Report title	**Treasury Management Report – Q3 2023/24**
Report author	Aidar Ismailov – Senior Accountant
Department	Financial Services
Exempt?	No
Exemption type	Not applicable
Reasons for exemption	Not applicable

Purpose of report:

For information

Synopsis of report:

This is the report on Council's treasury management activity and performance in quarter ended 31 December 2023 focusing on financing and liquidity, cash management and risk management.

The report also reflects on the review of Council's treasury and investment strategies, along with prudential indicators, and compliance with the limits set for 2023/24.

1. Background Information

1.1. The Council's treasury management activity is underpinned by CIPFA's (Chartered Institute of Public Finance and Accountancy) Code of Practice on Treasury Management ("the Code"), and the CIPFA Prudential Code for Capital Finance in Local Authorities ("the Prudential Code"). These require local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. From 2023/24, the Code also recommends that members are informed of treasury management activities quarterly.

1.2. The Council's Treasury Management Strategy for 2023/24 was approved at Full Council on 09 February 2023. This report sets out the Council's performance against the criteria in this report in the quarter ended 31 December 2023.

1.3. Treasury management is defined as: "The management of the local authority'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."

1.4. No treasury management activity is without risk; The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities focuses on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

1.5. The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report, therefore, provides details of the treasury activities and highlights compliance with the Council's policies previously approved by the members.

1.6. This report was presented to the Corporate Management Committee on 21 March.

2. Prudential and Treasury Indicators and Compliance

2.1. In compliance with the requirements of the Code this report provides members with a summary report of the treasury management activity during the quarter ended 31 December 2023 of the 2023/24 financial year ("Q3 2023/24"). Officers herewith confirm that during Q3 2023/24, the Council complied with all its legislative and regulatory requirements and its Treasury Management Strategy Statement and Treasury Management Practices.

2.2. There are no proposed changes to the current Treasury Management Strategy.

2.3. During the third quarter of the year the Council operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy and in compliance with the Council's Treasury Management Practices and a prudent approach was taken in relation to all investment activity with priority being given to security and liquidity over yield.

2.4. A full set of prudential and treasury indicators for Q3 2023/24 are set out in Appendix A

3. Risk management

3.1. The Council aims to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. The Treasury Management Strategy Statement ("TMSS") for 2023/24, which includes the Annual Investment Strategy, sets out the Council's investment priorities as being:

Credit risk
Counterparty credit quality is assessed and monitored with reference to credit ratings including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

Liquidity risk
In keeping with the DLUHC Guidance on Investments, the Council maintains a sufficient level of liquidity using Money Market Funds and call accounts.

Yield
The Council seeks to optimise returns commensurate with its objectives of security and liquidity.

4. Economic update

4.1. In line with regulations Appendix B sets out the economic context within which our treasury operations were working in during the period covered by this report. This economic update was provided by the Council's Treasury Advisors, LINK Group and reflects the market position in early January 2024.

5. Borrowing Activity in Q3 2023/24

5.1. The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement ("CFR"). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the Q3 2023/24 unfinanced capital expenditure, and prior period's net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources. The Council's current CFR is £702.5m.

5.2. Part of the Council's treasury activities is to monitor cash position and organise financing against the borrowing needs. Financing sourced through combination of external borrowing from external bodies, such as the Government, through the Public Works Loan Board ("PWLB"), or the money markets, or utilising temporary cash resources within the Council.

5.3. No new borrowing was undertaken during Q3 2023/24 meaning that the Council continued to maintain an under-borrowed position. This meant that the capital borrowing need, the CFR, was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure in the sharply rising interest rates environment and the period of low capital spend.

