2,303.6	0.0	2,539.7
Balance 30 November 2023	**20.2**	**345.2**	**171.9**	**202.4**	**739.7**

Total investments, including the bank and local authority deposits, have decreased by £89m during the period. It is anticipated that these will gradually reduce over the remainder of the financial year so as at 31 March 2024 they are estimated to be around £700m.

The current rate of return on the investment portfolio measured by Arlingclose is 2.94% which compares unfavourably with the Sterling Overnight Rate (SONIA) which averaged 4.86% over the period. This is largely due to the high level of balances held in Gilts and corporate bonds which are yielding relatively low rates but have high credit quality. However, to sell them would involve incurring a loss and therefore it is not considered to be financially advantageous at the current time.

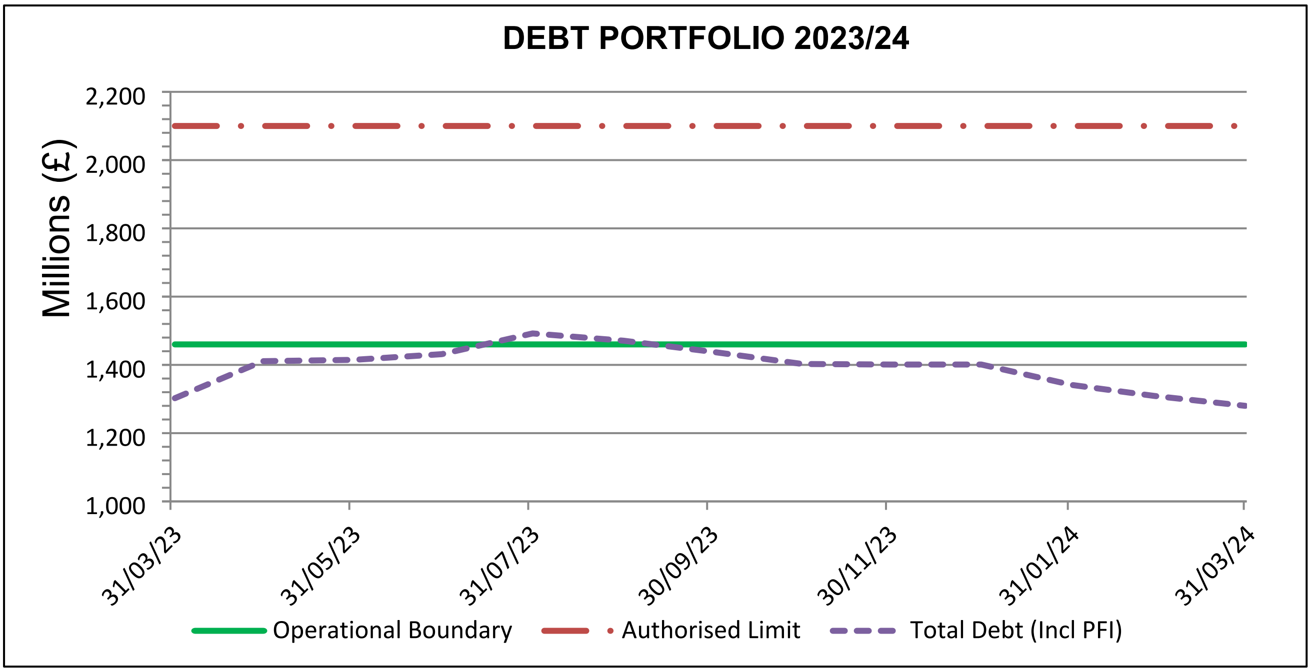
Borrowing Activity

The council's capital programme includes a requirement to borrow to fund new capital investment. The table below summarises the borrowing activity which has taken place between 1 April and 30 November 2023.

	PWLB Fixed £m	Long Term Bond £m	Other Locals £m	Police, Fire & Lancashire District Councils £m	Total £m
Balance 1 April 2023	**279.6**	**600.0**	**217.0**	**79.7**	**1,176.3**
New Borrowing	0.0	0.0	388.0	436.9	824.9
Maturities	0.0	0.0	-308.0	-426.0	-734.0
Balance 30 November 2023	**279.6**	**600.0**	**297.0**	**90.6**	**1,267.2**
Public Finance Initiative (PFI) Liability					126.0
Total Borrowing & PFI					**1,393.2**

Total borrowing at the end of November was £1.393bn including the financing of £126m of assets through remaining Private Finance Initiative schemes. The outstanding borrowing has increased by £91m in the period, which is largely due to the increased levels deposited by district councils along with some short-term borrowing from local authorities for cashflow purposes. It is expected that the borrowing levels will now reduce over the remainder of the financial year, as borrowings mature, so at 31 March 2024 being under the opening balance figure.

The borrowing is undertaken within the framework set by the 'Authorised' and 'Operational' limits. The following graph shows the level of debt for the current financial year compared with the prudential indicator operational and authorised boundaries. It is expected that the debt may exceed the operational limit on occasions, but it should not exceed the authorised limit. The debt shown from 30 November represents the debt position if no maturing debt was replaced rather than an estimate of the expected position.



Total debt during the year has remained below the authorised limit and for a large share of the year been under the operational limit. It is anticipated that the debt will be below both the operational and authorised limits at the financial year end.

The council's current interest rate payable on debt as measured by Arlingclose is 4.23%.

Budget Monitoring

The forecast position reported to the council's Cabinet in December was for treasury management expenditure to be in line with budget for the financial year 2023/24. This includes the assumption that if there is under-delivery against the £9m budget saving commitment, it will be funded by the use of the ring-fenced treasury management reserve.

