Title of Report	Treasury Management Update Report
For Consideration By	Audit Committee
Meeting Date	25 October 2023
Classification	Open
Ward(s) Affected	All Wards
Group Director	Jackie Moylan, Interim Group Director Finance

1. Introduction

1.1. The report, at Appendix 1, introduces the treasury management outturn report and the actual prudential indicators for 2022/23 for the Audit Committee setting out the background for treasury management activity over the previous financial year and confirming compliance with treasury limits and prudential indicators.

1.2. The report, at Appendix 2, provides a quarterly update on treasury management activity for the period July 2023 to Sep 2023 of 2023/24.

2. Recommendations

2.1. There are no immediate recommendations arising from this report as the purpose is to update the Audit Committee on the past events; the Audit Committee is therefore invited to note the contents of this report and the Appendices.

3. Reason(s) for decision

3.1. This report is an update on the past events.

4. Background

Policy Context

4.1. Treasury management and ensuring that the function is governed effectively means that it is essential for those charged with governance to review the operations of treasury management on a regular basis. This report sets out the prior year's outturn and forms part of the regular reporting cycle for the Audit Committee along with the second of the in-year updates for the current financial year covering the period from July 2023 to Sep 2023.

Equality impact assessment

4.2. There are no equality impact issues arising from this report.

Sustainability and climate change

4.3. There are no sustainability and climate changes issues arising from this report.

Consultations

4.4. No consultations are required in respect of this report.

Risk assessment

4.5. There are no risks arising from this report as it reports on past events. Clearly though the treasury management function is a significant area of potential risk for the Council if the function was not properly carried out and monitored by those charged with responsibility for oversight. Regular reporting on treasury management ensures that the Committee is kept informed.

5. Comments of the Interim Group Director, Finance

5.1. There are no direct financial consequences arising from this report as it reflects past performance through 2022/23 and for the period from July 2023 to Sep 2023. The information contained in this report will assist members of this Committee in monitoring the treasury management activities and enable better understanding of such operations. Officers continue to pay close attention to the council cashflow making sure there is enough liquid cash to meet any unexpected situation as a result of a highly volatile economy at present.

5.2. Global bond markets have been extremely volatile over the prolonged period following the recovery from the pandemic. Inflationary issues arising from supply bottlenecks, first considered transitory, have merged with inflationary behaviour.

5.3. No new borrowings have been undertaken since the last update due to sufficiency of internal cash levels. For future capital financing requirements, the Council will continue to consider borrowing rates offered by alternative lenders, including other local authorities alongside PWLB rates in order to minimise, where possible, its costs of borrowing. Officers regularly review council borrowing requirements based on development in cash forecasts and capital programmes. Cash needs have been pushed further out while the council cash balance remains high.

5.4. The Committee is requested to note this report.

6. Comments of the Acting Director of Legal, Democratic and Electoral Services

6.1. The Accounts and Audit Regulations 2015 place obligations on the Council to ensure that its financial management is adequate and effective and that it has a sound system of internal control which includes arrangements for management of risk.

6.2. In addition, the Council within its Annual Treasury Management Strategy has agreed to comply with the CIPFA Code of Practice on Treasury Management. This report sets out the work that Treasury Management is undertaking to ensure that it is meeting these requirements and adapting to changes as they arise.

6.3. There are no immediate legal implications arising from the report.

Appendices

Appendix 1 - Annual Treasury Management Outturn Report 2022/23
Appendix 2 - Treasury Management Update Report (July 2023 to September 2023)

Background documents
None

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APPENDIX 1: Annual Treasury Management Outturn Report 2022/23

1. External Context

1.1 **Economic background:** The war in Ukraine continued to keep global inflation above central bank targets and the UK economic outlook remained relatively weak with the chance of a mild recession. The economic backdrop during the January to March period continued to be characterised by high energy and commodity prices, high inflation, and the associated impact on household budgets and spending.

Central Bank actions remained consistent with combating inflation. The Bank of England, US Federal Reserve, and European Central Bank all increased interest rates over the period, even in the face of potential economic slowdowns in those regions.