5.4. Table 1 sets out the borrowing activity in the nine months of 2023/24:

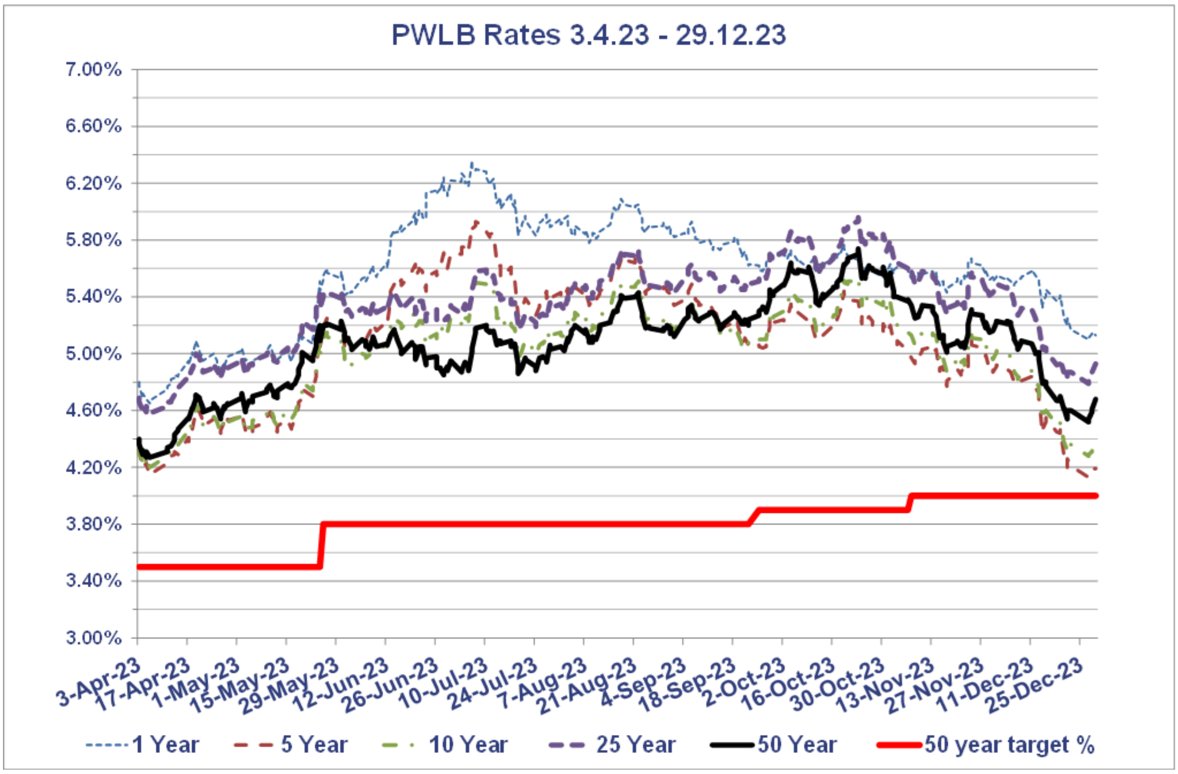
Table 1 – Borrowing activity YTD Q3 2023/24				
	Balance 31 Mar 2023 £'000	New borrowing £'000	Borrowings repaid £'000	Balance 31 Dec 2023 £'000
HRA – PWLB	100,000	0	0	100,000
General Fund - PWLB	499,000	0	10,000	489,000
General Fund – Other	44,181	0	5,566	38,615
	643,181	**0**	**15,566**	**627,615**

5.5. A full list of Council borrowings held as of 31 December 2023 is set out in Appendix C

5.6. PWLB rates are based on gilt (UK Government bonds) yields through HM 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.

5.7. Gilt yields have endured a volatile first nine months of 2023/24 with yields rising significantly on the back of inflation concerns in H1 before retracting much of those increases in Q3. The market now anticipates rate cuts by H2 2024, which is reflective of market confidence in inflation falling back in a similar manner to that already seen in the US and the Euro-zone.

5.8. The actual PWLB rates during the nine months of 2023/24 were as follows:



5.9. The Department for Levelling Up, Housing and Communities (DLUHC) has policy responsibility for the Prudential Framework under which local authorities borrow and invest. In October 2023, the Government introduced The Levelling Up and Regeneration Act ("LURA"), which includes new provisions that expand the government's statutory powers to directly tackle excessive risk within local government capital system. A local authority comes into scope of the new powers when a 'trigger point' is breached with respect to any of the four capital risk metrics as set out in the LURA.

5.10. Further explanation on the consequences of the LURA were explored in the Treasury and Capital Strategies approved by the Corporate Management Committee in January. At the time of writing, no further clarifications have been received on the trigger points, calculations or proposed sanctions.

6. Interest rates

6.1. At its 14th December 2023 meeting, the Bank of England's Monetary Policy Committee (MPC) kept rates on hold for the third time in a row, pushing back against the prospect of near-term interest rate cuts. The vote in favour of keeping rates on hold was 6-3.