Any changes to the 'fair value' of investments will be taken to/from reserves to prevent unrealised transactions impacting on the council's revenue account.

The financial position is kept under regular review and discussed with the Director of Finance on a monthly basis.

Prudential Indicators

The Treasury Management Strategy included some prudential indicators which provide a framework for the operation and risk management of treasury management activities. These are shown as follows for 2023/24 with the latest available actual position.

Authorised and Operational Limits for Debt

The 'authorised limit' is a prudent estimate of external debt but allows sufficient headroom for unusual cash flow movements.

	Limit	Actual
	£m	£m
Borrowing	1,700	1,267
Other long-term liabilities (PFI schemes)	400	126
TOTAL	**2,100**	**1,393**

The 'operational limit' for external debt is based on the same estimates as the authorised limit. However, although it reflects a prudent estimate of debt, there is no provision for unusual cash flow movements. In effect, it represents the estimated maximum external debt arising as a consequence of the council's current plans. As required under the Code, this limit has been monitored during the year.

	Limit	Actual
	£m	£m
Borrowing	1,300	1,267
Other long-term liabilities (PFI schemes)	160	126
TOTAL	**1,460**	**1,393**

Gross Debt and the Capital Financing Requirement

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the authority's total debt should be lower than its highest forecast capital financing requirement (CFR) over the next three years. The CFR is a measure of the total capital expenditure that is unfunded and therefore requires external or internal borrowing. The county council's borrowing initially appears in excess of the capital financing requirement however, in making this comparison certain borrowing is included in the total borrowing but does not count against the capital financing requirement. These include the premiums paid on the repayment of debt and debt held on behalf of other authorities i.e. due to historic local government reorganisation and that relating to the waste PFI project payable by Blackpool Council. The current level of debt also includes an element of borrowing in advance to cover new expenditure or maturing debt. In summary the position is

	£m
Total debt as at 30 November	1,393
Capital Financing Requirement estimated 31 March 2024	1,165
Debt in excess of CFR	228
Due to:	
Debt held on behalf other authorities	37
Premiums	38
Borrowing in advance	153

By 31 March 2024 some £166m of debt is maturing. Therefore, the Director of Finance confirms that the level of borrowing over the three years is within the capital financing requirement conditions.

Liability Benchmark

This new indicator compares the council's 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 £50m required to manage day-to-day cash flow.

	31/3/23 Actual £m	**31/3/24 Estimate £m**	**31/3/25 Forecast £m**	**31/3/26 Forecast £m**	**31/3/27 Forecast £m**
Loans CFR	1028.3	1046.1	1062.1	1076.5	1092.1
Less: Balance sheet resources	-507.3	-506.8	-506.8	-506.8	-506.8
Net loans requirement	521.0	539.3	555.3	569.7	585.3
Plus: Liquidity allowance	50.0	50.0	50.0	50.0	50.0
Liability benchmark	**571.0**	**589.3**	**605.3**	**619.7**	**635.3**
Committed borrowing	**1,176.3**	**1,044.6**	**529.6**	**504.6**	**494.6**

The liability benchmark data shows that from 2024/25 the committed borrowing is below the minimum required to finance existing plans therefore new borrowing will need to be undertaken.

Interest Rate Exposure

In order to control interest rate risk the council measures its exposure to interest rate movements. These indicators place limits on the overall amount of risk the council is exposed to. This covers the impact of the additional cost of borrowing and the income from investments. The one-year impact indicator calculates the theoretical impact on the revenue account of an immediate 1% rise in all interest rates over the course of one financial year.

	Upper Limit	Actual
One-year revenue impact of a 1% rise in interest rates	£50m	£5.4m

This arises as although a significant proportion of the debt is at fixed rates, the variable borrowings have increased significantly over the last few months. This is larger than the increase in interest rates for variable investments.

The indicator excludes the impact on fair values of an interest rate rise as these values are affected by various factors but could be estimated to be in the region of £5m, based on the 2022/23 year-end figures.

Maturity Structure of Debt

Limits on the maturity structure of debt help control refinancing risk.

	Upper Limit	Actual
Under 12 months	75%	18%
12 months and within 2 years	75%	41%
2 years and within 5 years	75%	3%
5 years and within 10 years	75%	4%
10 years and above	75%	34%

Investments Over 1 Year

Limit on the level of long-term investments helps to control liquidity, although the majority of these investments are currently held in securities which are readily saleable. The limit is largely determined by the forecast of reserves and balances held at the year-end. The level of investments is managed to be in line with the estimated reserves and balances and cash flow at 31 March 2024 (deemed an operational limit which is kept under review during the year).

The level of investments is expected to fall in the year to around the £700m level by the year-end due to the utilisation of reserves in-year, which will require bonds to be sold for liquidity purposes.

	Upper limit	Actual
Total invested over 1 year	£1,200m	£750m
Initial forecast at 31 March 2024	£800m	£750m

Minimum Average Credit Rating

To control credit risk the council requires a very high credit rating from its treasury counterparties.

	Benchmark	Actual
Average counterparty credit rating	A	AA

Liquidity Risk Indicator

The council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount it can borrow each quarter without giving prior notice.

	Limit	**Actual**
Total sum borrowed in past 3 months without prior notice	£50m	£4m

Over the period a total of £388m new borrowing (excluding amounts deposited by Police, Fire and Lancashire District Councils under the call account arrangement) has been taken, most of this was planned due to maturities and known borrowing requirements. In the period there was the need to borrow £4m due to unexpected cashflow requirements.