Starting the financial year at 5.5%, the annual CPI measure of UK inflation rose strongly to hit 10.1% in July and then 11.1% in October. Inflation remained high in subsequent months but appeared to be past the peak, before unexpectedly rising again in February. Annual headline CPI registered 10.4% in February, up from 10.1% in January, with the largest upward contributions coming from food and housing. RPI followed a similar pattern during the year, hitting 14.2% in October. In February RPI measured 13.8%, up from 13.4% in the previous month.

The labour market remained tight albeit with some ongoing evidence of potential loosening at the end of the period. The unemployment rate 3mth/year eased from 3.8% April-June to 3.6% in the following quarter, before picking up again to 3.7% between October-December. The most recent information for the period December-February showed an unemployment rate of 3.7%.

The Bank of England increased the official Bank Rate to 4.25% during the financial year. From 0.75% in March 2022, the Monetary Policy Committee (MPC) pushed through rises at every subsequent meeting over the period, with recent hikes of 50 bps in December and February and then 25 bps in March, taking Bank Rate to 4.25%. March’s rise was voted by a majority of 7-2, with two MPC members preferring to maintain Bank Rate at 4.0%. The Committee noted that inflationary pressures remain elevated with growth stronger than was expected in the February Monetary Policy Report. The February vote was also 7-2 in favour of a hike, and again with two members preferring to keep Bank Rate on hold.

1.2 **Financial markets:** Uncertainty continued to be a key driver of financial market sentiment and bond yields remained relatively volatile due to concerns over elevated inflation and higher interest rates, as well as the likelihood of the UK entering a recession and for how long the Bank of England would continue to tighten monetary policy. Towards the end of the period, fears around the health of the banking system following the collapse of Silicon Valley Bank in the US and purchase of Credit Suisse by UBS caused further volatility. Over the period the 5-year UK benchmark gilt yield rose from 1.41% to peak at 4.70% in September before ending the financial year at 3.36%. Over the same timeframe the 10-year gilt yield rose from 1.61% to peak at 4.51% before falling back to 3.49%, while the 20-year yield rose from 1.82% to 4.96% and then declined to 3.82%. The Sterling Overnight Rate (SONIA) averaged 2.24% over the period.

1.3 **Credit background:** InEarly in the period, Moody's affirmed the long-term rating of Guildford BC but revised the outlook to negative. The agency also downgraded Warrington BC and Transport for London.

1.4 As market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Authority's counterparty list recommended by treasury advisors remain under constant review.

1.5 Local authorities remain under financial pressure, but our treasury advisors continue to take a positive view of the sector, considering its credit strength to be high. Section 114 notices have been issued by only a handful of authorities with specific issues. While Arlingclose's advice for local authorities on its counterparty list remains unchanged, a degree of caution is merited with certain authorities.

2 The Borrowing Requirement and Debt Management

2.1 The Council currently had one £1.2m LEEF (London Energy Efficient Fund) loan from the European Investment Bank to fund housing regeneration. This loan is below market rate and was taken out in July 2014.

2.2 The LEEF loan is an EIP (Equal Instalment of Principle) loan where each payment includes an equal amount in respect of loan principle throughout the duration of the loan. Therefore the interest due with each payment reduces as the principle is eroded, and so the total amount reduces with each instalment. Consequently, part of the loan is short term in duration, the amount which will be paid via instalments within one year with the remainder of loan maturing beyond 1 year (long term).

2.3 In addition, the Authority had £76.4m in external borrowing. This was made of £10m from local authorities and £66.4m from PWLB to finance part of the borrowing requirement within the Housing Revenue Account associated with the delivery of the housing capital programme, particularly in respect of regeneration.