6.2. LINK now expects Bank Rate to be cut to 4.25% by the end of 2024 (4.5% previously) and 3% by the end of 2025. The low point of the interest rate cycle is also expected to be 3%.

6.3. LINK's forecast for interest rates previously reflected a view that the MPC would be keen to further demonstrate its anti-inflation credentials by keeping Bank Rate at 5.25% until at least H2 2024. Currently, the rate cuts are expected to start when both the CPI inflation and wage/employment data are supportive of such a move, and when there is a likelihood of the overall economy enduring at least a slowdown or mild recession over the coming months (although most recent GDP releases have surprised with their on-going robustness).

6.4. Naturally, timing on this matter will remain one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.

6.5. In the upcoming months, LINK's forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but also international factors such as policy development in the US and Europe, the provision of fresh support packages to support the faltering recovery in China as well as the on-going conflict between Russia and Ukraine, and Gaza and Israel.

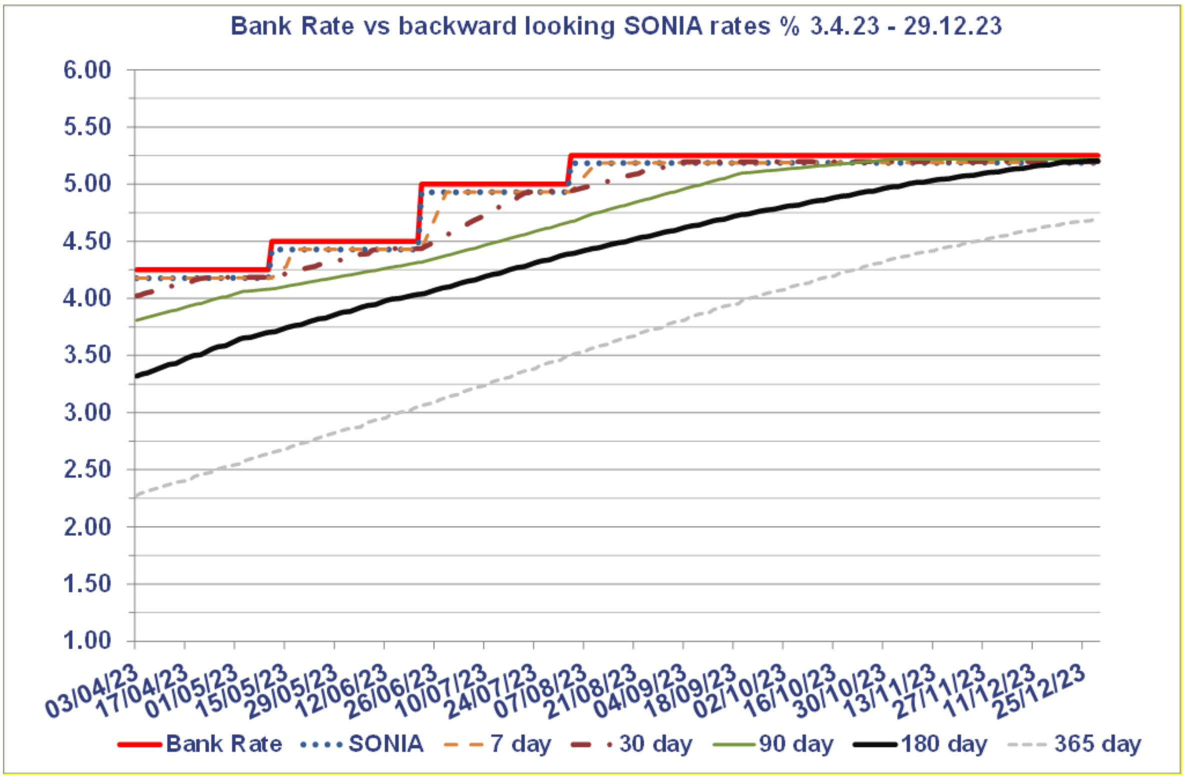
6.6. While the Council continues to take a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

6.7. Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates. This also provides benefits of reducing counterparty risk exposure, by fewer investments in the financial markets.

<u>Interest rate benchmark</u>

6.8. The Council uses the Sterling Overnight Index Average ("SONIA") as a benchmark interest rate. This is published daily and measures the cost of overnight borrowing on a backward-looking basis.