<u>Table 1: Capital Financing Requirement (CFR) & Total External Debt</u>

	Balance as at 31/03/22 £'000	**New Borrowing £'000**	**Debt Maturing £'000**	**Debt Repaid £'000**	**Balance as at 31/03/23 £'000**	**Average Rate %**
CFR	466,705				464,023	
	4,500	10,000	-	-	14,500	2.46%

	Balance as at 31/03/22 £'000	New Borrowing £'000	Debt Maturing £'000	Debt Repaid £'000	Balance as at 31/03/23 £'000	Average Rate %
Short Term Borrowing*						
Long Term Borrowing	67,600	-	-	4,500	63,100	1.92%
TOTAL BORROWING	**72,100**	**10,000**	**-**	**4,500**	**77,600**	
Other Long Term Liabilities	10,697	-	-	1,020	9,677	
TOTAL EXTERNAL DEBT	**82,797**	**10,000**	**-**	**5,520**	**87,277**	

2.4 The Council's underlying need to borrow, as measured by the Capital Financing Requirement (CFR), as at 31/03/2023 was provisionally (whilst accounts remain open and unaudited, but no expectation of change) £464m.

2.5 External Borrowing – During the year no new external borrowing was accessed by the council.

2.6 The cost of both long and short-term borrowing rose dramatically over the year, with rates at the end of March around 2% - 4% higher than those at the beginning of April. Rate rises have been driven primarily by inflation and the need for central banks to control this by raising interest rates. Particularly dramatic rises were seen in September after 'mini-budget' included unfunded tax cuts and additional borrowing to fund consumer energy price subsidies: over a twenty-four-hour period some PWLB rates increased to 6%. Rates have now fallen from September peaks but remain volatile and well above recent historical norms.

2.7 A new HRA PWLB rate of gilt yield plus 0.4% (0.4% below the currently available certainty rate) was announced on 15th March 2023. This discounted rate is to support local authorities borrowing for Housing Revenue Accounts and the delivery of social housing and is expected to be available, initially for a period of one year.

3. Investment Activity

3.1 CIPFA published a revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes on 20th December 2021. These define treasury management investments as investments that arise from the organisation's cash flows that ultimately represent balances that need to be invested until the cash is required for use in the course of business.

3.2 Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2022/23 Investments during the year included:

- Deposits with other Local Authorities
- Investments in AAA-rated Money Market Funds
- Market Funds
- Call accounts, deposits and
- Housing Associations

Table 2: Investment Balances

Investments	Balance as at 31/03/22 £'000	Average Rate %	Balance as at 31/03/23 £'000	Average Rate %
Short Term Investments	15,045		5,000	
Long Term Investments	200		200	
Housing Associations	15,000		15,000	
Money Market Funds	95,000		24,959	
TOTAL INVESTMENTS	**125,245**	**0.6**	**45,159**	**2.75**

3.3 The Council's investment balance decreased from £125m to £45m at the end of the financial year with an investment return of 2.75%. The Council is forecasting a further downward trend in cash balances as the Council progresses on a number of major capital schemes requiring forward funding.

3.4 Credit Risk- Counterparty credit quality was assessed and monitored with reference to credit ratings; credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP; any potential support mechanisms and share price. The minimum long-term counterparty credit rating determined for the 2022/23 treasury strategy was A- across rating agencies Fitch, S&P and Moody's.

Table 3: Credit Score Analysis

Date	Value Weighted Average Credit Risk Score	Value Weighted Average Credit Rating	Time Weighted Average Credit Risk Score	Time Weighted Average Credit Rating
31/03/2022	5.3	A+	6.0	A
30/06/2022	5.0	A+	5.9	A
30/09/2022	5.3	A+	6.1	A
31/12/2022	5.4	A+	6.3	A
31/03/2023	5.7	A	6.9	A-

3.5 Liquidity - The Council maintained a sufficient level of liquidity through the use of Money Market Funds/overnight deposits/call accounts.

3.6 Yield - The Council sought to optimise returns commensurate with its objectives of security and liquidity. The UK Bank Rate changed from 0.75% to 4.25% in March 2023.

4. Compliance

4.1 The Council can confirm that it has complied with its Prudential Indicators for 2022/23, which were approved on 2nd March 2022 as part of the Council's Treasury Management Strategy Statement.