6.9. The SONIA (backward-looking) rates during the nine months of 2023/24 were as follows:



FINANCIAL YEAR TO QUARTER ENDED 29/12/2023	Bank Rate	SONIA	7 day	30 day	90 day	180 day	365 day
High	5.25	5.19	5.19	5.20	5.22	5.20	4.70
High Date	03/08/2023	24/11/2023	27/11/2023	12/12/2023	22/12/2023	29/12/2023	29/12/2023
Low	4.25	4.18	4.18	4.02	3.81	3.32	2.27
Low Date	03/04/2023	04/04/2023	11/04/2023	03/04/2023	03/04/2023	03/04/2023	03/04/2023
Average	4.95	4.89	4.88	4.84	4.71	4.43	3.60
Spread	1.00	1.01	1.01	1.18	1.41	1.88	2.43

6.10. The Council's actual interest rate performance during three quarters of 2023/24 was 4.80 which compares favourably with the average SONIA rates as can be seen in the above table.

6.11. The Council's Treasury Management Strategy sets out a lower rate of interest for the Housing Revenue Account based on the risk-free nature of the account. This lower rate is achieved by deducting the credit risk margin from the actual rate achieved by the Council. The resulting interest rate[1] applicable to the HRA during three quarters of 2023/24 was 4.71%.

7. Investments in Q3 2023/24

7.1. The Council's investment policy is governed by DLUHC investment guidance and is reflected in the Annual Investment Strategy approved by the Council each year. This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.). The investment activity during the three quarters of financial year of 2023/24 conformed to the approved strategy, and the Council had no liquidity difficulties.

7.2. Investments of £65.5million were held by the Council as of 31 December 2023 with investment turnover principally driven by the availability of counterparties that meet the criteria set out in the Annual Investment Strategy. Table 3 below summarises investment activity during the three quarters of the year, split between the sectors of the counterparties that the funds were invested with.

Table 2 - Investment activity in YTD Q3 2023/24

	Balance 31 Mar 2023	New Investments	Investments Recalled	Balance 31 Dec 2023
	£000	£000	£000	£000
Specified Investments				
Banking sector	25,000	75,000	61,000	39,000
Building societies	6,000	9,000	15,000	0
Local Authorities	26,000	13,000	34,000	5,000
Money Market Funds	12,000	124,500	119,000	17,500
Unspecified Investments				
Pooled Funds & Investment Schemes	4,000	0	0	4,000
Funding Circle	42	0	19	23
	73,042	**221,500**	**229,019**	**65,523**

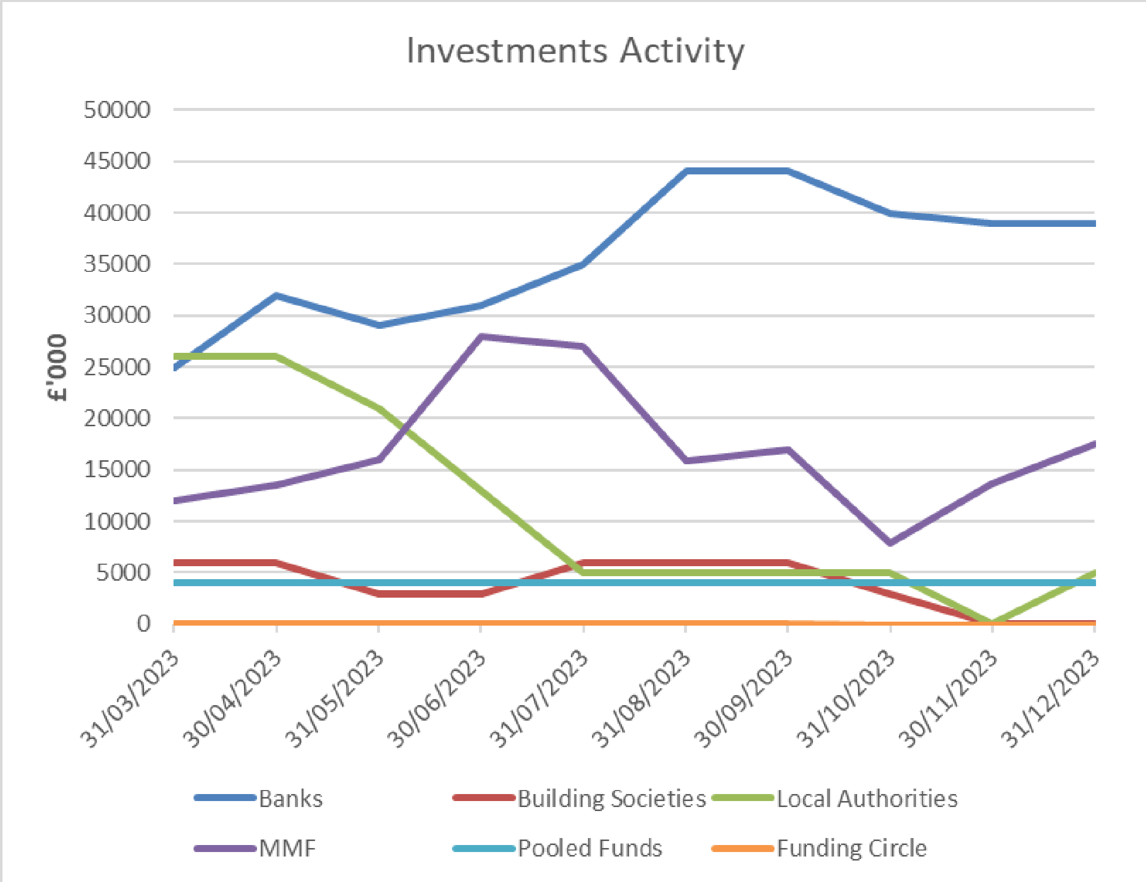
[1] The applicable rate benchmark for a risk-free rate being the average 90-day backward looking SONIA