4.2 In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during 2022/23. None of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

4.3 The Authority can confirm that during 2022/23 it complied with its Treasury Management Policy Statement and Treasury Management Practices. However, the Audit Committee will be aware that the 2022/23 accounts at this point remain open and unaudited. There is the possibility that changes to the numbers could occur but this is not expected.

5. Prudential Indicators

5.1 Capital Financing Requirement (CFR)

The Council's cumulative maximum external borrowing requirements for 2020/21 to 2023/24 are shown in the table below.

	31/03/21 Actual £'000	**31/03/22 Draft £'000**	**31/03/23 Draft £'000**	**31/03/24 Estimated £'000**
Gross CFR	503,330	466,705	464,023	706,013
Less: Other Long Term Liabilities	11,646	10,697	9,677	8,581
Borrowing CFR	**491,684**	**456,008**	**454,346**	**697,433**
Less: Existing Profile ofBorrowing	76,600	72,100	77,600	63,100
Gross Borrowing Requirement/Internal Borrowing	**415,084**	**383,908**	**376,746**	**634,333**

Usable Reserves	283,313	309,894	332,872	292,872
Net Borrowing Requirement/(Investment Capacity)	**131,771**	**74,015**	**43,874**	**341,461**

In the Prudential Code Amendment (November 2012), it states that the Chief Finance Officer should make arrangements for monitoring with respect to gross debt and the capital financing requirement such that any deviation is reported to him/her, since any such deviation may be significant and should lead to further investigation and action as appropriate.

	2020/21	**2021/22**	**2022/23**	**2023/24**
	Actual	**Draft**	**Draft**	**Estimate**
	£'000	**£'000**	**£'000**	**£'000**
Gross Debt	88,246	82,797	87,277	71,681
CFR	503,330	466,705	464,023	706,013
Borrowed in excess of CFR? (Y/N)	N	N	N	N

5.2 Prudential Indicator Compliance

(a) Authorised Limit and Operational Boundary for External Debt

- The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached.
- The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit.
- The Group Director of Finance confirms that there were no breaches to the Authorised Limit and the Operational Boundary during the year.

	Operational Boundary (Approved) as at 31/03/23 £'000	**Authorised Limit (Approved) as at 31/03/23 £'000**	**Actual External Debt as at 31/03/23 £'000**
Borrowing	550,000	580,000	77,600
Other Long-term Liabilities	18,000	18,000	9,677

Total	568,000	598,000	87,277

(b) Capital Expenditure

This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits, and, in particular, to consider the impact on Council tax and in the case of the HRA, housing rent levels.

	2021/22	2022/23	2023/24	2024/25	2025/26
	Draft	Draft	Estimate	Estimate	Estimate
	£000	£000	£000	£000	£000
Capital Expenditure					
Housing	102,105	79,916	113,957	297,901	235,562
Non-Housing	52,089	53,085	134,594	179,054	93,071
Total spend	**154,194**	**133,001**	**248,551**	**476,955**	**328,633**

Current capital expenditure financing is as per the table below. However further review of the capital programme will be happening during the 2023/24 financial year meaning configuration of numbers below are likely to change. The Prudential borrowing line below relates primarily to regeneration schemes.

Capital Financing	2021/22	2022/23	2023/24	2024/25	2025/26
	Draft	Draft	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Prudential Borrowing	9,584	23,291	151,251	354,976	160,821
S106/CIL	11,003	17,518	11,496	7,535	2,725
Capital receipts	68,463	30,628	2,092	20,344	84,308
Grants	21,392	19,251	38,363	45,495	24,572
Reserves/ Discretionary	0	643	4,453	2,405	1,598
RCCO	43,751	41,670	40,896	46,201	54,610
Total	**154,194**	**133,001**	**248,551**	**476,955**	**328,633**

Financing					

The above table shows that the capital expenditure plans of the Authority could not be funded entirely from sources other than borrowing.

(c) Ratio of Financing Costs to Net Revenue Stream

- This is an 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.
- The ratio is based on costs net of investment income.
- The 2021/22 and 2022/23 number here is provisional whilst the accounts remain open, and 2023/24 to 2024/25 numbers will be updated again in this financial year prior to year-end.

Ratio of Financing Costs to Net Revenue Stream	2021/22 Draft	2022/23 Draft	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Non-HRA	0.8%	1.0%	2.6%	5.7%	6.0%
HRA	28%	30%	30%	35%	40%

(d) **Adoption of the CIPFA Treasury Management Code**

This indicator demonstrates that the Authority adopted the principles of best practice via approval of the CIPFA Treasury Management Code

Appendix 2 – Treasury Management Update Report

Treasury Management Activities from July 2023 to September 2023

1. Economic Highlights

1.1 **Growth:** First estimates suggest that UK GDP increased in Q2 2023 to grow by 0.2%. On a monthly basis, GDP is expected to have grown by 0.5% in June 2023, preceded by an unrevised fall of 0.1% in May and growth of 0.2% in April. Relative to the same quarter last year, GDP is estimated to have increased by 0.4%.

1.2 **Inflation:** CPI inflation rose by 6.7% year-on-year in August 2023 down from 6.8% in July. On a monthly basis, CPI rose by 0.3% in August 2023, compared to a 0.4% rise in July.

1.3 **Labour Market:** The UK unemployment rate increased by 0.5 percentage points to 4.3% in May to July 2023, and this increase was mostly caused by a rise in people unemployed for up to 12 months. The employment rate was estimated at 75.5% for May to July 2023, 0.5 percentage point lower than the previous reading in February to April. This fall was largely driven by full-time self-employed workers.

1.4 **Monetary Policy Committee:** The MPC maintained the Bank Rate at 5.25% in a narrow vote, a level that looks to be the peak of this tightening cycle. The reduction in the inflation rate, particularly core and services inflation, allowed policymakers to place more weight on the weaker recent and forward-looking activity indicators, especially given that the drag from higher rates will increase as time passes. The minutes supported the expectation that Bank Rate will persist at current levels until the second half of next year. Our advisors believe that UK economic growth will continue to weaken as the year progresses, as higher interest rates bear down on household and business investment and activity, and unemployment rises. With interest rates being held at this level for longer to push down on inflation and inflation expectations, the Bank will need to cut rates relatively significantly from later 2024.

2. Borrowing & Debt Activity

2.1 The Authority currently has £65.55m in external borrowing. This is made up as a single LEEF loan of £1.2m from the European Investment Bank to fund housing regeneration and £64.35m borrowed from Public Work Loan Board for housing capital programme, particularly in respect of housing regeneration. No new borrowing was done during the period due to high cash balance and uncertainty over economic outlook.

3. Investment Policy and Activity

3.1 The Council held average cash balances of £98 million during the reported period, compared to an average £105 million for the same period last financial year.

Movement in Investment Balances 01/07/23 to 30/09/23

	Balance as at 01/07/2023 £'000	Average Rate of Interest %	Balance as at 30/09/2023 £'000	Average Rate of Interest %
Short Term Investments	0	-	0	-
Long Term Investments	200	-	200	-
Housing Associations	10,000	-	10,000	-
Money Market Funds	54,363	-	100.245	-
	64,562	**4.12**	**110,445**	**4.73**

3.2 Due to the volatility of available creditworthy counterparties, longer term investments have been placed in highly rated UK Government institutions, thus ensuring creditworthiness of investments.

4. Counterparty Update

4.1 Moody's has affirmed the long-term and short-term issuer ratings for the European Investment Bank (EIB). The outlook remains Stable. Our treasury advisors remain comfortable with clients making investments in bonds with the European Investment Bank (EIB), in line with approved strategies. Fitch has upgraded the long-term deposit rating of Council of Europe Development Bank (CEDB) to AAA from AA+. The Outlook is Stable. Our treasury advisors remain comfortable with clients making secured investments with the Council of Europe Development Bank, in line with approved strategies. Our treasury advisors advise against new lending to Birmingham City Council for treasury management purposes while their legal power to enter into new agreements is unclear.

4.2 Whilst the ongoing investment strategy remained cautious counterparty credit quality remains strong, as can be demonstrated by the Credit Score Analysis summarised below.