7.3. Aside from the parameters set in the Annual Investment Strategy, the main factors that determine the amount of investment income are the level of interest rates, cash flow and the level of reserves and balances. The impact of capital cash flows – receipts from sales and timing of capital projects – also has a significant impact on cash flows.

7.4. As discussed in previous reports, the Funding Circle balance is slowly being wound down as loans mature following the decision of the company to close reinvestments for retail customers for which the Council is one.

7.5. The monthly movement in balances between these categories during the nine months of 2023/24 is set out in Table 4 below and reflects the available counterparties and investment rates at that time.

Table 3 - Movement between investments during YTD Q3 2023/24



7.6. The Council invests in two Pooled Funds (operated by CCLA (Churches, Charities and Local Authorities) Investment Management Limited). These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Investments in these funds are long term in nature and over long-term horizons they provide investors with relatively strong levels of interest (in the form of dividends). However, the capital values of these assets can be subject to large fluctuations (both up and down) over relatively short time frames. The movement of the Council's two CCLA pooled funds is as follows:

Table 4 – Pooled Funds YTD Q3 2023/24				
	Original Investment £'000	**Value 31 Mar 2023 £'000**	**Value 31 Dec 2023 £'000**	**Annualised Return %**
CCLA Property Fund	2,000	2,263	2,190	5.56
CCLA Diversified Income Fund	2,000	1,895	1,976	3.45

The differences between the Original Sums invested and the Values on 31 December 2023 are held on the Council's Balance Sheet in the Pooled Investments Adjustment Account.

7.7. CCLA have proposed to merge CCLA Diversified Income Fund with a new fund, the CCLA Better World Cautious Fund, on 16 February 2024. This change is effectively meant to open the investment strategy to a wider customer base (by reducing minimum size of investment ticket). The new fund will continue to invest globally under the same management, albeit with enhanced ESG investment policy and using formal KPI for the expected minimum return of CPI+2% per annum over any 5-year period. The new fund structure will also allow for more streamlined tax compliance and administration for the foreign tax credits.

7.8. A full list of Council's investments held as of 31 December 2023 is set out in Appendix D.

8. Non-treasury Investments

8.1. The Prudential Code, TM Code and DLUHC regulations include guidance on what is termed "non-treasury" investments. These are predominantly investments for commercial return such as:

- commercial loans to companies and other organisations, and
- holding property for a financial return (investment property).

The Council owns a significant investment property portfolio which is now managed through its developing Asset Management Strategy and provided loans to its wholly owned companies and local community groups.

Commercial Loans

8.2. The Council has funded its three wholly owned companies via Loan Facilities (that have been approved by the Full Council at rates set in accordance with the competition rules) which enabled them to buy some of the properties resulting from the Council's regeneration schemes. There are no plans in the current Capital Programme to increase investments in these areas. The table below sets out the list of loan facilities and movements in their balances in the three quarters of 2023-24.

Table 5 –Loans to Runnymede Companies YTD Q3 2023/24				
	Balance 31 Mar 2023 £'000	**YTD 2023/24 Movement £'000**	**Balance 31 Dec 2023 £'000**	**Interest Rate %**
Dev-t Loans - Addlestone One	25,326		25,326	5.04
Dev-t Loans – Magna Square	11,838		11,838	4.22
Dev-t Loans - Other	1,000		1,000	4.86
Working Capital Loans	445		445	7.54
Working Capital Loans	300		300	7.36
Working Capital Loans	2,100	400	2,500	7.40
Totals	**41,009**	**400**	**41,409**	

8.3. The Working Capital Loan Facilities approved in October 2020 allowed a sum of £3m available to draw down as required. Of this amount £500,000 is still available to drawdown as of 31 Dec 2023. It is anticipated that this will be required before the end of this financial year.

Property performance measurement

8.4. To better describe the role the investment property portfolio plays in the Council's capital and revenue strategies a set of performance reporting measures were approved as part of both the Annual Asset Management Strategy and the Capital & Investment Strategy.

8.5. Appendix E sets out the key performance indicators in Q3 2023-24. These will be further developed during 2024-25 using benchmarking analysis relative to the broader market, based on frequent data via a subscription to MSCI Analytics. Work on uploading data to MSCI is currently being undertaken.

9. Legal Implications

9.1. The powers for a local authority to borrow and invest are governed by the Local Government Act 2003 and associated Regulations. A local authority may borrow or invest for any purpose relevant to its functions, under any enactment, or for the purpose of the prudent management of its financial affairs. The Regulations also specify that authorities should have regard to the CIPFA Treasury Management Code, the Government Investments Guidance and the CIPFA Prudential Code for Capital Finance in Local Authorities when carrying out their treasury management functions.

10. Environmental/Sustainability/Biodiversity implications

10.1. Ethical or Sustainable investing is becoming a more commonplace discussion within the wider investment community. There are currently a small, but growing number of financial institutions and fund managers promoting Environmental, Social and Governance (ESG) products however the types of products we can invest in are constrained to those set out in our Investment Strategy which is driven by investment guidance, both statutory and from CIPFA, making it clear that all investing must adopt SLY principles – security, liquidity and yield: ethical issues must play a subordinate role to those priorities.

10.2. The Council does not invest directly in any companies – other than our own - and our investments are primarily limited to investments with the banking sector and other authorities (term deposits etc) and investments in property (our investment properties).

10.3. The Council does have two pooled funds both managed by the CCLA and their approach to ESG can be found on their website: Approach to ESG | CCLA.

11. Council Policy

11.1. This is set out in the Treasury Management Policy Statement, the Annual Investment Strategy, and associated Practices and Schedules.

11.2. The Council's treasury management policy statement states:

"The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks."

11.3. It is the security of investments that has always been the main emphasis of our treasury strategy. In balancing risk against return, Officers continue to place emphasis on the control of risk over yield following investment guidance, both statutory and from CIPFA, which make it clear that all investing must adopt SLY principles – security, liquidity and yield in that order.

12. Risk Implications

12.1. The risks associated with Treasury Management activities are set out in the Council's Treasury Management Strategy approved in February 2023 and in the Councils Statement of Accounts.

12.2. The risks associated with Non-Treasury Investments are set out in the Council's Capital and Investment Strategy approved in February 2023 and also in the Annual Asset Management Strategy.

13. Conclusions

13.1. The first three quarters of 2023/24 continued the challenging investment environment with counterparty risk remaining our primary treasury management priority. The criteria in the Annual Investment Strategy are continuously reviewed to minimise risk as much as practicable whilst retaining the ability to invest with secure institutions.

13.2. During the quarter ended 31st December 2023, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2023/24. The Corporate Head of Finance reports that no difficulties are envisaged for the current or future years in complying with these indicators.

13.3. All treasury management operations have been conducted in full compliance with the Council's Treasury Management Practices.

14. Appendices

- Appendix A - Treasury and Prudential Indicators 2023/24 as of 31 December 2023
- Appendix B – Economic update for the period
- Appendix C - Borrowings as of 31 December 2023
- Appendix D - Investments as of 31 December 2023
- Appendix E - Property Performance Indicators as of December 2023