5. Credit Score Analysis

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating Score	Time Weighted Average – Credit Risk Score	Time Weighted Average – Credit Rating Score
31/07/2023	A+	5.2	A	6.2
31/08/2023	A+	5.2	A	6.2
30/09/2023	A+	5.2	A+	5.1

5.1 The Council continues to utilise AAAmmf/Aaa/AAAm rated Money Market Funds for its very short, liquidity-related surplus balances. This type of investment vehicle has continued to provide very good security and liquidity.

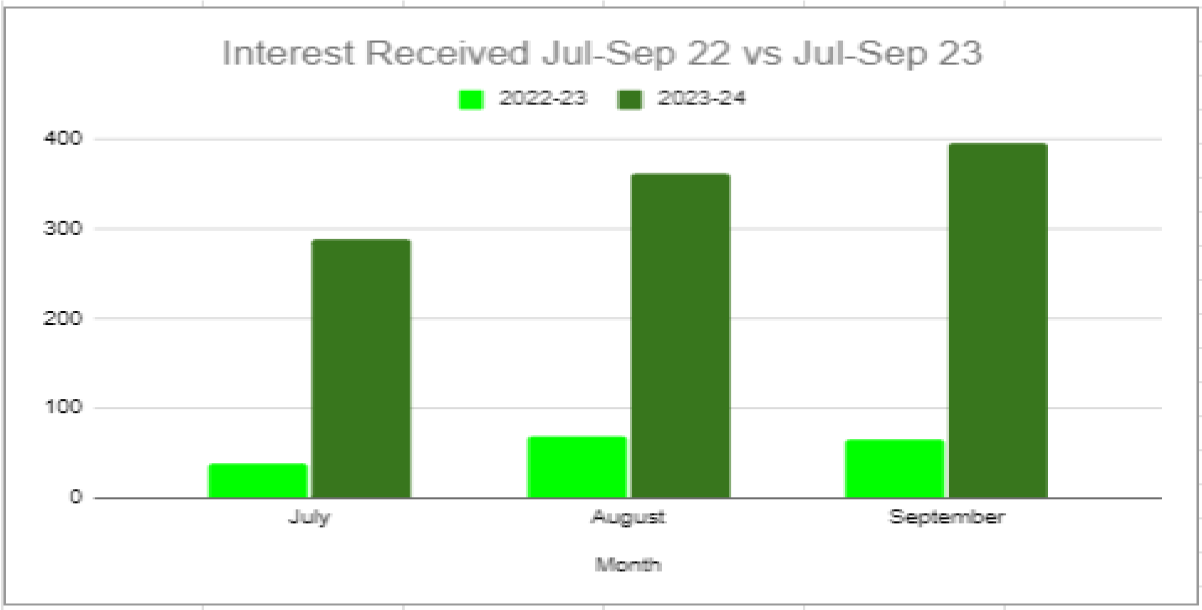
5.2 Council continues to invest in highly rated UK Government institutions, Building Society and Housing Associations. This investment vehicle offers a good level of security and increases diversification for the Council’s portfolio whilst achieving a reasonable yield.

6. Comparison of Interest Earnings

6.1 The Council continues to adopt a fairly cautious strategy in terms of investment counterparties and periods. Due to the volatility of available creditworthy counterparties, longer term and short term investments have been placed in highly rated UK Government institutions and Housing Associations, thus ensuring creditworthiness whilst increasing yield’s through the duration of the deposits.

6.2 The graph below provides a comparison of interest earnings for July 2023 to September 2023 against the same period for 2022/23.

6.3 Average interest received for the period July 2023 to September 2023 was £349k compared to £57k for the same period last financial year. Increased interest received this year is due to increase in interest rates.



7. Movement in Investment Portfolio

7.1 Investment levels have increased to £110 million at the end of Sep 2023 in comparison to the end of Sep 2022 last year of £97 million. It is anticipated that overall levels of investment balance will reduce as and when the capital programmes are delivered, although we need to maintain liquidity for day-to-day operational purposes.